

THE STATE OF THE NATION IN SUSTAINABLE
HUMAN DEVELOPMENT
SUMMARY

*A broad and objective analysis of Costa Rica
based on the most current indicators (2004)*

Abstract

This summary provides a non-exhaustive summary of the issues addressed in the four regular chapters of this Eleventh Report, as well as a synthesis of the general assessment of the country's performance in 2004. Two criteria guided the choice of topics: a) they are areas relevant to the analysis of human development noteworthy because of the challenge they represent to the nation, and b) the findings are specific to the year under study. For further and more detailed information on the specific subjects, readers are invited to consult both the complete Report and the specialized documents (in Spanish only) that can be accessed on the web site www.estadonacion.or.cr.

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¹ COCIM: Inter-municipal Cooperative Agreement involving the municipalities of San José, Goicoechea, Tibás, Montes de Oca, Curridabat, Moravia, Desamparados, Alajuelita, Escazú, Coronado, La Unión and Aserrí.

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Preface

The practice of monitoring the components of sustainable human development

Eleven years ago, a project was undertaken by the National Council of University Chancellors (CONARE), representing of the public universities of Costa Rica, and the Office of the Ombudsman of the Republic. This effort received support from international cooperation, initially the United Nations Development Programme (UNDP), then later the European Union, the Kingdom of the Netherlands, Sweden, the International Labour Organization (ILO), the Pan American Health Organization (PAHO), the United Nations Children's Fund (UNICEF), the United Nations Population Fund (UNFPA), and other national and foreign institutions. The State of the Nation Program of today was launched as an informational and educational initiative to prepare and publish a national report monitoring in detail the country's performance vis-à-vis sustainable human development, a sort of mirror in which society can view the clearest possible reflection of its expectations.

The task of the State of the Nation Program is to provide society with easily accessible instruments for understanding the country's development, develop mechanisms for accountability and strengthen those for participation and negotiation, and contribute to building national consensus. It is not a government report, nor is it anti-government: its focus is on assessing the progress, setbacks, and trends of the development process in Costa Rica.

Ever since the first Report of the State of the Nation in Sustainable Human Development was published, the Reports have maintained a core structure that has been modified and enriched each successive year with a view to identifying and tracking trends important to the analysis of national performance. That structure includes several permanent chapters that address national expectations for sustainable human development in the economic, social, environmental, and political areas, and a statistical compendium of more than 248 variables, broken down by different criteria (sex, area, region, age group, production or institutional sector, etc.), obtained from 32 official sources of information.

While his 2004 Report continues to monitor national performance, it adds new features and follows new inclinations (Box 0.1). The contents have been reorganized to accommodate increasingly complex information –based as it is on ever more studies– and to introduce a new area of work for future reports. This year the text is divided into three parts. The first is entitled “Monitoring Human Development,” which contains the Report's regular chapters on equity and social integration, opportunities, economic stability and solvency, harmony with nature, and strengthening of democracy, as well as the corresponding annexes. The second part is called “Discussions on Development,” which presents for discussion topics related to policy options for promoting human development. Its purpose is to expand the public policy options of specific issues selected by the Program's Advisory Committee, based on a review of international experiences. On this occasion, the Report addresses two issues that pose important challenges for the nation: the universalization and diversification of secondary education in the medium term, and the situation with regard to the prevention, control, and penalization of political corruption. The section also includes a series of “miniforums,” where specific topics are discussed by specialists.

Main features of the Eleventh Report

In 2004, the State of the Nation Program completed a decade of producing the State of the Nation Report, one of the longest-lasting reports on human development in the nation. The Report has earned various distinctions for its role in national life: two national awards (Áncora (2003) and Aquileo Echeverría (2005)) and an international recognition, in the form of the UNDP Human Development Award (2000). In addition, the State of the Nation Program has been called upon to facilitate social dialogue; it has played a growing and sustained role as a source for consultation by the communications media; it has worked with the Ministry of Education over an eight-year period to systematically include the concepts of human development in the nation's school curriculum; it has involved a broad network of national researchers in producing the Report and secured the firm and critical participation of distinguished Costa Ricans in the Advisory Committee. Moreover, the Program's website has registered more than half a million visits per year,¹ 46% of which are from returning visitors. The Program's impact has extended beyond the country's borders, earning it an invitation to prepare and publish two reports on human development in the Central American region.

The Tenth Report marked the end of the period in which the Program provided the country with an analysis of the principal development trends. The Eleventh Report signals the beginning of a new stage. While it continues to monitor Costa Rica's most recent performance in human development, maintaining thus its core nature as a monitoring system, it includes an important innovation: it adopts a more analytical approach with a few selected challenges facing the nation, to a certain degree offering proposals in that regard.

Over the years, the Program has moved from making detailed descriptions based on a rigorous review of information available toward greater analytical complexity. The Report is increasingly able to track trends, visualizing results in the medium and long terms; it is also now more concise and more analytical. Another important change is that, although it continues to be based on quantitative analysis, with increasing frequency and new methods it addresses qualitative elements to supplement its assessments.

Over time the State of the Nation has gained experience and legitimacy, which has enabled it to suggest innovative ways to treat its topics. The Eleventh Report has been designed to be more concise although it continues to address a broad range of topics; its focus is more argumentative and draws more conclusions.

The following are the principal features of this new report:

- | Presentation of the "macro" balance for each component of human development has been improved through a precise identification of conceptual axes, and their relationship to the aspirations that orient the analysis.

- | It systematically addresses the thematic ties between chapters.

- | It analyzes a few special subjects in greater depth.

- | It systematizes key aspects of the national debate on strategic issues ("mini-forums").

- | It adopts an approach that puts forward proposals in a key subject area: the universalization of secondary education.

- | It introduces comparative analysis with other countries.

- | All chapters address three particular dimensions: gender equity, youth, and the sub-national situation (especially the Brunca region).

In line with a recommendation from the Advisory Committee, priority has been given to subjects that link the chapters, addressing them in more orderly fashion so they can serve as a common thread for readers.

Source: Proposed general strategy and research approach, reviewed by the Program's Advisory Committee on 8 March 2005.

The third and last part of the Report is the "Statistical and Methodological Annex," which is the section of indicators and statistics on different aspects of human development. It provides continuity to the efforts of previous years by updating (and expanding) the Statistical Compendium that has been included at the end of each of the previous ten Reports. A new component has been added to this section, the Methodological Appendix, which explains the criteria used to calculate the complex indicators of some of the most important analyses of this Report. It also discusses the quantity and quality of the information sources available for monitoring human development. This appendix was included because of the growing technical complexity of the subjects addressed in the document.

The possibility of putting forward proposals in the State of the Nation Reportⁱⁱ

In recent years, as the State of the Nation Report has been gaining prestige and greater public influence, the Program has been receiving more and more requests for it to propose solutions to the problems and challenges it has analyzed. In short, these requests state (or accuse, depending on the tone of the request) that the Report's assessment of the national situation is sufficiently robust –and Costa Rica's situation sufficiently critical– to serve as the basis for proposing solutions to various of the country's human development problems. In response, the Program's Advisory Committee has deemed it necessary "to take a step forward," by drawing up specific public policy proposals in view of the absence of practical solutions. Over time, the Report's principal strength has been its focus on achieving its objective: to offer rigorous analysis and often unpublished information to the citizens of Costa Rica. This has earned it prestige and bring influence to bear on public opinion, academic centers (national and international), and, in particular, decision makers.ⁱⁱⁱ

There are solid institutional, conceptual, and contingent reasons why the State of the Nation Reports have never ventured to formulate specific recommendations for solving the country's problems, which explain what has occurred to date in that regard.^{iv} However, this does not impede the Report from including in the future concrete proposals for some topics. What was valid in the past does not necessarily remain so in the present.

The three guiding principles of the State of the Nation Report

Academic rigor

The first principle of the State of the Nation Program is to articulate public university research capabilities in order to obtain relevant and quality information and analysis without creating complex structures. Each year nearly 300 bibliographic references are systematized and some 30 studies are undertaken. In total, during the eleven years of Program activity, more than 500 specialists from a wide range of fields have contributed to this effort, generating a current of analysis on sustainable human development and new research policies at the national and sub-national levels. It has also made it possible to systematize information from a wide range of sources, which has had a real impact on the formulation of indicators, from their identification to the methods used, and to address topics rarely examined before. In addition, based on the Program's capabilities, two reports of Central American scope were prepared and published, and national mechanisms for monitoring human development were promoted in other countries of the region.

Social legitimacy

To ensure the good standing and legitimacy of the Program, working methods were designed as a fundamental part of the Report's preparation process. These include: participatory identification of the topics and aspects to be investigated; creation of a legitimate and active Advisory Committee, comprising individuals renowned for their experience, their contributions to development, and their links with diverse sectors of society or government; consultation workshops with academia and social stakeholders in at least three stages of the Report preparation process; daily contacts with social and political leaders to determine new mandates for research; and promotion of social dialogue on public policies.

Wide dissemination

The third principle is to ensure maximum dissemination of the Reports, other publications, and the Program itself. Some characteristics of this strategy are: emphasis on direct relationships; promotion of publications through articles and reports in the press, radio, and television; a website, which receives a high volume of visits from both Costa Rica and abroad; development of community actions in order to reach many parts of the country; organization of activities with the educational system; use of Program publications in university courses on the state of the nation; and design of teaching modules for primary and secondary schools, as well as for schools serving migrant children. These actions can be found in the files attached to this Preface for purposes of accountability.

Despite the decision not to put forward proposals, it should be noted that the Report has not been limited to assessing the country's problems. As of the second Report, it began to identify challenges –national priorities that require concerted action– with a view to contributing to the definition of an agenda of development policies. This has been the strategy followed to bring influence to bear, without suggesting specific solutions, on discussions regarding how to advance national development. The challenges have been formulated in such a way as to maintain the delicate balance: they are closely related to the conceptual framework of the Report, which itself is not ethically nor theoretically neutral since it is based on the concepts of social equity, environmental sustainability, increased economic opportunities for the population, and democracy. In fact, on two occasions –the second and third reports– specific recommendations were made for the action of two of its sponsoring institutions: the National Council of University Chancellors (CONARE) and the Office of the Ombudsman of the Republic.

In addition, on several occasions the State of the Nation Program participated in designing public policy proposals for the housing, health, and employment sectors, and for the management of social welfare, fiscal reform and social dialogue programs. These experiences were carried out independently of the Report in order not to alter its nature or objectives. All were done with the express approval of the Steering Committee, in response to formal requests from interested parties; in some cases, the Program received funds specifically to cover such efforts. Although this has involved ongoing activity to support social and institutional stakeholders in making public policy, as a whole it must be viewed as “responsive” rather than “proactive” action. In each case, these tasks involved adding to the work load of the Program's technical team.

Finally, it is important to note that there have been many significant changes since the first years of the Report. Be it because of express requests, new circumstances (political and institutional), the experience gained, and greater awareness of the relevance of the Reports, the question of whether the Program should venture into putting forward proposals became inevitable. A limited approach can be adopted without having to amend the Framework Agreement that underpins the Report or the conceptual framework approved by the Advisory Committee. This approach offers significant advantages and will enable the Report to capitalize on its strengths and, more importantly, to offer new strengths to the citizens of Costa Rica at a time of great uncertainty when urgent decisions are needed to address the challenges.

In assuming this new research mandate, the main challenge has been to determine whether there is a way to put forward proposals without undermining the strengths of the Report or changing its nature. The decision was to use a methodology that does not ask the traditional question “What should the country do to solve problem X or reach objective Y?”, but rather to pose the question by introducing a comparative approach: Which countries/regions/cities have been able to solve problem X or reach objective Y? How did they do it? Were they able to sustain the improvements? What conditions facilitated or undermined their success? Are those conditions present in Costa Rica?

On this basis, the State of the Nation Report includes for the first time a component that includes proposals, without recommending a particular action or group of actions, with the purpose of expanding the range of public policy options that can be examined by the different sectors of the population in tackling a human development problem. Concrete, reliable and timely information is provided on solutions that have worked in other settings. While this information can be useful for addressing certain situations, the Report does not hold that “what worked in those cases must work in Costa Rica.” This new line of research will enrich the nation’s discussion of alternatives for solving national problems and supplements the information normally provided by the Report.

The Program’s Advisory Committee gave its approval for making a first cautious and limited effort to put forward proposals as part of the research strategy for the Eleventh Report. The topic selected for this effort is a challenge that has been thoroughly documented in several versions of this Report and in other specialized publications of the State of the Nation Program, namely: “to increase coverage, improve quality, and diversify secondary education.”

In keeping with the tradition of concluding the Preface of the Report with an inspirational thought, we have chosen the words of Aquileo Echeverría:

But man, consider the following; are you not a son of this nation? Where the devil were you born? Where were your parents born?

For the reasons already mentioned, I hereby confirm my consent to sign ... this Preface.

Miguel Gutiérrez Saxe
DIRECTOR
STATE OF THE NATION PROGRAM

General assessment of the State of the Nation in 2004

In previous years, the *State of the Nation Report* pointed out that the country's economic and social performance was inadequate for tackling long-term human development needs. The 2003 Report noted that profound transformations were urgently needed to address those challenges. It also noted that Costa Rica had only a few years in which it could bring about, with the necessary foresight, the changes needed to boost productivity, improve social equity, and make sustainable use of biodiversity, while tapping the relatively favorable conditions offered by the demographic profile and the growing working-age population, conditions that will persist into the near future.

The 2004 Report shows some signs that Costa Rica has entered a new and more dangerous phase. In light of this, two important questions must be asked: What does this new phase consist of? How serious is the situation? With regard to the first question, we can say that Costa Rica, our common home, is debilitated. Unlike in the past, when achievements were insufficient to meet the country's needs, 2004 was characterized by a significant and simultaneous deterioration of core aspects of national life in an increasingly difficult international setting. The real income of the Costa Rican population declined for the third consecutive year, to the point that the current minimum wage is similar, in real terms, to the minimum wage of two decades ago, despite the considerable economic growth experienced during that period. Today, the foundations of economic stability are increasingly shaky. In addition to the lack of growth in tax revenues, indispensable for maintaining and increasing public investment, serious institutional problems affected the management of resources allocated. The decision to cut back social investments in order to maintain fiscal equilibrium and prevent further risks to stability has primarily impacted low-income groups and is squeezing the middle class. Among the poorest households, the income received from public social welfare institutions was almost three times that earned through work. In addition, cutbacks in public investments in infrastructure affect both the quality of life of the population and undermine competitiveness and productive investment, both national and foreign, which are of key importance for the country's further development. Finally, environmental protection is still under-funded, and the problems associated with growing urbanization, industrialization, and intensive agriculture continue to be neglected. In short, Costa Rica has begun to "consume its future" so as to maintain, in the short term, the (appearance of) normalcy.

In addition to this rather negative scenario, a number of corruption scandals erupted in 2004 involving three former presidents who governed the country between 1990 and 2002, as well as high-ranking leaders of the National Liberation and Social Christian Unity parties, revealing the vulnerability of the State procurement system to collusion among political authorities and the commercial interests of contractors and private suppliers. Although it is still impossible to determine the political and legal implications of these events, the outcome of which is still unclear, the widespread unrest and condemnation on the part of Costa Rican citizens has already claimed its first victims: the political parties and the electoral climate.

Thus, the serious problems of political representation that have characterized Costa Rican democracy in recent years worsened in 2004, aggravated by the fact that citizen support for democracy today is significantly lower than it was twenty years ago. With elections just a few months away, a large segment of the electorate, unprecedented for its size in the country's recent political history, appears very reluctant to participate in the electoral process, and the political parties, both old and new, are not very highly regarded. The parties represented in the legislative assembly have almost entirely lost their internal coherence. At present, for a variety of reasons nearly 20% of the *diputados* (legislative representatives) have abandoned the parties that brought them to public office in 2002, another unprecedented occurrence in Costa Rica. Legislation that has been approved is highly specific in nature, and focuses primarily on administrative-type provisions or on obtaining benefits for specific groups. Thus, in 2004 there was a sharpening of the contrast between the political system's promise to its citizens – evidenced by the sizeable body of new social, political, civil, and environmental legislation approved during the last two decades– and the State's growing inability to fulfill its mandates.

This situation can be described with a metaphor: a large family lives in a large, old house that has cracks and leaks, and is poorly maintained. The members of the family begin pulling doors off the hinges to build fires to keep warm since the electricity has been cut off because they haven't paid the bills. They begin selling windows for cash to buy food. Those who live on the floor with the fireplace do keep warm; the lot of the others barely improves, and some shiver with cold. Moreover, since the money obtained by selling the windows is not enough to buy food for everyone, the struggle over food distribution heightens disputes, and dissatisfaction poisons relations among family members. The unrest intensifies when it is discovered that some family members are opportunists who have, on the sly, begun to disassemble the house for their own benefit. The strongest and most opportunistic family members eat well, those who tag along get a little to eat, and the rest receive little or nothing. However, even this unfair arrangement will be short-lived: unless an alternative is found, tomorrow the family will have to sacrifice more of its assets, some to burn and others to sell.

Although by late 2004 the country's situation was extremely complex, the aforementioned scenario was not the only cause of this complexity. In a short period of time, major changes in the world setting created more adverse conditions, which seem not to have been noticed by the social and political actors engaged in insular discussions on the distribution of positions and possessions, as if a small nation can ignore its surrounding environment. Even though soaring oil prices in the past eighteen months have placed the country's solvency under pressure and boosted inflation, the country has no energy policy to reduce the domestic economy's dependency on fossil fuels. Rising international interest rates signal the end of the era of easy and abundant money, which is a blow to a dollarized economy such as Costa Rica's. At the same time, the rapid development of export capacity in the People's Republic of China poses important challenges to Costa Rican exports and, in general, to those of Central America. The country will soon have to face growing competition resulting from the combination of China's cheap labor and sophisticated technology.

In July 2005, the United States Congress ratified the United States-Central America-Dominican Republic Free Trade Agreement (CAFTA-DR), giving rise to a new international political scenario. Now that almost all the countries, including the most powerful of the lot, have approved the agreement, Costa Rica is no longer merely faced with having to decide whether to ratify it or not; its decision is now affected by the fact that the rest of the parties have already given thumbs up to the initiative. In this context, the paralysis of political debate in the country is surprising: both the fiscal reform and the CAFTA-DR are bogged down, with no resolution in sight one way or the other. Even more significant is the fact that, between the time the State of the Nation Program published its study on that trade agreement in February (State of the Nation Program, 2005) and the period this report was being prepared, no progress at all was made on the development agenda, which is fundamental for progress and equity in the country, regardless of whether the CAFTA-DR is approved or not (box 3).

Box 3

The development agenda: still pending

In Latin America, and Costa Rica is no exception, experience with economic opening has shown that, although it has contributed to expanding trade and direct foreign investment, it has not produced economic growth accompanied by more jobs, better wages, and greater equity (ECLAC, 2004 and 2005; Lederman et al., 2003). In this connection, Lora and Panizza (2002) have indicated that countries with strong institutions and human capacities are in the best position to tap certain advantages afforded by a stronger role in the world economy. In the context of the CAFTA-DR deliberations, a new discussion has emerged on the domestic actions needed to ensure that economic opening contributes to growth and equity. The domestic policies needed to ensure a better distribution of the benefits of trade opening are also being discussed, including institutional reforms to improve the State's capacity to promote development and equity.

In Costa Rica, this involves the discussion of two specific agendas: the complementary agenda and the implementation agenda. The complementary agenda focuses on actions that will contribute to achieving economic openness with greater competitiveness, such as reform of the institutional framework, the administration of trade agreements, payment for environmental services, and the signing of agreements to avoid double taxation, among other things. These, in turn, have implications for the implementation agenda, which includes the commitments associated with the CAFTA-DR, should it be approved. These are pressing matters that must be resolved in the short term and include strengthening the Instituto Costarricense de Electricidad (ICE)², regulations governing insurance and intellectual property, and, in general, the services that would be opened up to competition, public sector procurement, and labor oversight and inspection (Gutiérrez, 2005). In short, implementation of these agendas will enable the country to honor its commitments under the CAFTA-DR and, at the same time, to

² Costa Rican Electricity Institute

improve its capacity to tap opportunities and minimize the risks associated with the agreement.

However, these agendas together do not make up a development strategy capable of promoting sustained economic growth, well-being, and social equity. A development strategy requires definition and execution of policies that will enable the country to rapidly improve its performance in education, overcome its shortcomings in infrastructure, remedy the debilitation of the social security system, promote rural development, foster science and technology, and implement fiscal and financial reform to expand the investment base and ensure the efficient and secure use of such funds.

Although this issue is pending and now has become urgent under current circumstances, no progress has been made to discuss the national development strategy, much less implement actions that make it up. Given the nature of Costa Rica's political-institutional system, and considering the current situation, definition of such a strategy will require internal negotiations among social and political forces to reach decisions that are acceptable to the majority.

In light of this report's somber assessment of developments in 2004, one cannot avoid wondering how serious the country's situation is. Given the accumulated economic, social and political problems that trouble national life, can Costa Rica be approaching the abyss, or is it already on the edge? Despite the undeniable gravity of the problems, the data analyzed in this document and in previous reports do not support that conclusion.

Important historical strengths are still in place. For example, viewed over the long term, Costa Rica's achievements in human development place it in a favorable position. The recent expansion of its external sector has made it the principal exporter per capita in Latin America. Its environmental conservation policies and the exploration of its rich biodiversity provide the country with an important asset for improving the quality of life of its people and promoting development, as they are a core factor of the progress to be made in the areas of science and technology. Being the oldest and most stable democracy in Latin American is an advantage for Costa Rica vis-à-vis its position in the surrounding environment. More recently, the domestic economy grew in 2004 (although less than in 2003) and, while this was not reflected in higher incomes for the population, it does show that the country has competitive economic sectors. Although progress has been slow and tentative, recovery of school attendance levels and investment in public education provide the groundwork for more vigorous action in this field. Costa Rica's legal institutions were able to submit powerful political figures to legal proceedings as called for under the law, despite the tensions generated by the situation. And a short while ago, a process of social consensus-building produced an agreement to reform, for the first time since it was established in the 1940s, the social security system's regulations on disability, old age and death benefits (IVM).

Seen in isolation, some of this progress, especially the most recent, is not proportional to the magnitude of the problems to be solved. On the whole, however, the strengths—long and short term—are a platform that Costa Ricans can lean on to design intelligent responses to the complex problems facing their society. Moreover, we should add that, comparatively, it is an unusually broad

platform for a small country surrounded by a region of low development. Therefore, although the situation is troubling and urgently requires decisions, Costa Rica is not trapped in a narrow, dead-end alley.

In assessing the country's problems and strengths, the Tenth Report defined the current period as a "time for change." With regard to sustainable human development, it stated that in the coming years it would be necessary to substantially raise labor productivity and expand investments in –and distribution of– capacities and opportunities for the population, and to strengthen the social security system. This report is in agreement with that strategy, and further specifies it by focusing on a specific challenge: the short-term universalization of secondary education. Some of the many benefits of universal secondary education include better possibilities for boosting productivity and narrowing the equity gap. As that issue is geared to the future, it will be discussed in the new section of the report entitled "Discussions on Development."

The transformations needed to rekindle human development in Costa Rica are diverse in nature: economic, social, environmental, and political. We must acknowledge, however, that the Gordian knot of transformations in these fields is the political system. Due to the nature of democracy and, more particularly, the institutional arrangements of the Costa Rican system, we must accept that any changes approved, no matter how sweeping they may be, will only be gradual and partial. No one in the country today has enough power to impose their version of reforms, and the power of most of the groups erodes as political problems worsen. Although this situation has brought things to a standstill because it makes it impossible to act, it can become a positive factor because it opens up the possibility of forging a multisectoral agreement around a development proposal.

In order to move forward, a social pact needs to be negotiated to distribute opportunities and benefits among the country's inhabitants, especially the sectors that have gained little or nothing from economic opening and the international trade policies implemented over the past twenty years. Since every solution has a cost, sacrifices will also have to be distributed, but they should not be shouldered by the most vulnerable groups. It is unpleasant to have to listen to the party upstairs when you have not been invited, and it is even worse to have to pick up the tab for those who are having a good time.

This social pact may include a proposal to tackle concerns over productivity, but it should also address the question of equity. It may foster more vigorous development of the export economy, but should also strengthen weak fiscal linkages. It may promote the development of new sectors of business activity, but should also address the need to improve environmental protection. Finally, it may consider measures to respond to the demand for more public investments and services, coordinated with actions to ensure a greater and more equitable distribution of the tax burden, with effective controls over public funds.

Reaching agreement on a social pact of this nature will not be easy. In the first place, it will be impossible to include everything demanded by the population and to cover all desirable topics. In the second place, it requires credibility: both on the part of those involved in forging the pact and on the part of the citizens who must believe that it will be implemented. In the third place, overcoming the principal obstacles to development requires an enormous creative effort and full awareness

that all change involves risk, and that risk must be addressed on time so as not to weaken the outcomes. Finally, something needs to be done to eliminate the temptation to ignore what has been agreed upon, which is commonplace in Costa Rican politics. In this connection, the pact will face the difficult task of restoring the value of politicians' word in national politics. In spite of these difficulties, the worst scenario would be not to break the stalemate that has persisted in recent years among the political forces and that impedes any of them from attaining any objectives. This, then, is the great responsibility facing present day Costa Rican political and social leaders; it is also the parameter for evaluating their performance and demanding accountability. Politics is a civil right that should be taken up again by all who aspire for a better future for Costa Rica.

Box 4

Challenges mentioned in various State of the Nation Reports

- ? Restore faith in politics and political institutions, and improve the quality of democracy.
- ? Create better and more productive jobs and business opportunities, and link new exports to the rest of the economy.
- ? Modernize transportation and communications infrastructure.
- ? Control domestic debt.
- ? Close development gaps among the different regions of the country.
- ? Close social, economic and political gaps between the genders.
- ? Adopt national policies on key issues including the tax system, poverty, migration, and relations with Nicaragua.
- ? Expand coverage, improve quality, and diversify secondary education as a means to progressively reduce poverty.
- ? Tackle the cumulative decline in equity.

Source: State of the Nation Project, 1995, 1996, 1997, 1998, 1999, 2000, 2001b, and 2002; State of the Nation Program, 2003 and 2004.

Equity and social integration

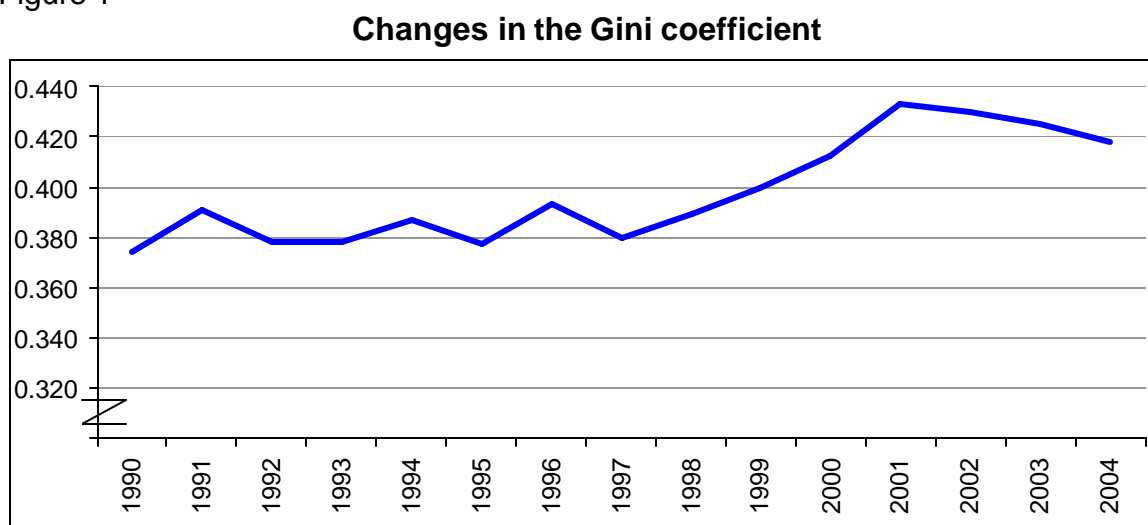
During 2004 there was a decline in opportunities in the country, expressed in terms of a sharp rise in poverty, falling earned income among the entire population, and a decline in the social income provided by the State to households. This occurred in a society that was unable, over the past fifteen years, to establish a link between the development of human capabilities and the construction of a more equitable society.

I. There were more poor households in 2004 than in the past fifteen years.

Widespread decline in incomes and rise in poverty

In 2004, income distribution continued to show one of the highest levels of inequality of the decade while poverty, measured in terms of income shortfalls, rose sharply.

Figure 1



Source: Sauma, 2005, from the INEC Household Surveys.³

Figure 1 shows the pattern of inequality in income distribution, measured by the Gini coefficient.⁴ It can be seen that, although still high, there was a mild decline in inequality. Similarly, a comparison of the average income of the highest per capita income decile (10%) of the population to the lowest per capital income decile of the population yielded a 20.7 ratio for 2004 (1.1 percentage points lower than in 2003). A comparison of the average income of the highest per capita income quintile (20%) of households with the lowest per capita income quintile resulted in a 10.2 ratio (0.3 times less). Underlying these patterns of inequality is a troubling phenomenon: between 2003 and 2004 there was a decline in the average per capita income of all households grouped by decile, except the lowest.

Despite the slight fall in the income distribution indicator for 2004 as compared to 2003, there was a 3.2 percentage point increase in the incidence of poverty, from 18.5% to 21.7%. According to the Household Survey (INEC, 2003 and 2004), the number of poor households grew from 168,659 in 2003 to 208,680

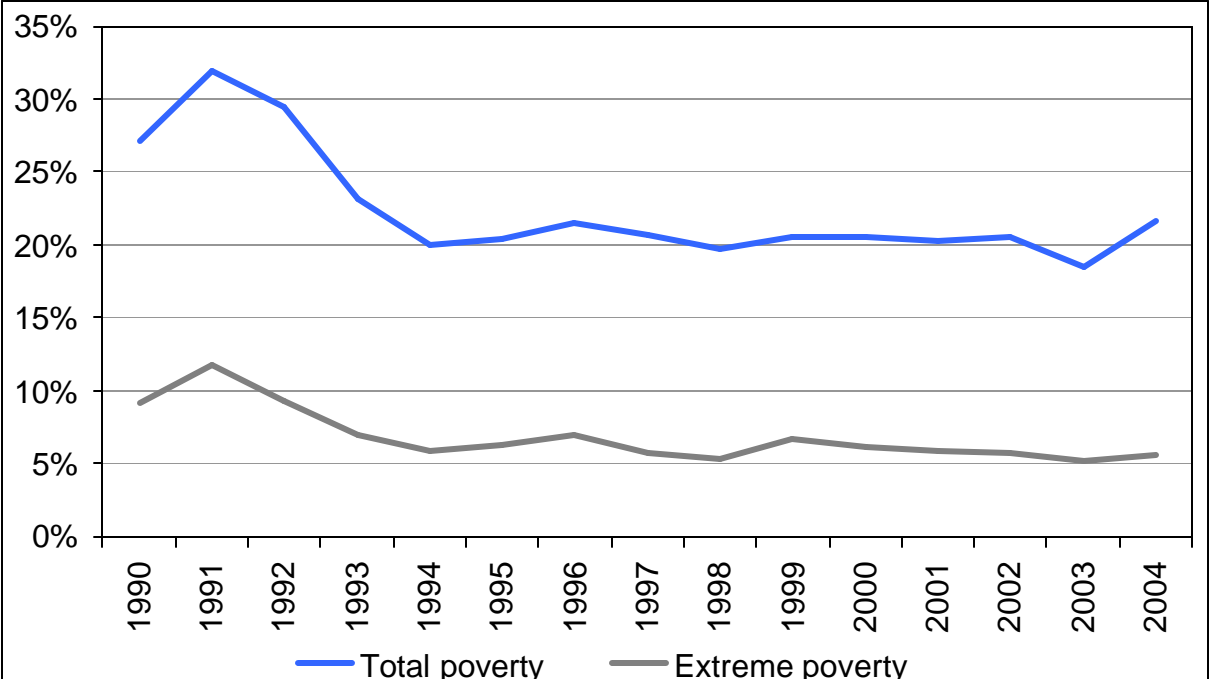
³ INEC: Instituto Nacional de Estadística y Censos [National Institute of Statistics and Census].

⁴ The Gini coefficient is an aggregate numerical measure of inequality in the distribution of income. It runs from 0 (perfect equality) to 1 (perfect inequality). The higher the coefficient, the greater the inequality in income distribution.

in 2004, excluding households that did not provide income information. After making adjustments by adding an estimate of poor households in the unknown income bracket to households with known incomes, it is estimated that, for the entire country and in that period, the number of poor households rose from 195,306 to 234,005, that is, an additional 38,700 households were living in poverty (6,436 in extreme poverty) (Sauma, 2005). In terms of total poverty, there were more poor households in 2004 than in the past fifteen years (1990-2004).

Figure 2

Incidence of poverty among households
(percentages)



Source: Sauma, 2005, from the INEC Household Surveys.

In 2004, the percentage of poor urban households surpassed the percentage of poor rural households for the first time. Fifty-two percent of total poor households were in urban areas while 48% were in rural areas (50.7% and 49.3% of the poor, respectively). Although the incidence of poverty is higher in rural areas, high population density in urban areas makes the number of poor households greater in urban areas. A serious problem faced by low-income groups is the difficulty of obtaining decent housing, a situation reflected in the growth of shantytowns in the Greater Metropolitan Area (GMA) (box 5).

Photo 1

La Carpio shantytown
(infrared aerial photography⁵ CARTA 2005)



This image shows geographical features typical of human settlements near rivers, in areas highly vulnerable to natural disasters; it also shows spatial disorganization. Large properties belonging to high-income households in Heredia can be seen in the lower left-hand corner.

Source: DCS digital camera, CENAT-PRIAS.

Box 5

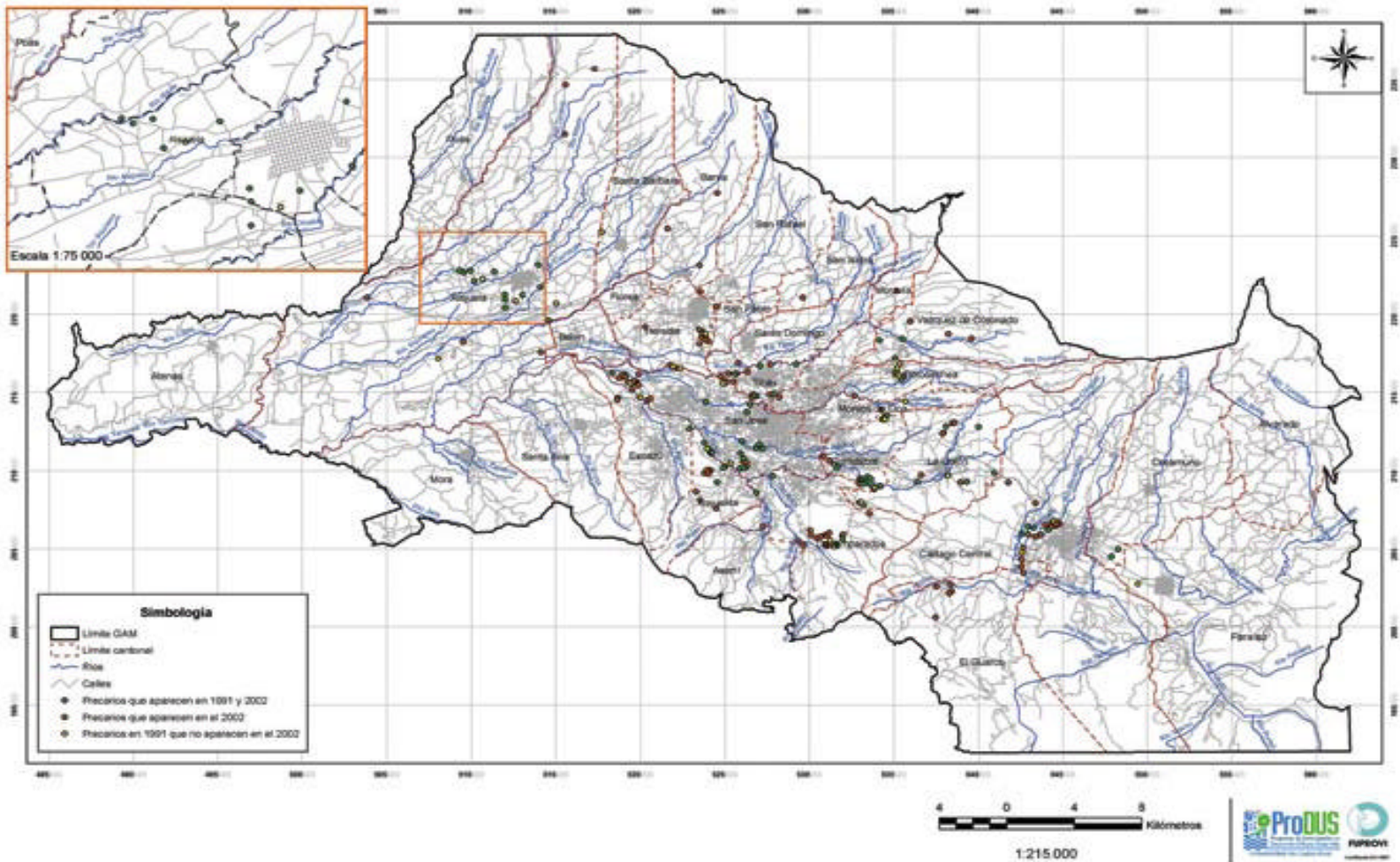
Growth of shantytowns in the GMA

A study conducted for the Eleventh Report sounds an alarm regarding the growth of shantytowns in the GMA, which doubled in size between 1987 and 2002, and reveals serious shortcomings in the housing policy's ability to reduce their number and compensate for natural growth. The fact that no coherent and planned State policy exists to systematically eradicate the problem partly explains the growth of the number of people living in shantytowns, from 3.2% between 1987 and 1991 to 6.7% between 2002 and 2004.

⁵ False-color infrared is a system that extracts reflected radiation and records only the radiation emitted by the target area and the objects in it. "Redness" indicates the state of the vegetation and crops: the redder the color, the healthier or denser the vegetation. Types of vegetation and crop can be differentiated by texture.

Map 1

GMA: Pattern of shantytown growth between 1991 and 2002



Source: ProDUS, based on data from the National Geographical Institute, INEC, and MIVAH,⁶ 1991, 2002.

⁶ MIVAH: Ministry of Housing and Human Settlements

Also with regard to poverty, wide gaps continue to exist between territories, genders, and age groups. An example of the magnitude and depth of same can be seen in the situation of the Brunca region, which registered a 6.8 percentage point increase in the incidence of poverty, from 33.6% in 2003 to 40.4% in 2004. In that region, the real average income of households fell by 17.2%. Table 1 shows the findings for 2004 of various poverty-determining indicators at the regional level.

Table 1

Some variables that affect poverty, by region. 2004

(absolute figures and percentages)

Variable and year	Central	Chorotega	Central Pacific	Brunca	Atlantic Huetar	Northern Huetar
Households with known income						
Persons per household	3.8	3.8	3.7	3.9	3.7	4.0
Employed per household	1.5	1.4	1.4	1.3	1.4	1.5
Open unemployment rate	6.4	6.7	6.7	5.5	5.5	5.0
Homes with women head of households (percentage)	28.0	24.0	25.5	28	22.4	17.0
Demographic dependency ratio ^{a/}	0.5	0.6	0.6	0.6	0.6	0.6
Economic dependency ratio ^{b/}	1.5	1.6	1.4	1.8	1.6	1.6
Hours per week in principal occupation	45.1	42.8	45.8	42.8	48.1	46.4
School attendance in population 15 years of age and older	8.6	7.0	6.7	6.3	6.4	6.1
Average household income ^{c/}	110,061	65,859	68,260	53,580	62,627	71,024,0
Per capita household income ^{d/}	28,990	17,124	18,319	13,890	16,833	17,925,0
Entire population						
Gross rate of participation	44.3	38.9	41.6	35.8	39.0	40.0
Total employed	1,108,842	115,650	84,707	108,099	151,045	85,536
Open unemployment rate	6.6	7.6	7.1	5.8	6.0	5.1

a/ Ratio of children under 15 and adults over 64 as compared to the population between the ages of 15 and 64.

b/ Ratio of children under 12 and the unemployed population as compared to the work force.

c/ In January 1995 colones.

d/ Corresponds to the economically active population as compared to the population 12 years of age and older.

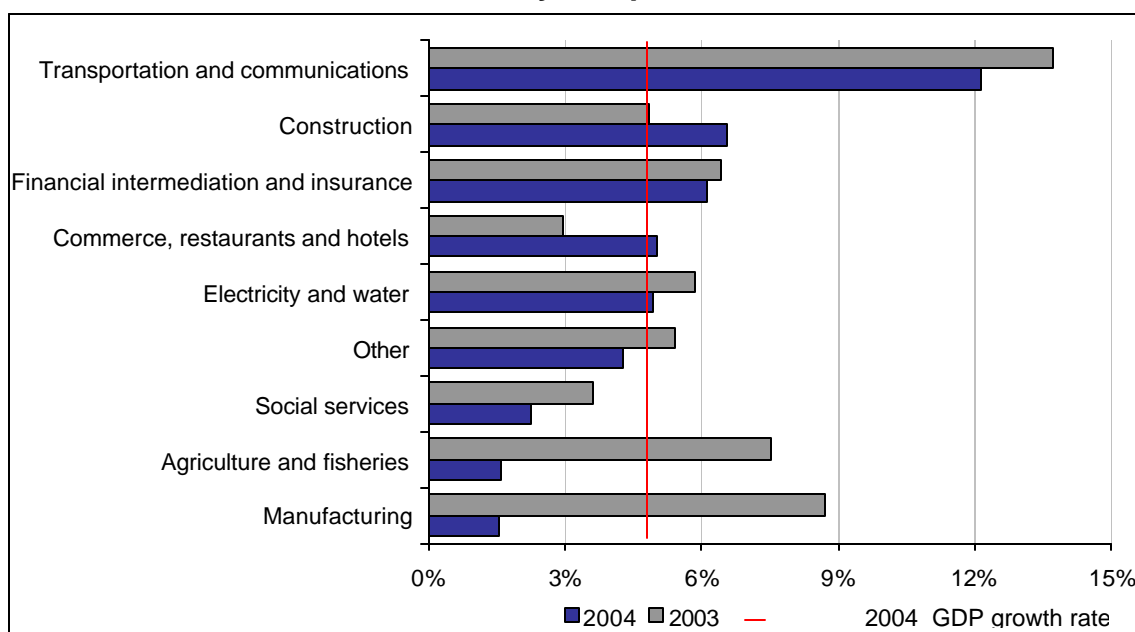
Source: Sauma, 2005, from the INEC Household Survey.

Inflation produced an increase in poverty.

The decline in real household incomes was the factor that determined the increase in the incidence of poverty between 2003 and 2004. The prices of goods and services making up the basic food basket rose more than the prices of other articles, thus having the greatest impact on lower-income people. From July 2003 to July 2004, while the general CPI⁷ increased by 12.4%, the cost of the basic food basket rose by 17.2% (16.3% in urban areas and 18.1% in rural areas).

Figure 3

Inflation rate, by component of CPI



Source: INEC.

It is important to note that inflation per se will not increase poverty if incomes rise at the same rate as prices. In the absence of effective wage and income adjustment mechanisms, a steady growth in prices (inflation) erodes real income, which impacts the ability to buy goods and services.

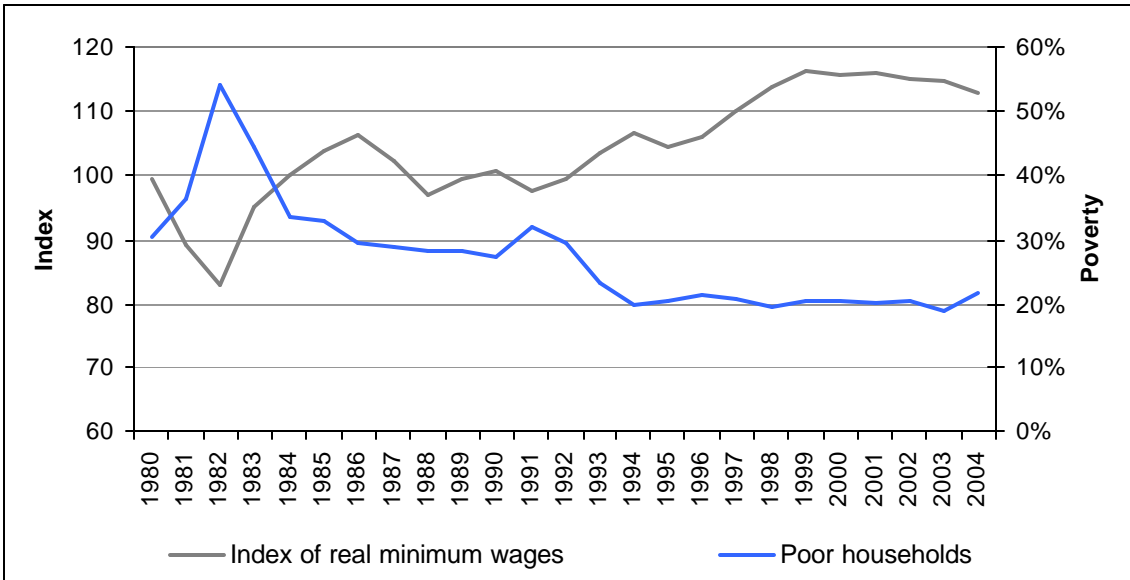
FOR MORE INFORMATION ON
POVERTY AND INCOME INEQUALITY (in Spanish only)
 See Sauma, 2005b at the Web site www.estadonacion.or.cr

⁷ CPI: Consumer price index

The minimum wage declines.

The real minimum wage fell for the third consecutive year, reaching a level very similar to that of 1997. Wages are the principal source of income for Costa Rican households, and salary increases in most employment categories are generally based on the nominal variation decreed for the minimum wage (arrived at through a tripartite mechanism involving workers, employers, and Government, which primarily assesses the performance of inflation).

Figure 4
Index of real minimum wages and incidence of household poverty
 (base 1984=100 and percentages)



Source: Based on Trejos, 2005, and BCCR⁸ data.

Like private income, social income also shrinks.

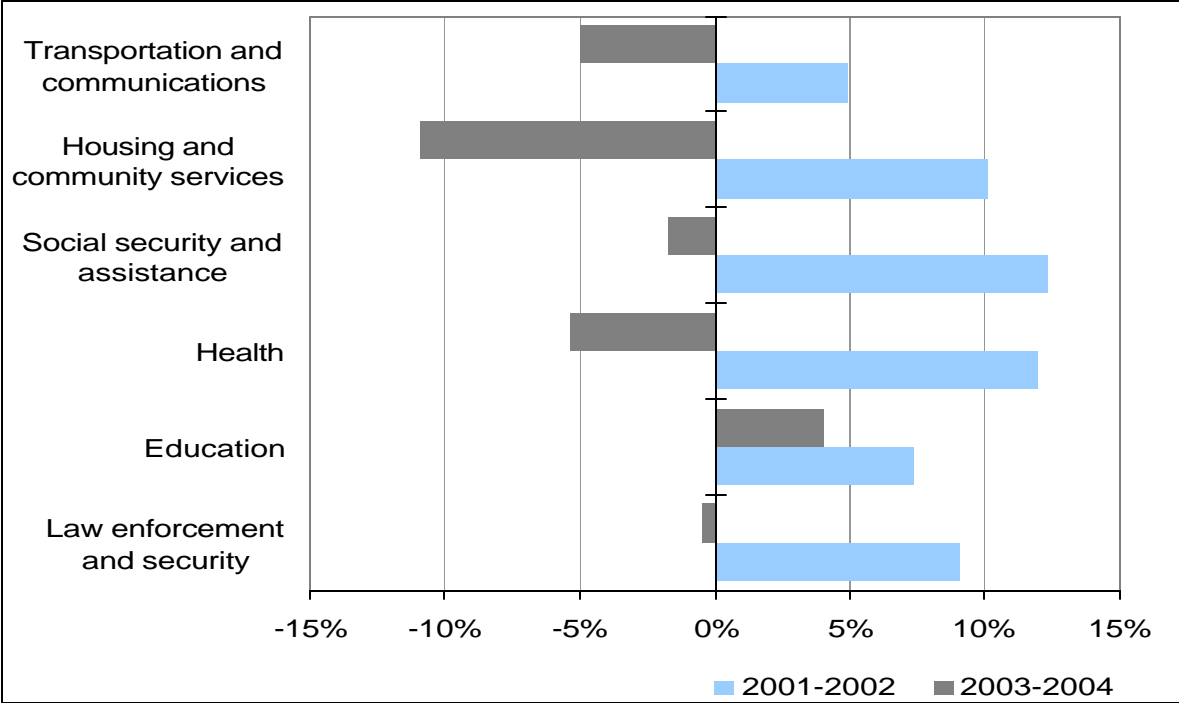
In a scenario of growing poverty and faced by the need to maintain macroeconomic stability, the Central Government implemented a spending control strategy during 2003 and 2004 that involved cutbacks in social and infrastructure investments. The sharpest cutbacks were applied to the categories of housing and community services, health, transportation and communications, social security and social assistance, law enforcement and safety, and, to a lesser degree, education. As a whole, investments in all these categories fell in real terms from a 9.2% expansion in the 2001-2002 period to a 0.2% decline between 2003 and 2004 (Rosales, 2005).

It is worth underscoring that “social income” (the goods and services received by the population from social investments) is very important to low-income families. The social income of the lowest-income families (first decile) amounts to 2.32 times of their earned income. For families in the second decile, it is almost equal to their

⁸ BCCR: Central Bank of Costa Rica.

earned income (Trejos, 2004). These figures show how cutbacks in social investments primarily affect the neediest families.

Figure 5
Real growth of Central Government spending, by function or type of use
 (2004 colones)



Source: Rosales, 2005, based on CGR data.

The case of FODESAF⁹ offers a good example of how cost-cutting measures have weakened social investment. Cutbacks in this fund, which lost 23% of its real value between 2000 and 2004, were attributed primarily to a reduction in its share in the National Budget. If only the effective transfer from sales tax is taken into account, that contribution falls from 27.5% of revenues in 2000 to merely 3% in 2004, for a real contraction of 92% during that period. This means that, although in early 2000 FODESAF was receiving only about half its share of its revenues from the aforementioned tax, in the last two years the relationship between what is provided for under the law and the current situation has all but been lost.

There is also concern over the efficiency with which FODESAF's resources are being managed. Although greater spending is not synonymous with greater efficiency, an inability to spend can indeed suggest planning and management problems. In this connection, the CGR¹⁰ has called attention to the fact that in 2004 the institutions in charge of selective social programs recorded a surplus of 17.5 billion colones. In fact, FODESAF's surplus has been growing since 2000, when its real income has been shrinking. Its surplus amounted to 5.77 billion colones in

⁹ FODESAF: Social Development and Family Allowance Fund.

¹⁰ CGR: Office of the Comptroller of the Republic.

2003, the year its real resources were most drastically slashed, and in 2004 its surplus was almost as large as its allotment from the National Budget.

This problem with the surplus can be explained in part by the fact that the Finance Ministry has been allocating a large part of the funds to public agencies during the last month of the year, making it impossible for them to implement the projects and meet the goals set out in their annual plans. Moreover, pursuant to the new Law on Public Budgets, these institutions are not allowed to use the funds the next fiscal year.

The social programs, particularly those financed by FODESAF, do not have efficiency estimates. While it is possible to determine how much FODESAF has spent, the cost of the services provided cannot. There is no standardized information on services provided. In the best of cases the number of beneficiaries can be determined although this information is also not standardized (number of people, families, projects, actions, etc.). This information is hard to obtain and of dubious quality. Therefore, in this scenario, less spending per beneficiary does not necessarily mean an improvement in the program's economic efficiency; rather, it probably reflects a weakening of service quality.

II. Access to knowledge

The trend to extend coverage continues but so does the dropout rate.

In 2004 the trend to extend the coverage of the educational system continued, especially for preschool and secondary school. Coverage can be estimated by means of two indicators: the gross school enrollment rate, which measures the proportion of children or youths enrolled at given educational levels as compared to the total population of the age for that school level, and the net rate, which excludes older students who are at greater risk of dropping out of the system.

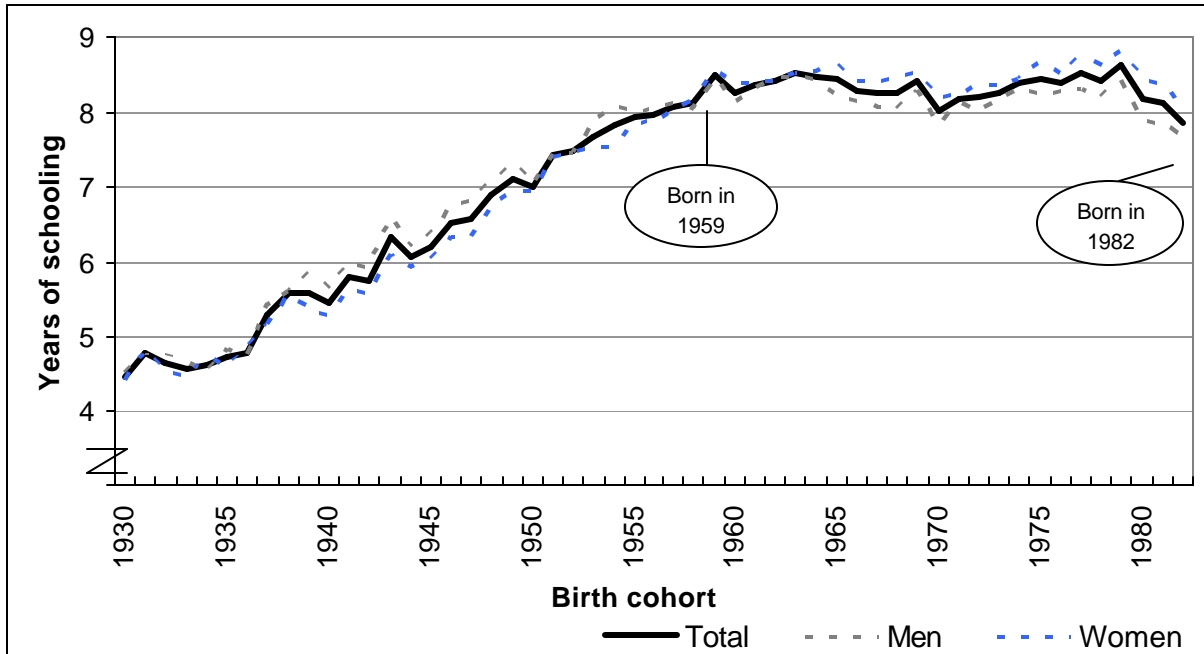
In 1990, the gross enrollment rate in preschool educational programs was 62%; by 2004 it had climbed to 90.3%. In secondary school, and taking only formal academic education into account, the gross rate rose from 68.8% in 2003 to 72.6% in 2004, while the net rate grew from 60.9% to 63.8%. When the new alternatives for secondary education are taken into account (distance education, IPEC,¹¹ CINDEA¹²), the gross enrollment rate climbs from 79.2% in 2003 to 84.0% in 2004, and the net rate rises from 66.2% to 69.3% in that same period. Enrollment in specialized education, which covers the last two or three years of secondary schooling, is considerably lower: the gross rate in 2004 was 53.1% and net rate was 38.4%.

¹¹ IPEC: Professional and community education institutes.

¹² CINDEA: Integrated youth and adult education centers.

Figure 6

**Average school enrollment of the population, by birth cohort.
2000 Census**



Source: Based on data from the 2000 Population Census (INEC).

In turn, the secondary school dropout rate rose from 10.4% in 2003 to 11.6% in 2004, showing a reversal of this indicator’s positive trend of recent years. For primary and secondary schooling, dropouts occur most frequently in public schools, in rural areas, and mainly among men. The dropout rate in the first year of secondary school (18.3% for day school in 2004) continues to be a concern. A sharp break occurs in the transition from sixth grade (primary school) to the first year of secondary school as a large number of students must repeat the year; this seems to be associated with the high dropout rate.

Non-enrollment of youths between the ages of 12 and 17 in the educational system is explained not only by the socioeconomic status of the household, but also by their lack of interest in formal education: 16.3% cannot cover the cost of their studies, 12.2% have to work or help with domestic chores, 6.2% have problems getting to school, 10.5% find studying too difficult, 27.6% are uninterested in formal education, 6.1% prefer to work, and the remaining 21.0% mention other reasons (INEC, 2004). Research conducted for this State of the Nation Report indicates that the contents, methods, and quality of education have much to do with why students drop out of school. If these were improved and schooling was made more attractive to students, this could be an important factor to keep them in the educational system (Ruiz, 2005).

Poor performance

Poor performance and the frequency with which grades must be repeated have severe repercussions on the effectiveness and efficiency of Costa Rica's educational system. On average, students take 9.4 years to graduate from secondary school, almost twice the five years it takes if grades are not repeated.

With respect to national tests, the performance in 2004 was poor for all subject areas as compared to previous years. The percentage of students passing the national secondary school tests was lower than in 2003 for all subjects, except mathematics and physics, which rose by less than 0.5%. The results of the schooling third stage¹³ reveal a decline in the percentage of passing students for most subjects, including subjects where performance had traditionally been poor but that had experienced a certain degree of recovery, such as mathematics.

Table 2

Percentage of third stage students whose examination grades were 65 or higher, by year and subject

Subject	1996	1997	1998	1999	2000	2001	2002	2003	2004
Spanish	93.5	68.5	81.7	84.1	79.5	67.5	77.9	73.9	65.9
Social studies	37.7	23.5	38.1	44.0	63.2	72.5	75.6	77.9	71.0
Mathematics	9.2	14.9	22.1	23.0	17.0	26.9	31.3	28.9	20.5
Sciences	54.3	42.3	33.2	37.7	58.6	47.1	63.8	66.8	72.8
Civic education							64.6	66.3	55.3
French	87.6	60.9	88.7	69.0	90.0	89.3	92.4	81.8	68.2
English	74.7	80.4	68.7	62.6	75.7	64.1	62.0	58.6	74.3

Source: MEP, 2005b.

It is difficult to compare the performance of Costa Rican education with other countries because Costa Rica does not engage in standardized international testing which other countries use to monitor the performance of their educational systems.

Difficulties to invest in infrastructure and close gaps

Because of the difficulty of increasing capital investments, aggravated in the past two years by the measures to contain public spending, the serious shortcomings in educational infrastructure persist. The most pressing needs in primary schools are classrooms for academic subjects, for preschool activities, and for special subjects. Other needed improvements include sports facilities, teachers' rooms, mesh fencing to protect the schools, science laboratories, libraries and computers.

Although the shortcomings of public secondary schools are relatively less pronounced than those of primary schools, there is a very large deficit in terms of the things that take education beyond classroom-and-chalkboard type learning. There is a need for libraries (148), science laboratories (164), gyms (145), and computers. Internet access is very limited in both primary and secondary schools.

¹³ Seventh through ninth grades.

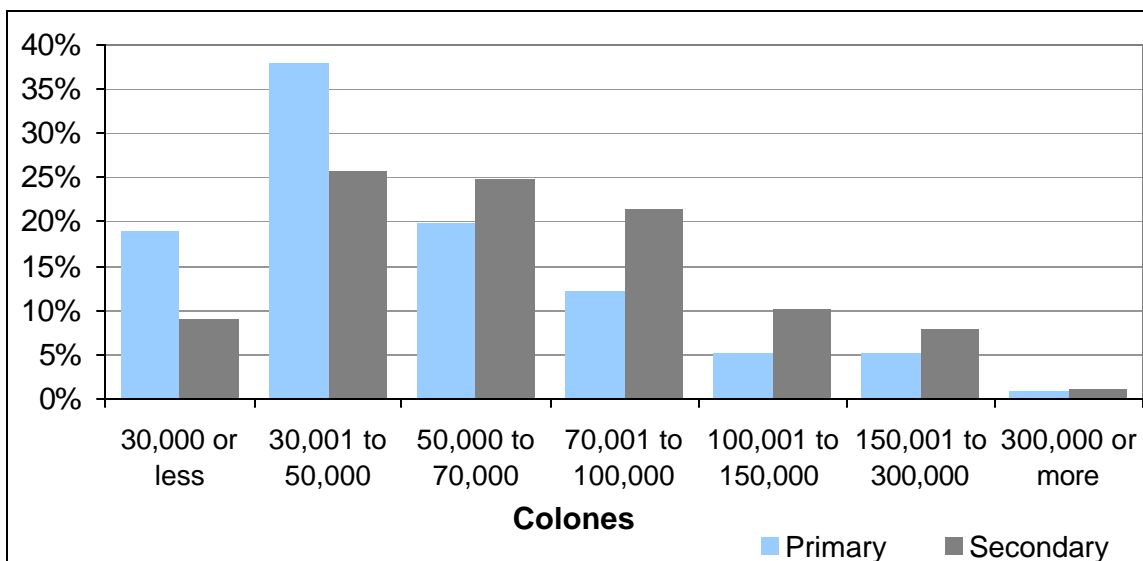
Very few schools have access ramps for disabled students: only 14.7% of primary schools and 29.8% of secondary schools do (MEP, 2005a).

These infrastructure problems must be addressed in order to improve quality and prevent a further widening of the gap between public and private schools, and between urban and rural areas since, in addition to the internal weaknesses of the educational system, external problems (social, economic, and geographical factors) also limit access to education. For example, an analysis of enrollment in formal education centers by geographical area shows significant differences for youths living in rural areas: school enrollment for this group is 59.4% while in urban areas it is 77.1%. The regions with the lowest school enrollment rate among students between 5 and 24 years of age are Huetar Norte, Central Pacific and Huetar Atlántica. Among all age groups, except preschool, the Huetar Norte region has the lowest school enrollment rate.

Other important gaps exist between public and private education, both in terms of student performance and dropout rates, and in the condition of infrastructure and access to technology. There is a rising trend for secondary students to attend private schools. Enrollment in public schools, which in 1980 accounted for 93.8% of the student population, currently stands at 88.2%. Almost a third of the country's schools are private, which indicates not only a greater demand for this type of education, but also a lack of confidence among middle- and high-income households in the quality of public education. As already mentioned, although 88.2% of students are presently enrolled in public schools, the better quality of private education, for example in bilingual learning, which is limited and of poorer quality in public schools, and access to computer technologies, spurs the higher-income brackets to seek paid-for educational options.

The cost of private education is considerable for a middle-income family. The average cost of registration and monthly payments for private primary school is a little more than 60,000 colones; for secondary schools it is 75,000 colones. If a family has two children enrolled in a private secondary school, this means an average monthly outlay of 150,000 colones. For some perspective on this situation, according to the Multiple-purpose Household Survey, the monthly average income of the employed population is 169,125 colones.

Figure 7
Percentage of private schools^{a/}, grouped by average cost of monthly payment. 2005



a/ Information was provided by 116 private primary schools and 89 secondary schools, from a total of 314 private schools.

Source: Elizondo, 2005, based on information provided by the schools.

III. Access to a healthy life

Life expectancy continues to rise.

In 2004 life expectancy rose again, to 78.7 years for both sexes (76.5 for men and 81.0 for women). This was accompanied by a decline in the infant mortality rate, to 9.25 per 1,000 live births, the lowest recorded for the country. These indicators, which summarize the health conditions of the population, are among the best in Latin America. Consistent with this trend, the overall fertility rate fell again, to 2.0 children per woman.

For several years now, Costa Rica's epidemiological profile has been characteristic of countries that have completed their demographic transition. Most deaths occur in people over 65 years of age. The leading causes of death are cardiovascular diseases and tumors (breast, stomach, colon and cervical cancer among women; gastric, prostate, lung and colon cancer among men). Diabetes is an important cause of death among older adults, with a significance increase in 2004 over 2003. Among the general population, violence and traffic accidents are frequent causes of death, despite the fact that the rate for both fell in 2004.

A Ministry of Health (MINSa) survey of diabetes mellitus, hypertension, and related risk factors, covering 2,400 people twenty years or older residing in the San Jose Metropolitan Area, revealed that 8% of the respondents are diabetes patients, 18% have altered glycemia (sugar in the blood), 25% are hypertensive, and 25% are pre-hypertensive, while 45.7% have cholesterol levels above 200 mg/dl, and 51.7% have triglycerides above 150 mg/dl. The risk factors of these diseases

include insufficient activity physical (41%), overweightness and obesity (58%) (MINSAs, 2005).

One of the most important health care challenges continues to be notifiable diseases. In 2004 there was a decline in the number of deaths caused by AIDS. Nevertheless, vector-borne diseases continue to be a serious problem, evidenced by the increase in cases of malaria and leptospirosis. Although the incidence of dengue fell sharply from 19,703 cases in 2003 to 9,408 in 2004, there was a strong upsurge and by July 2005 the number of people with dengue surpassed the 2004 total. It is important to recall that this disease can only be controlled if communities and all social and institutional sectors are actively involved in prevention efforts.

Health results for 2004 show that, in order to preserve the progress it has attained and tackle the challenges posed by the current epidemiological profile, Costa Rica must improve its prevention and early warning instruments, and adjust its services to strengthen their vitality and effectiveness in dealing with the complexity of certain diseases, including cancer and dengue.

IV. The financial sustainability of the social security system is a concern.

Health insurance and pension coverage

In accordance with the Costa Rican Social Security Administration (CCSS), in 2004, 87.8% of the population contributed to the health insurance system. By type of coverage, 23.8% were self insured, 12.8% were State-insured, 6.3% were pensioners, 44.8% had family insurance, and 12.2% were uninsured. From the standpoint of the economically active population (EAP), health insurance covered 53.4% of total EAP, 61.8% of employed EAP, and only 39.1% of unemployed EAP.

Pension insurance coverage was barely 45.1% of total EAP (56.8% employed and 21.7% unemployed). In 2004 pension coverage was characterized by a declining contributor base and a growing beneficiary population. Over the past 14 years, coverage of salaried workers declined by 11 percentage points, while coverage of the unemployed rose by 18.1%.

Challenges to sustainability

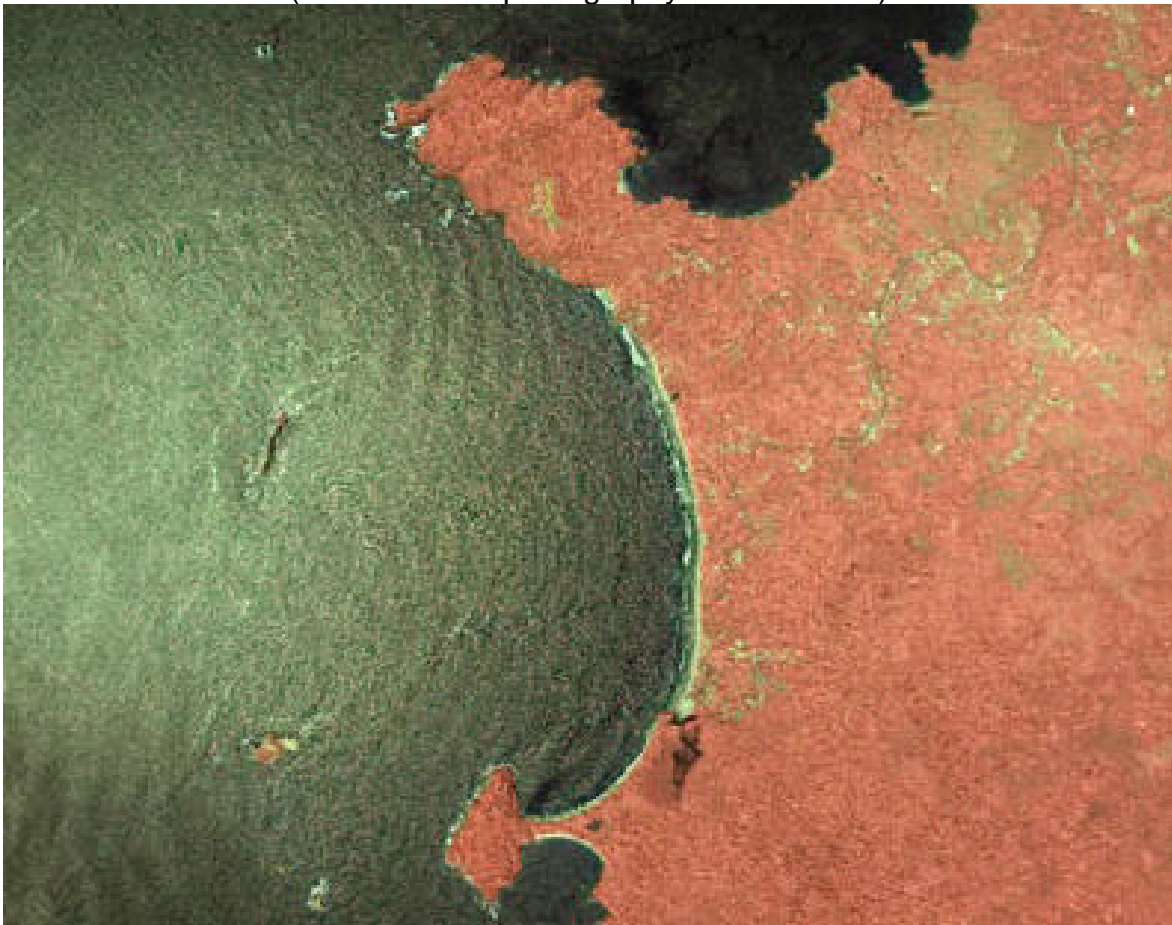
The health and pension insurance situation faces two main challenges. In the case of health insurance, revenues must be increased and a review made of the distribution of the different revenues to finance it. For pension insurance, the key issue is to expand the contributor base.

When health insurance was originally proposed, it was to be a universal, solidary, equitable, and mandatory public system based on the tripartite contributions of workers, employers and the State. In recent decades, this system has come under pressure from different sources. For one thing, the new epidemiological profile and technological advances have made treatments more complex and expensive; for another, financial sustainability is threatened by problems associated with revenue collection, such as private sector evasion and arrearages, State debt, and the low levels of coverage of unemployed workers (as mentioned, just 39.1% in 2004). In 2005, employer arrearages with the CCSS amount to a total of 67.3 billion colones, of which 27 billion correspond to active employers and the remaining 40.3 billion to inactive employers. The State's debt is 301.5 billion colones, of which 181,478 million are owed by FODESAF for the

State-insured population; 72,401 million are worker-employer quotas owed; and 47,626 million are debt carried forward by the State from the transfer of Ministry of Health employees who used to be responsible for the primary care program (CCSS, 2005a and 2005b). These private and public debts have generated increasingly serious liquidity problems for the institution.

Photo 2

Manuel Antonio National Park
(infrared aerial photography CARTA 2005)

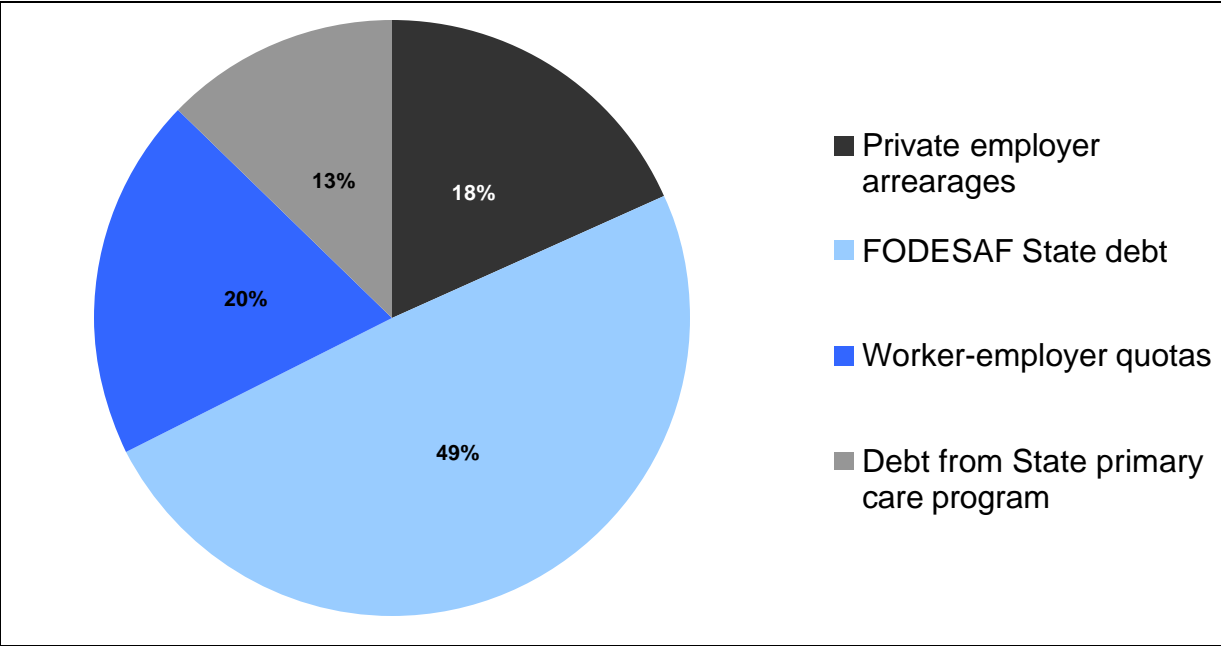


Although Manuel Antonio National Park is one of Costa Rica's smallest parks, it is among the most popular, due to its accessibility and the diversity of its ecosystems. Quepos point and Espadilla beach can be seen in the upper part of the image; Cathedral point and Gemelas islands in the lower. Source: DCS digital camera, CENAT-PRIAS.

FODESAF's debt with the CCSS has grown significantly over the last four years (123.8% real cumulative), undermining the financial sustainability of the health insurance system. As mentioned above, this debt comprises State contributions owed to the insurance system, the objective of which is to provide full benefits to the most disadvantaged sectors. This arrangement has been changed several times, since the State had originally pledged to provide only hospital and health care for indigents. That arrangement, however, is incompatible with the

comprehensive care model that shapes the CCSS’s operations, as it does not guarantee the entire population’s right to health, as called for under the Political Constitution. From 2001 and until this report went to press, the CCSS, the Ministry of Labor, and the CGR have been exchanging notes and observations regarding the scope of legislation, decrees, and regulations that protect this insurance, although as yet they have been unable to resolve the discrepancies.

Figure 8
Public and private debt owed for CCSS health insurance. 2005



Source: Based on CCSS information, 2005a and 2005b.

At present, DESAF¹⁴ has justified not disbursing the funds owed to the health system on the basis of an opinion of the CGR, which considered that the CCSS had to demonstrate the effective care of patients insured by the State and the cost of that service (CGR, 2001). However, after the CCSS submitted several arguments, the CGR agreed that what must be demonstrated is the insurance, not the effective attention, so long as the CCSS can present a reliable record of the total number of persons insured under the system. By mid-2005 the CCSS had not finished preparing the report, nor had it managed –with DESAF– to establish the definitive criteria for the transfer of funds.

Although ensuring the financial sustainability of the health insurance system is a significant challenge, any proposal to address it must be widely discussed and based on technical studies, and should uphold the principles of universal coverage, solidarity in funding, and equitable access.

¹⁴ DESAF: General Directorate for Social Development and Family Allowances.

With respect to pension insurance, in 2004 the IVM¹⁵ system was reformed with a view to strengthening its financial sustainability. An interesting piece of information noted in the Eleventh State of the Nation report regarding the coverage of pension insurance is that, in accordance with a 2003 study, nearly 45% of the non-paying population can afford the insurance and 55% can afford to pay part of it (Martínez and Trejos, 2004).

Economic opportunities, stability and solvency

In general, economic performance in 2004 was unsatisfactory and not much improved over previous years. Economic growth –albeit reasonable in the context of Latin America as a whole– was not enough to generate an expansion of job opportunities. Stability was weakened and although cost-containment policies effectively reduced the government’s financial deficit, their sustainability is a serious concern since the objective was achieved at the expense of the State’s capacity to serve the most vulnerable groups. Moreover, these policies were the reason for postponing investments in public infrastructure, an area in which the country is already seriously lagging.

V. The job market continued to stagnate.

Few new jobs

In terms of job opportunities for the population, no major progress was noted in 2004. There was very little growth in employment (0.8%) but, given that the net employment rate fell from 55.5% in 2003 to 54.4% in 2004, open unemployment declined slightly (to 6.5%). Unemployment is higher today than it was in the early 1990s.

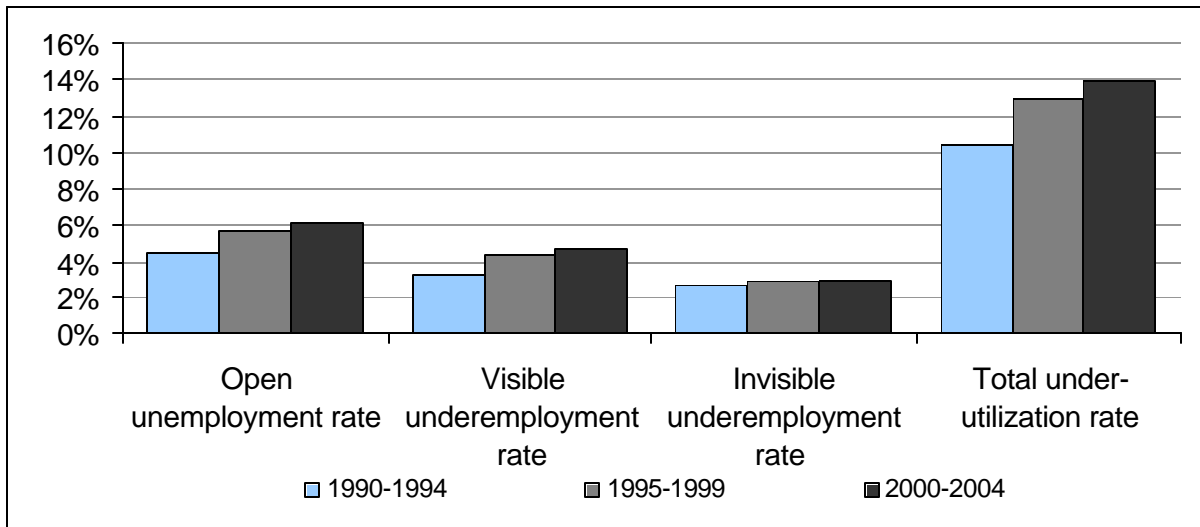
Aside from those who are completely unemployed, there is also a sizable number of underemployed people who, although they have a job, want to work longer hours, or are earning less than minimum wage. In 2004 the number of unemployed and underemployed people was 502,680 (Figure 9).

Access to the labor market is estimated by comparing the principal unemployment indicators for different groups. In 2004, while women had a higher open unemployment rate than men (8.5% as compared to 5.4%), men represented more than half the total unemployed. Open unemployment in urban and rural areas does not differ a great deal, although the rate is slightly higher in urban areas (6.7% as compared to 6.1%). There are almost two unemployed urban dwellers for every unemployed rural inhabitant.

¹⁵ IVM: Disability, old age and death.

Figure 9

Unemployment and underemployment rates
(percentages)



Source: Sauma, 2005, from the INEC Household Surveys.

By age group, youths between the ages of 16 and 20 have the highest open unemployment rate (17.2%), although that unemployment rate can be extended to the entire 12 to 25-year-old group. Youths between 16 and 25 years represent half the total unemployed, while the population between 31 and 50 years accounts for 33.1% of same, although almost 3 of every 5 employed persons are between 31 and 59 years of age. Finally, by educational level, the group comprising persons who completed primary school or dropped out of secondary school has the highest open unemployment rate (7.5%) and accounts for more than half the total unemployed (56.6%). It also represents almost half of the employed population.

There was a decline in the number of agricultural jobs and an increase in the number of service jobs.

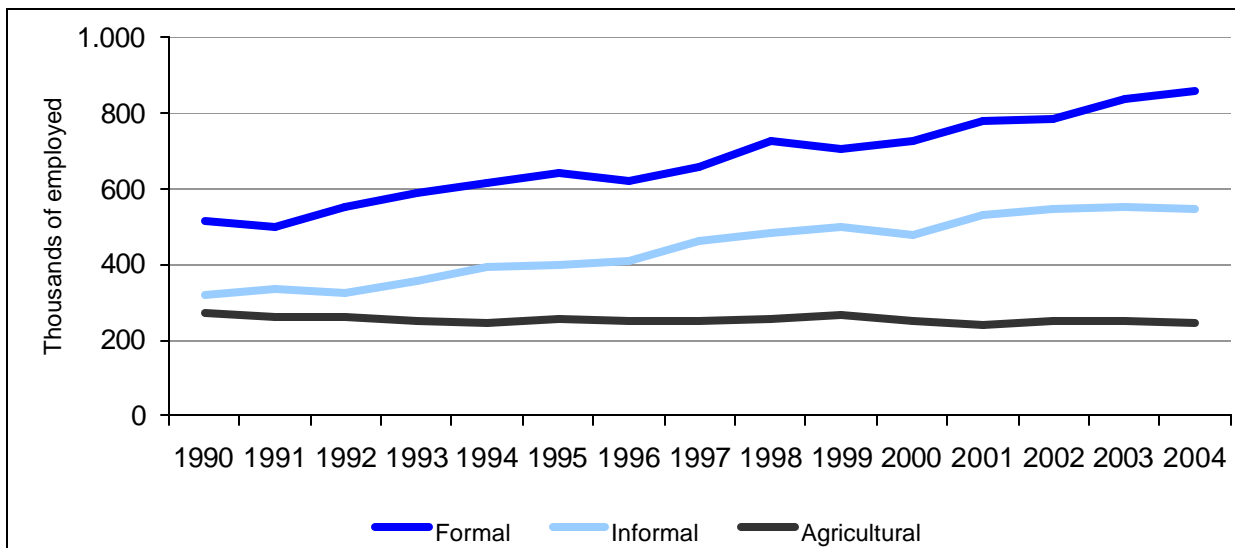
An analysis of employment by branch of activity shows both a relative and an absolute loss of importance of the agricultural sector in total employment (from almost 265,000 employed in 1990 to 245,000 in 2004). The share of jobs in industry also fell, although in absolute terms the variation was small and employment in that sector has held steady at around 200,000 since 1990. There was a surge of employment in commerce, restaurants and hotels associated with the tourism boom, and also in informal activities, primarily commercial. More than 85% of the employed are in the private sector. Their share in total employment is growing, in contrast with the decline of the share of public sector jobs.

Figure 10 illustrates changes in employment by productivity sector. Although it shows that most jobs in the country are formal, which is positive, it also shows

that informal employment¹⁶ is growing rapidly. This suggests that thought should be given to the quality of jobs being created.

Figure 10

Changes in employment by productivity sector



Note: The factors of expansion for the 1990-1999 period were adjusted for this estimate.

Source: Sauma, 2005, based on the INEC Household Surveys.

¹⁶ The *State of the Nation Report* defines the informal sector as non-agricultural productive activities characterized primarily by low amounts of capital, human and physical resources (i.e., a low capital/work ratio). Because they are usually subsistence activities, they produce low incomes. Other non-agricultural jobs are considered formal. In addition, for purposes of this analysis, the agricultural sector is considered separately (Sauma, 2005).

Bahia Culebra
(aerial infrared photography CARTA 2005)



This photograph shows a large tourism complex in an area offering great potential for tourist activity. The hotel's golf courses (shaded in light red) are surrounded by native vegetation.

Source: DCS digital camera, CENAT-PRIAS.

VI. The unresolved fiscal crisis constrains development.

The search for long-term solutions is at a standstill.

Costa Rica's fiscal situation has become increasingly complex due to the delay in implementing measures offering a long-term solution to the fiscal deficit. On the one hand, institutional changes in the area of public finance are advancing very slowly, for example in the areas of customs reform, improved direct taxation, modernization of tax administration, and "digital government." Moreover, no clear political consensus has been achieved regarding whether the deficit should be reduced and controlled by adjusting expenditures, by growing income, or both. This is the case even though abundant evidence exists to show that, compared internationally, Costa Rica is lagging notably behind with regard to the level of its tax burden, even though a positive relationship has been established between the degree of a nation's development and its level of taxation.

Negotiation of the bill of law entitled Fiscal Reform (still under discussion) has not been easy and the reforms proposed for addressing the system's imbalances

are still flawed. The aims of simplifying the tax structure and significantly expanding the tax base are apparently hampered by the interest to secure exemptions.

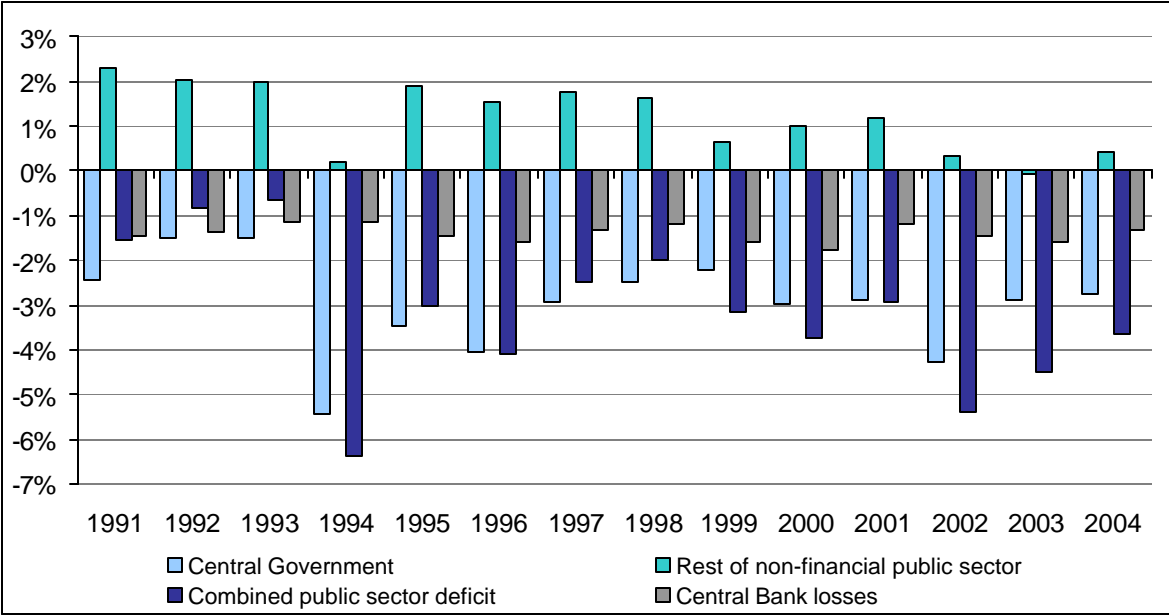
The fiscal imbalance is aggravated by the heavy domestic debt and by the “triggers” of expenditure –wages, pensions and interest– which undermine the sustainability of the policies of the past two years to curb public spending. On the revenue side, it is not simply that the country does not have a large amount of resources to tax, there is also a high degree of tax evasion.

Although the fiscal deficit was reduced, the margins of sustainability narrowed.

In the absence of measures to resolve the fiscal problem once and for all, the government has opted for short-term measures that, although successful at reducing the deficit, threaten economic growth and human development over the medium and long terms.

In 2004, the combined public sector deficit was equivalent to 3.6% of GDP, the lowest in the last three years. This resulted from a reduction in the Central Bank’s losses (amounting to 1.3% of GDP) and in the Central Government’s deficit (to 2.8% of GDP), combined with a surplus of about 0.4% of GDP in the rest of the non-financial public sector.

Figure 11
Fiscal deficit of the combined public sector and its components, relative to GDP (percentages)

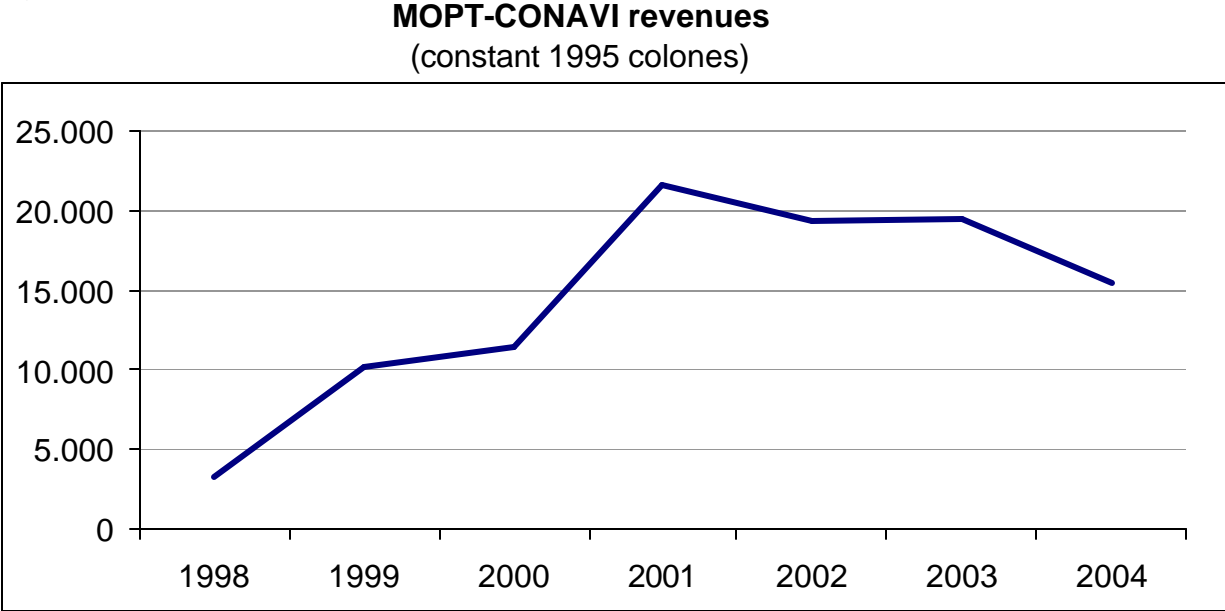


Source: Based on data from the Ministry of Finance and the BCCR.

The government has been implementing a policy to curb public spending since 2003, primarily through cutbacks in social investments, especially the

FODESAF's programs, and in the funds transferred to CONAVI¹⁷ for investments in road infrastructure, which further sharpened the contracting trend in evidence since 2001 (Figure 12).

Figure 12



Source: LANAMME¹⁸ - UCR, 2005, based on CGR data.

With regard to traditional spending “triggers,” 2004 was not particularly restrictive; the ratio of spending on wages, pensions, and interest to GDP held steady and even rose between the 2001-2002 and 2003-2004 periods. On the other hand, spending on goods and services, current and capital transfers, as well as gross fixed capital formation contracted with regard to GDP during the same periods. Although real growth of the first three aforementioned expenditures declined from an average 8.9% to 1.9% between the biennial periods, their growth during the restrictive years exceeded total expenditures (-0.4%). This led to an increase in the share of wages, pensions, and interest in total expenditures, from 68.0% to 70.6% between 2001-2002 and 2003-2004.

VII. Economic slowdown

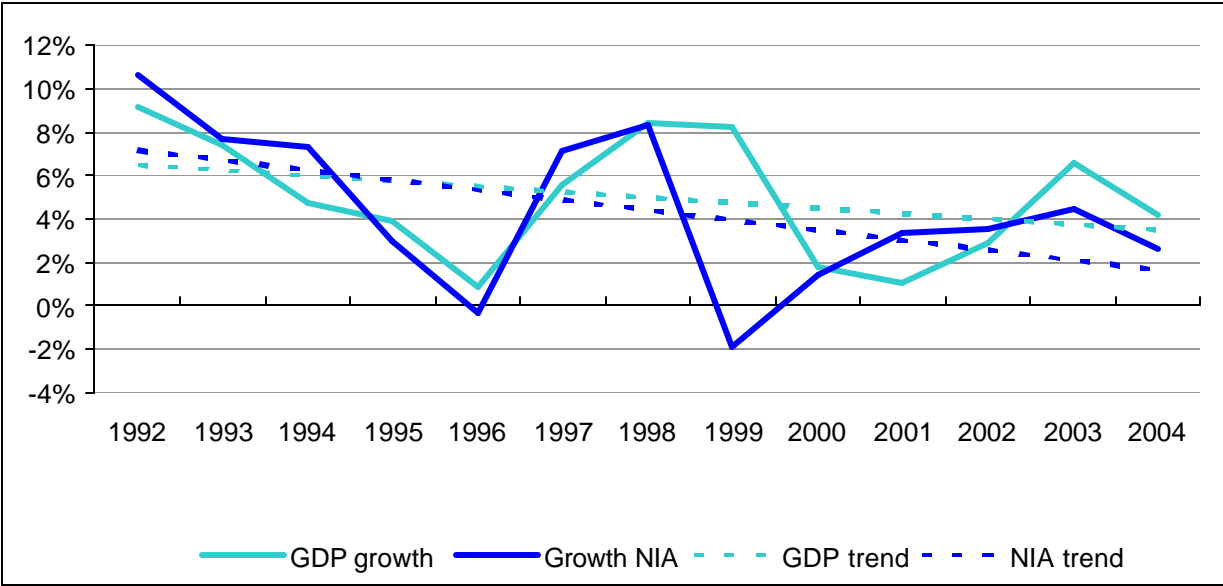
National output and national revenues grew during 2004, but at a lower pace than in 2003 and less than the average for the decade; they continue to be low in per capita terms. GDP grew by 4.2% as compared to 6.5% in 2003, and the national income available (NIA)¹⁹ rose by less than 1% per capita. This situation

¹⁷ CONAVI: National Highway Council.
¹⁸ LANAMME: National Laboratory for Structural Materials and Models, University of Costa Rica.
¹⁹ Gross national income available measures the income available in a country for final consumption and savings, and is obtained by subtracting from GDP the net balance of primary income and current transfers paid abroad. This represents the difference between remunerations to

occurred in a buoyant international scenario, with world economic growth standing at 3.8% and growth in Latin America and the Caribbean as a whole at 6%.

Figure 13

Real GDP growth rate and real national income available
(percentages)



Note: The dotted lines correspond to the linear trend of GDP and NIA growth, and show the direction in which the variables are moving.

Source: Based on BCCR data.

External demand loses momentum.

The loss of economic buoyancy experienced in 2004 reflects the performance of external demand, which is key to growth in a small economy such as Costa Rica's. Demand grew by 6.8% in 2004 as compared to 12.3% in 2003. With regard to the components of demand, the export of goods suffered a sharp downturn, from 13.4% in 2003 to 6.4% in 2004, while the export of services held steady as compared to 2003 (8.1% in 2004) (Figure 14).

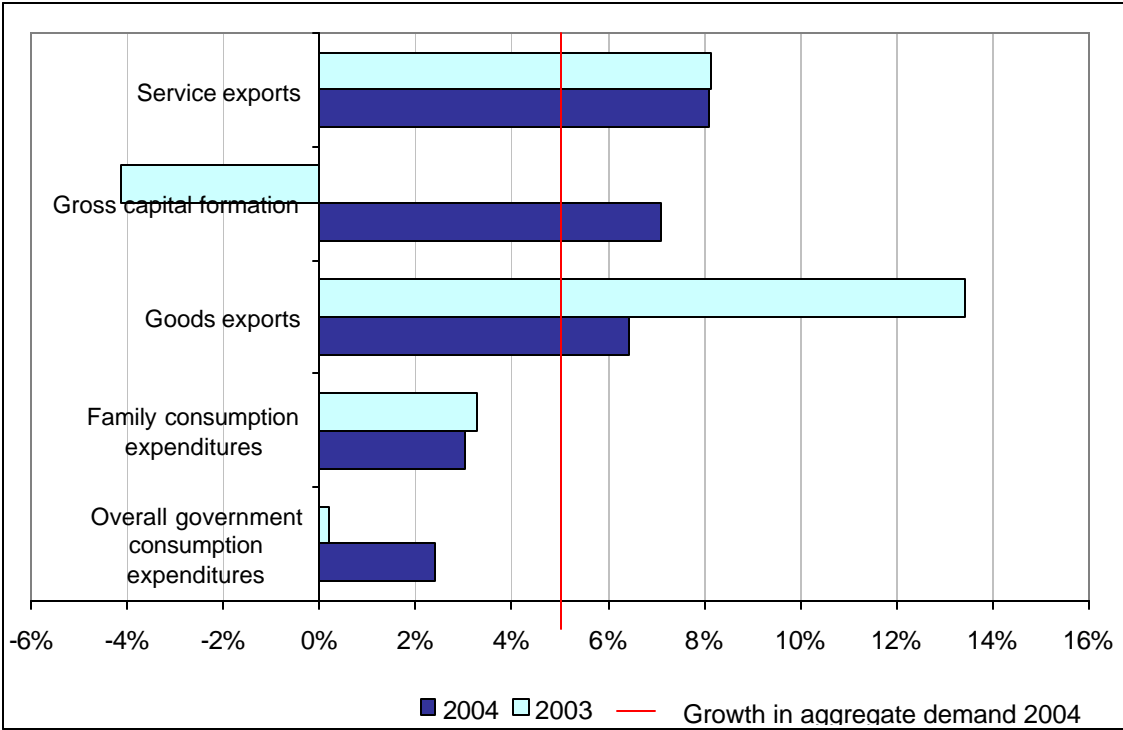
This performance had a strong impact on the manufacturing and agricultural sectors, which are heavily export-oriented. The level of growth for both was lower than in 2003 and lower than the average for the past decade.

In the service sector, construction, commerce, restaurants and hotels grew at a faster pace than in 2003, counteracting the downturn affecting all other services. With this, the tertiary sector maintained its 2003 performance (5.9%) and the service sector further strengthened its position in the economy.

wage earners, income from properties, and current transfers received by the country from other countries, and the payments made by Costa Rica to other countries for the same items.

Figure 14

**Growth in the components of aggregate demand
(percentages)**



Note: Gross capital formation includes the variation in inventories.
Source: Based on BCCR data.

The efforts to promote and diversify exports have not been enough to attenuate the fluctuations in external demand and achieve sustained growth. Of the more than 3,600 goods currently exported by Costa Rica, seven account for 50% of the total exports of goods, while some 20 make up 70% of total exports (box 6). Dependence on a few products reduces the relative diversity of the country’s total exports and its ability to cope with declining terms of trade.²⁰

**Box 6
In 2004, exports of services and from duty-free zones contributed more to the growth of total exports.**

The **pattern of exports** in 2004 shows a change with regard to recent years. The categories that most contributed to export growth were goods not subject to special treatment, and services, while duty-free zones recorded a negative contribution. Nonetheless, in absolute terms, duty-free zones continued to be the most important.

The performance of **traditional exports** fluctuated and, generally, tended to decline, especially as a result of the fall in coffee prices. However, efforts to

²⁰ That is to say, the prices of Costa Rican exports compared to the prices of its imports.

differentiate Costa Rican coffee in the world market, combined with improved prices in 2004, enabled coffee exports to make a noteworthy recovery in the last two years. An ever-larger proportion of Costa Rican coffee obtains higher prices than those offered on international commodity exchanges. In particular, the differentials for specialty coffees (*Primer Pergamino*, *Chorro Europeo*, Strictly Hard Bean) have grown steadily, to the point of earning a surcharge of US\$32.29 per hundred-weight in the 2004-2005 harvest.²¹

In the last eight years the relative share of **service exports** in total exports has increased, reaching 26.1% in 2004. Expansion of tourism, call center and back office services account for that growth.

The **tourism industry** and its potential for development look promising. In 2004 there was an increase in the number of visitors (1,452,926), and the foreign exchange generated by tourism amounted to around US\$1.36 billion. To tap that potential, the institutions that oversee the tourism sector should strengthen promotional efforts.

Costa Rica's **competitiveness** in international markets will be challenged in the near future by China's growing participation in the world economy, given its competitive capacity based on cheap unskilled labor. In particular, textile exports may face very tough competition because the Agreement on Textiles and Clothing (ATC) expired in late 2004. That agreement protected the development of the textile industry in Costa Rica and other Central American countries.

VIII. External balance: stable but fragile

Service exports averted a larger current account deficit.

Costa Rica's balance of payments showed three main features during 2004: a growing gap in the balance of trade (exports minus imports of goods), a recovery for the second consecutive year in the current account (exports minus imports of goods and services, income and current transfers), due to an improvement in the services account, and a change in the performance of the capital account, whose surplus was reduced.

In the year under study, the current account deficit represented 4.5% of GDP, compared with 5.3% in 2003. This result was largely due to the buoyancy of the tourism industry and the positive performance of exports of goods, despite deterioration in the terms of trade prompted by increases in the prices of oil and some raw materials. The country continued to enjoy access to international financial resources, which enabled it to finance the deficit in the real sector of the balance of payments and accumulate international monetary reserves.

The balance of trade deficit increased by almost two points as a percentage of GDP, from -6.5% in 2003 to -8.0% in 2004, which is consistent with the growth in the value of external purchases. Exports of goods and products subject to special treatment recorded a modest performance, highly influenced by the decline in the value of external sales that affected the electronics industry.

Income from service transactions showed an increase of nearly 9%, while external purchases in this category grew by only 7%. The result was an

²¹ By 30 June 2005, 92% of the output had been sold.

improvement in this sector's net contribution to the current account, due mainly to the vitality of receptive tourism, computer and information services, business, professional and technical services, and services related to the commissions on the purchase and sale of goods. The services account went from representing 4.8% of GDP in 2003 to 5.1% in 2004. This partly helped to finance the current account deficit.

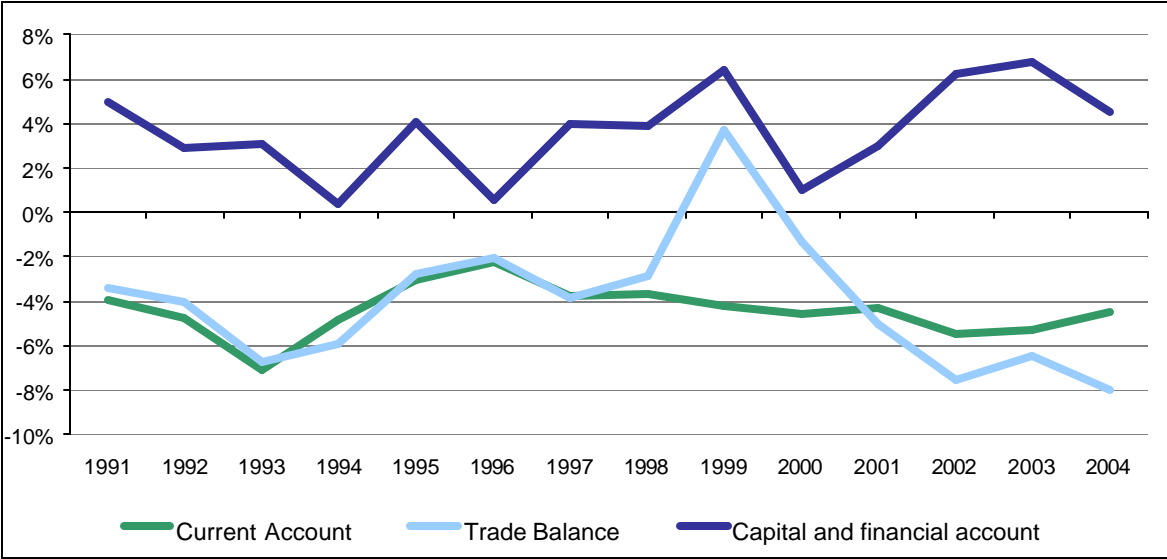
The income account, in turn, showed a decline in relation to the previous year. This pattern stemmed from the lower profits earned by foreign companies in the sectors of technology, financial services and medical products based in the country, and also from lower interest payments on the external public debt, which were similar to the previous year. In addition to these factors, the Central Government made payments on sovereign bonds while the Central Bank reduced its expenditures in this area, as part of the restructuring of its external liabilities.

The current transfers account was positive and grew in nominal terms at a rate of nearly 8%, mainly as a result of family remittances from the United States (US\$240 million), a figure higher than the family remittances received in Nicaragua (US\$120 million).

With regard to access to external savings, lower capital flows –both public and private–compared with 2003 were reported. However, these were sufficient to finance the current account deficit and increase reserve assets by US\$80.3 million.

The trade and current account deficits remain high, suggesting weakness in the management of the external sector, i.e., the exchange rate policy and the capacity to maintain the amount of international monetary reserves in reasonable condition.

Figure 15
Balance of the balance of payments accounts in relation to GDP
 (percentages)



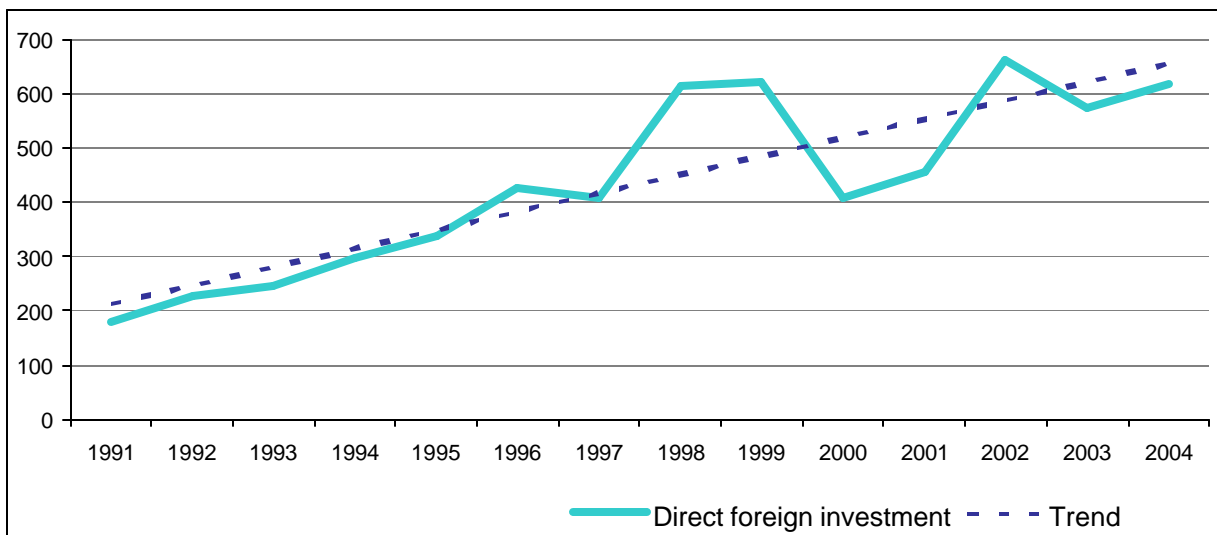
Source: BCCR.

Direct foreign investment finances current account deficit

In the last fifteen years, surpluses from the capital and financial account of the balance of payments have been essential for counteracting the current account deficit. In 2004, direct foreign investment (DFI)²² once again provided the principal source of that financing, equivalent to just over 74%.

Figure 16

Pattern of direct foreign investment
(million US\$)



Source: BCCR.

At the same time, in 2004 there were changes in the pattern of foreign investment, with the agricultural, business, and financial sectors reporting an increase over previous years. In the case of agriculture, this was the result of net financing provided by the head offices of transnational companies, amounting to US\$45 million, or 89% of DFI in this sector. In the case of businesses in the trade and financial services sectors, contributions by partners and plowed-back profits were particularly important. The industrial sector, which is concentrated mainly in duty-free zones, continues to be the principal recipient of DFI. Of the US\$456 million invested in industry during 2004, US\$401.9 million went to duty-free zones. However, it is important to note that, during the past several years, most of those resources have corresponded to reinvestments by companies already established in the country.

IX. Highest inflation rate of the last eight years

In 2004 the inflation rate reached 13.1%, the highest of the last eight years and two percentage points above the target projected by the BCCR.

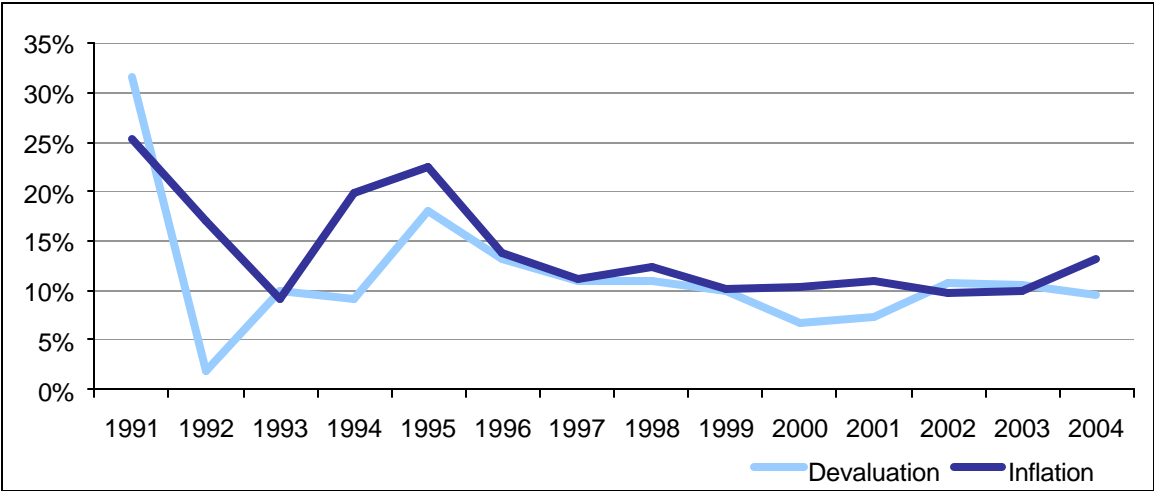
Greater inflation was not prompted by additional imbalances in the monetary market that might have exerted pressure on domestic demand, since the money

²² DFI: Direct foreign investment.

supply was increased as planned. Rather, it was the result of deterioration in the terms of trade, which, in turn, was caused by the rising cost of oil and, to a lesser extent, of building materials. Another contributing factor was the more than 11% surge in administered prices (water and electricity). Costa Rica was not the only country in the region to face this situation. In El Salvador, for example, inflation doubled compared with 2003, and it is estimated that 72% of that increase may be attributed to the rise in oil prices, which had a strong impact on transportation and food costs. The same happened in other Latin American countries, where the impact of the prices of commodities on domestic prices was also noted (BCCR, 2005b).

Figure 17

Devaluation and inflation rates
(percentages)



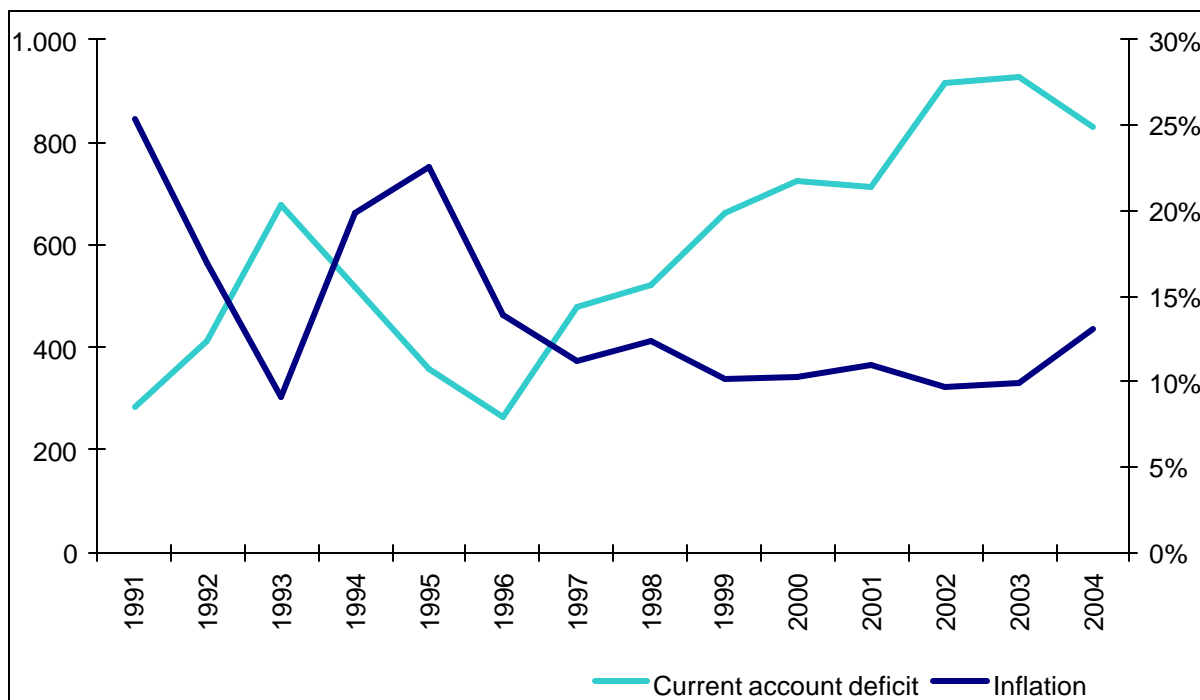
Source: BCCR.

Another important factor is the external pressure on the demand for certain industrial goods, among them steel and other construction materials. In particular, the growth of the Chinese economy impacted the import costs of these goods. In addition, housing services were the components of the housing index that increased beyond the inflationary average, by nearly 20.2% in 2004. This is explained by the fact that during 2004, all administered prices rose at a rate higher than the average inflation rate. For example, the cost of water rose by 30.5% and electricity by 17%; however, the cost of telephone and municipal services grew at a rate lower than inflation. These increases in the cost of housing services had a sharp impact on the incomes of households with a limited capacity to reduce consumption.

The increase in the cost of imported goods, which is pushing inflation higher, is also reflected in a larger current account deficit in the balance of payments (Figure 18).

Figure 18

Inflation rate and current account deficit in the balance of payments
(million US\$ and percentages)



Source: BCCR.

X. Dollarization of loan portfolios continued.

In 2004 the Central Bank continued its efforts to control the amount of money in circulation and, despite a strong increase in public sector credit resulting from the investment funds crisis, no significant pressures on credit were observed.

During the year under analysis, there was a 26.2% expansion of net domestic credit within the national banking system, slightly higher than the figure for 2003 (23.0%). Meanwhile, private sector credit grew at a lower pace in 2004, at 18% compared with 20.6% in 2003. In terms of the composition of the credit portfolio by type of activity, the sectors that showed higher growth compared with 2003 were housing (34.5%), tourism (27.5%), trade (21.8%), farming (13.3%) and livestock (10.6%). The share in private credit of the latter two sectors continues to decline, while consumption remains the most important activity, with a share of 25.7% in 2004.

The percentage of the national banking system's credit portfolio in foreign currency fell slightly in 2004, from 56.3% in 2003 to 54.2% in 2004. This was due to actions taken by state banks, including to restrict access to credit in dollars for economic agents that do not generate income in that currency.

Table 3

Percentage of the loan portfolio in dollars, by activity. 1999-2004

	Total	Trade	Consumption	Industry	Services	Housing
1999	32.9	51.0	16.3	68.3	32.9	8.9
2000	40.3	55.4	22.5	76.4	36.3	23.5
2001	45.8	63.2	24.3	74.2	53.2	39.0
2002	49.3	67.2	26.3	76.2	49.8	44.7
2003	56.3	64.7	33.2	77.0	62.4	62.2
2004	54.2	62.0	30.8	74.1	56.8	59.0

Source: BCCR, 2004 and 2005a

However, the percentage of credits in dollars continues to be high and remains a cause for concern because of the factor of vulnerability. The proportion of banking liabilities in foreign currency rose, particularly in state banks, from 41.9% in 2003 to 50.7% in 2004. For private banks, the increase was 2.1 percentage points; in 2004, they maintained 64.0% of their liabilities in foreign currency, which led to a change in overall financial strength (BCCR, 2005a). The performance of the financial sector and the transfer of resources as a result of the investment fund crisis produced a 17.6% growth in financial resources, although this was lower than in 2003 (19.8%).

Negative real interest rates on deposits

No significant changes were noted in the general pattern of interest rates in comparison with 2003, except for a decline in the rates for the housing sector, which were not only lower than those for other sectors, but also the lowest of the last twelve years. This probably explains the growing and marked buoyancy of construction activity, despite the sharp price increases that affected the sector. In ascending order, interest rates for housing were followed by those for industry, agricultural activity and others such as trade.

Despite the downward trend in interest rates observed since January 2004, intermediation margins continue to be very wide and underscore the structural problems of the financial system mentioned in earlier reports. Another basic problem must be mentioned, which seemed to have been resolved through the financial reform process: the negative real interest rates that financial intermediaries have been applying on deposits. The persistence of high intermediation margins and negative real rates encourage the dollarization of credits and deposits, which makes the system highly vulnerable to possible speculative attacks on the exchange rate; it also limits the Central Bank's capacity to manage monetary policy.

XI. Modest results in programs to support small and medium-sized enterprises (SMEs)

The greater part of Costa Rica's business sector is composed of micro- and small businesses, and there is little information on them. The total number of business establishments is estimated at around 122,000 (E²³: Trejos, 2005), of which 75% are small units with one to four employees, making up the microbusiness segment. Legally established companies number around 41,000 and represent one-third of total establishments. If the number of microbusinesses is subtracted from the total legally established companies, the number of small and medium-sized enterprises (SMEs) comes to around 15,000 (Castillo and Chaves, 2001).

The approval, in April 2002, of the *Ley para el Fortalecimiento de las Pequeñas y Medianas Empresas* [Law to Strengthen Small and Medium-sized Enterprises] (Law N° 8262, known as the SME Law) created great expectations for the future development of micro- and small-sized businesses, including their participation in exports, and supplemented a number of isolated actions being implemented to promote production linkages (Box 7). The new regulations governing access to sources of financing, collateral and guarantees, together with the institutional framework that supports this sector, involve a series of tasks initiated in 2004 that led to efforts to define a policy to support small and medium-sized businesses.

The SME Law calls for a series of requirements to be met by specific deadlines. In 2004, the Ministry of the Economy, Industry and Trade (MEIC) created the General Directorate of Small and Medium-sized Enterprises (DIGEPYME). In addition, the SME Advisory Council was established; the implementing regulations of Law 8262 were approved, and a series of actions were taken to create the SME Support Network. The latter went into operation in April 2004, with the participation of the National Vocational Training Institute (INA), the National Bank's BN-Development Program, the Technological Institute (ITCR), the External Trade Development Corporation (PROCOMER) and the Costa Rican Chamber of Industries. Since then, other institutions have joined the initiative: BPDC²⁴, ACORDE²⁵, FUNDES²⁶, REDCOM²⁷, CAATEC²⁸, BCAC²⁹, University of Costa Rica (UCR), National Autonomous University (UNA), IMAS³⁰, JAPDEVA³¹ and the Special Economic Zone (ZEE) of the Huétar Norte Region; others are in the process of joining.

²³ References prefaced by the letter "E" correspond to interviews held during the process to prepare this report. The relevant information can be found under "Interviews" in the bibliography of this summary.

²⁴ BPDC: Community Development Bank.

²⁵ ACORDE: Costa Rican Association of Development Organizations.

²⁶ FUNDES: Foundation for Sustainable Development.

²⁷ REDCOM: Costa Rican Network of Micro-finance Organizations

²⁸ CAATEC: Foundation of the Advisory Commission on High Technology.

²⁹ BCAC: Agricultural Credit Bank of Cartago

³⁰ IMAS: Semi-public Social Assistance Institute

³¹ JAPDEVA: Administrative Board for Ports and Atlantic Watershed Development

The “Costa Rica Provee” Project

The project “Development of Suppliers for Multinational High-technology Companies,” known as “Costa Rica Provee,” (Costa Rica Supplies) was an IDB-financed pilot project that began in 2001 and concluded mid-year in 2005. PROCOMER assumed responsibility for the project upon its conclusion and currently monitors its progress, although continuity is not assured. The initiative was prompted by widespread concern over the absence of production linkages between companies operating under the duty-free zone arrangement and small and medium-sized Costa Rican businesses. Its general objective was to develop local suppliers in order to boost the share of national value added in the output of multinational high-technology companies, and to improve the competitiveness of SMEs. With US\$1.3 million in funding, the project had three components: i) a pilot program to develop suppliers, ii) creation of an information system on supply and demand for use by SMEs, multinational companies and supporting institutions, and iii) establishment of a national development office for suppliers. The expected outcome was 45 successful linkages.

The project assessed 674 SMEs and worked with 36 multinational firms. A total of 336 business opportunities were identified, of which 99 were executed, 76 are currently in progress, 56 have intended linkages, and 105 have not yet been consolidated. Some 17.3% of the businesses participating in the project are directly associated with the end products manufactured by multinational high-technology firms in the country. The remaining 82.7% produce goods or services needed to manufacture those products. The project focused on developing suppliers for the medical and electronics industries, and generated linkages valued at US\$49.5 million in goods and services provided by nearly 50 SMEs, which received assistance in meeting the requirements of the multinational companies.

Source: Chaves, 2005.

Less than 300 SMEs are registered with the DIGEPYME, and the funds provided for under the law and administered by the BPDC show little activity. The guarantee fund reached the target of 9 billion colones in October 2004 and the financing fund has a portfolio of 1.626 billion colones. As of 31 December 2004, the Special Fund for the Development of Micro, Small and Medium Enterprises (FODEMIPYME) reported only 16 operations for a total of 132 million colones in credits, and 46.6 million colones in guarantees. For its part, the financing fund recorded only one credit operation, for 5.9 million colones. These results signal the need to give serious consideration to the types of SMEs that are eligible, the criteria used to allocate funds, and the willingness of other financial intermediaries to make use of the funds assigned by the SME Law to the BPDC.

Clearly, the SME Law is only just beginning to show some progress and achievements, and much remains to be done to consolidate the process. Most of the initial legal requirements have been met and, with the creation of the DIGEPYME, the MEIC now has greater capacity for internal management and for

providing regional assistance. Nevertheless, challenges still exist and the issue of SME participation in public sector procurement is a matter of the utmost importance that still needs to be addressed.

It is also worth noting the development of regional initiatives not covered by the SME Law, but that have managed to secure State involvement in communities. An example of this is the Special Economic Zone (ZEE) established in the Huetar Norte region, which began in March 2001 and was legally constituted in May 2002.

For further details on SMEs AND DEVELOPMENT BANKS, see the paper by Angulo, 2005, (in Spanish only) at www.estadonacion.or.cr

Harmony with nature

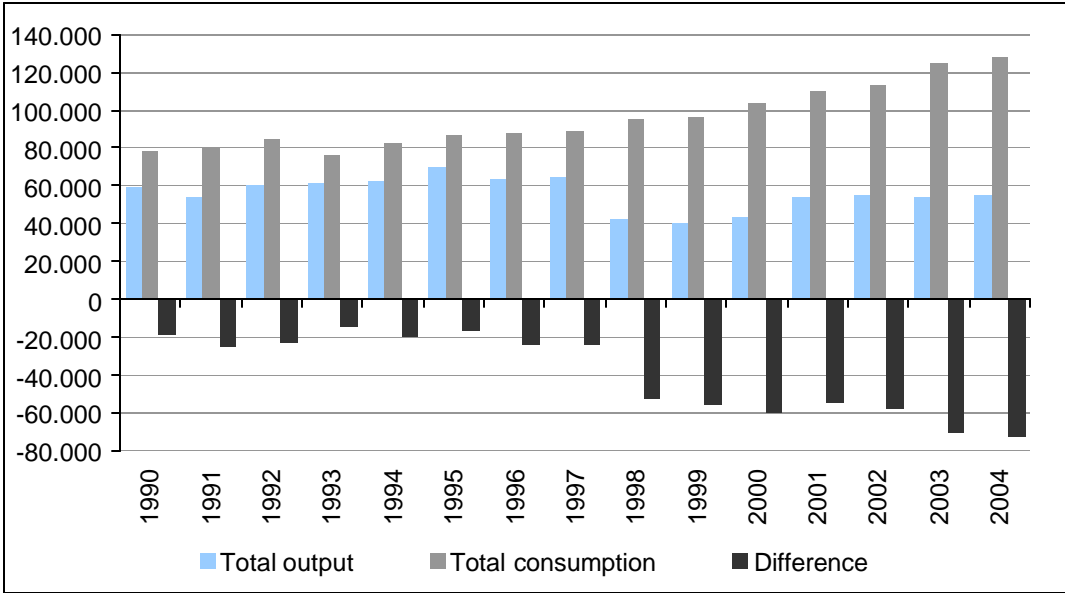
During 2004, the country's environmental performance was dominated by the issue of energy. Soaring oil prices (more than 30%) impacted a society characterized by unsustainable patterns of consumption and an ever-growing vehicle fleet of more than 950,000 units. In addition, the limited growth of the country's operating capacity for hydroelectric power (barely 1.2% as compared to the 4.4% expansion in consumption), launched a nationwide debate on the risk of possible electric power shortages in the future and the economic and environmental importance of developing alternative energy sources.

XII. New energy sources: an inevitable challenge

In 2004, the country's vulnerability vis-à-vis energy resources became all too evident. Faced with dramatic increases in oil prices, Costa Rica showed a limited ability to expand its capacity to generate electricity, while total energy consumption continued to rise (Figure 19).

Figure 19

Output and total consumption of energy
(terajoules)

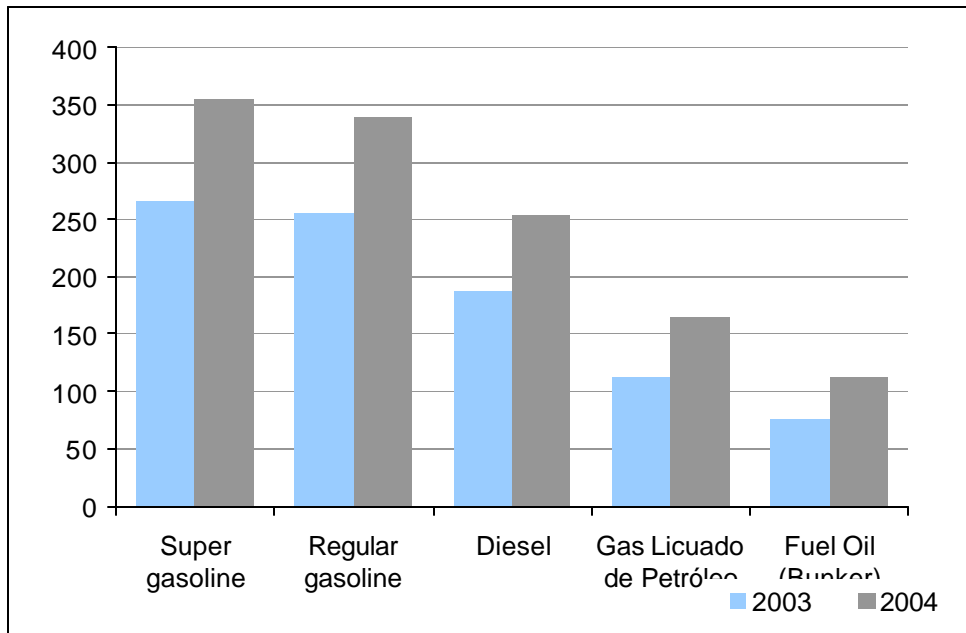


Source: Prepared by the authors with DSE data, 2002, 2003, and 2005.

International oil prices reached historic highs, increasing the final price of fuel by between 33% and 48% during the 2003-2004 period (Figure 20). This had a significant impact on the country's economy and cost of living.

Figure 20

Average price of fuel to consumers
(colones per liter)



Source: Prepared by authors with RECOPE data.

Despite this situation, petroleum demand did not decline during the period, partly because of the sizeable growth of the vehicle fleet (6.5%). Oil imports accounted for 11% of export revenues in 2004, and the national oil bill rose from US\$525 million in 2003 to US\$729 million by late 2004.

In the electric power subsector, projects to expand ICE's generating capacity were delayed, resulting in an increase of only 23 MW in 2004, as compared to the annual 110 MW of operating capacity called for in the institution's plans. The controversies surrounding the construction of new hydroelectric plants and the need to diversify supply posed major challenges. Meanwhile, domestic electricity consumption rose by 295 GW/h.

In response to the problems created by the energy crisis, proposals have been put forward to reduce oil consumption by substituting it with alternative energies, such as biofuels in the transportation sector. However, this issue is just being brought forward.

FOR MORE INFORMATION ON ENERGY

See presentation by Blanco and Fajardo, 2005 (in Spanish only) at the website: www.estadonacion.or.cr

Photo 4

Cachí hydroelectric dam
(Aerial infrared photography CARTA 2005)



This photograph shows chayote crops, coffee plantations and pastures. Large amounts of water lilies are visible in the dam reservoir, which create problems for generating electricity. Source: DCS digital camera, CENAT-PRIAS.

XIII. Limited effectiveness in conserving resources outside protected wilderness areas

New findings confirm deterioration of water sources

Recent water quality measurements and studies confirm the deteriorating condition of various sources of surface and underground water. Concentrations of nitrates have been reported in some wells and water sources in the GMA, where levels –according to at least one test– have reached the maximum level allowed by health authorities (50 mg/l as NO₃). In addition, preliminary evidence of saline infiltration has been found in the aquifers of Tamarindo, Sámara and Jacó. Previous issues of this report have documented a decline in water quality in the Río Grande de Tárcoles watershed. This year, the use of bio-indicators revealed further signs of deterioration in water quality in the Virilla River watershed (Box 8).

Box 8**Bio-indicators reveal decline in water quality in the Virilla River watershed**

By monitoring bio-indicators to measure the impact of human activity on water quality in the upper and middle watersheds of the Virilla River, the Water Resource Management Laboratory of the Autonomous National University (UNA) detected progressive deterioration in the biotic quality of water as it flows downstream. For example, at the river's headwaters in Las Nubes de Coronado some 2,100 meters above sea level, the index was between 80 and 70 (good physical-chemical quality); according to the biotic index, quality ranged between good and poor. At 1,490 meters above sea level, in the center of Coronado where urban development has replaced natural ecosystems (even on riverbanks) the physical-chemical index stood between 76 and 57 (good and regular quality, respectively). These changes revealed a deterioration in biotic quality to regular and regular-poor quality, according to the biotic index.

Another reason for the deterioration of surface waters –and also soil quality– is erosion, caused by natural phenomena (landslides, hurricanes and earthquakes), flawed road construction specifications, and unsound agricultural practices. For example, ICE studies show significant accumulation of sediment in the reservoirs of hydroelectric power plants. Another recent study by Marchamalo (2004) analyzed different land uses and their impact on water erosion in the Birris River watershed basin, the most important in the country for electricity generation. An estimated 16% of the sediment reaching the hydroelectric infrastructure of the Reventazón watershed comes from the Birris subwatershed (50 metric tons of soil/hectare/year). In that area, short-cycle agricultural crops grown over-intensively (sometimes up to three crops annually) with unsound farming practices are the greatest contributors to water erosion and the silting of ICE's reservoirs in the Reventazón watershed (Jiménez, 2005).

The population is unaware of the effects of the declining quality of water sources, at least for the time being, because access to potable water is still expanding. In 2004, access to potable water expanded by 3.3 percentage points, reaching 82.8% of the population.

Air pollution generates high costs

Efforts to control vehicle emissions appear to have prevented an increase in air pollution. A study of 100,000 technical revision tests for gasoline-fueled vehicles in the Greater Metropolitan Area showed that the initiative generated a 47% reduction in carbon dioxide emissions. This was not sufficient, however, to offset the rapidly growing number of vehicles in circulation, which has resulted in an overall increase in total emissions. Research conducted by the Air Quality Studies Program of the UNA demonstrated that, in peak traffic hours, pollution levels in some parts of San José are almost double the maximum allowed by the Ministry of Health to protect the population's health.

A recent study by the Clean Air Project has provided a better understanding of the cost of air pollution, estimated at 92,246 million colones per year, on people's health in the Greater Metropolitan Area.

Table 4

GMA: Estimated cost of air pollution on people's health. 2001
(millions of colones)

Health problem ^{a/}	Cases per million inhabitants	Average cost per million inhabitants (millions of colones)
Total mortality (30 years or older)	475	55,497
Hospitalization due to respiratory causes (all ages)	550	317
Hospitalization due to cardiovascular causes	226	196
Incidence of chronic bronchitis (adults= 25 years)	12,638	142
Bronchitis (children < 15 years)	30,987	395
Days of disability (adults= 20 years)	71,565	233
Asthma episodes (children < 15 years)	9,601	133
Asthma episodes (adults= 15 years)	9,450	119
		57,032

^{a/} Cases attributable to each 10 µg/m increase in PM-10, per million inhabitants.

Note: PM-10 particles are all those collected with 50% efficiency by a high-volume sampler, whose diameter or cut-off point is 10 microns (µm), and which are capable of entering the thoracic area of the respiratory system.

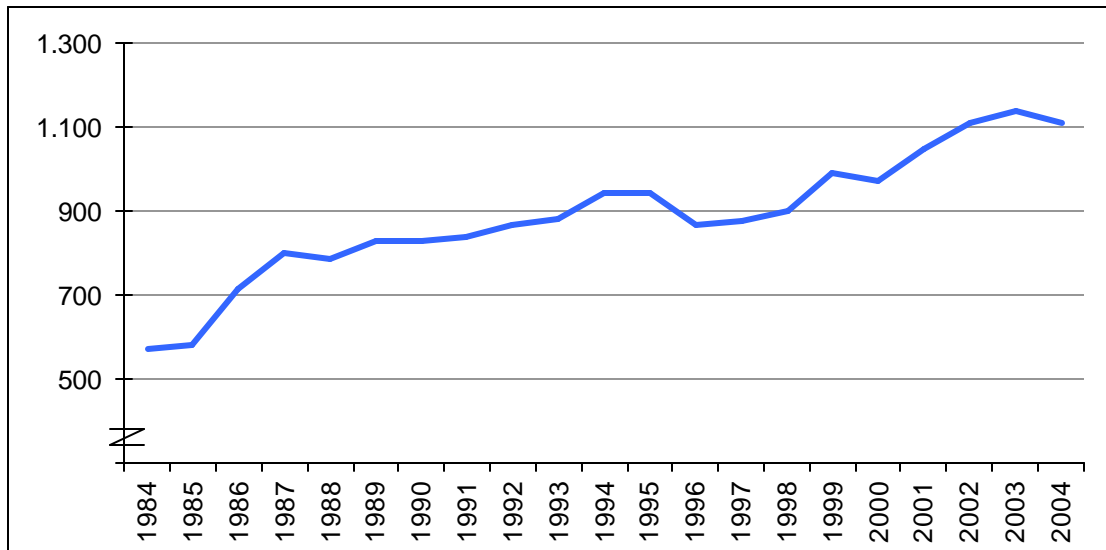
Source: Allen et al, 2005.

Solid waste management: an ongoing problem

Solid waste management remains an unresolved problem in Costa Rica. The State has still not taken an active role in controlling the quantity and quality of refuse generated and no comprehensive plans exist to that end. The amount of urban waste continues to rise: in the last twenty years the amount generated per person in the GMA has doubled.

Figure 21

Waste per capita collected by COCIM³²
(Grams per capita/day)



Source: Municipality of San José, 2005.

Efforts to open new sanitary landfills continue to be thwarted, despite plans to close the Río Azul landfill in 2005, which has again been deferred. Some isolated improvements have been made, however, through the establishment of environmental education and waste management programs in various municipalities and public and private institutions, including the municipalities of San José, Naranjo, Escazu and Esparza, several national parks, hospitals, national universities, EARTH University, the National Electricity and Light Company (CNFL) and ICE.

Pressure on marine resources

As documented in previous issues of the *State of the Nation Report*, marine and coastal resources are vulnerable to a variety of threats, particularly pollution, overexploitation and the unsound use of biodiversity. Damage can also be traced to sources far from the coast, such as urban centers, agricultural areas and industrial plants.

Studies were published in 2004 on the pollution found in coastal sediments, in particular from samples collected between 1996 and 2003 in Bahía Culebra, Golfo Dulce, the Gulf of Nicoya and Limón. The findings show concentrations of industrial compounds on the list of persistent toxic substances known as PCBs.³³ Although Costa Rica banned their use in 2001, untreated waste is still found in areas surrounding electrical transformers and other sites, which continues to impact watercourses. PCBs have a very long half-life in adult fish, cause endocrine

³² COCIM: Inter-municipal Cooperative Agreement involving the municipalities of San José, Goicoechea, Tibás, Montes de Oca, Curridabat, Moravia, Desamparados, Alajuelita, Escazú, Coronado, La Unión and Aserrí.

³³ PCB: polychlorinated biphenyls.

disorders in different organisms, and are carcinogenic; their half-life in aerobic sediments is more than six years. Moderate concentrations of these substances were found in Golfito, while in the Gulf of Nicoya, Papagayo and the Caribbean coast, concentrations were determined to be low.

Several beaches lost their Ecological Blue Flag award, reversing the 1996-2003 trend of increasing numbers of award winners. In 2004, the number of Blue Flag beaches fell from 56 to 50. Of those that did receive the award in 2004, nine are located in Limón, 19 in Guanacaste and 22 in Puntarenas (Mora and Chávez, 2005). The beaches of Tamarindo and Penca, in Guanacaste, Santa Teresa in the Nicoya peninsula, and El Roble, Doña Ana and Puntarenas city lost their awards, the latter three due to the waste carried downstream from the Central Valley by the Tárcoles river (Rojas, 2005). In the case of Puntarenas, the progress made to restore water quality through the “*Salvemos el Estero*” [Let’s Save the Estuary] project was maintained in 2004, although sewerage discharge and garbage dumps in the surrounding areas are problems that remain unresolved (E: Marín, 2005).

The overexploitation of marine biodiversity for human consumption is a second threat to Costa Rica’s marine-coastal resources, and particularly affects sea bass, snook, snapper, whitecap, conger, and three species of shrimp. However, a major surge in the aquiculture sector in 2004 produced an output that for the first time exceeded the total volume of national fisheries, with a 21.4% increase, from 20,248 metric tons in 2003 to 24,583 in 2004. This was largely due to a 29.3% increase in tilapia farming. More research is needed to determine the environmental impact of this type of activity.

Conflict over the use of environmental resources

Institutional jurisdiction over natural resources is scattered, so the pressures to use limited and vulnerable natural resources often results in conflict. This problem is compounded by the fact that the official authorities who receive such complaints do not process all the environmental concerns, which means that disputes are often resolved outside the institutional framework or at the judicial level. Serious conflicts have arisen in recent years over shared environmental resources, particularly water. In most of the recent cases, the confrontation has generally been between communities and the private sector, with the State mediating.

As of 2000, the most notable conflicts have been between communities and tourism activity, as in the case of Santa Cruz over the use of the River Nimboyores aquifer for hotel projects. The problem involves a large number of public environmental and water management institutions, the executive and judicial branches of government, various environmental NGOs, as well as technical and legal bodies. One solution proposed is to consider the aquifer a reserve for human consumption along the entire coast, and for agricultural production. A study is under way to determine whether the Piedra River, in Bagaces, could supply the coastal area with sufficient water to water golf courses, farmlands, gardens and other water-intensive activities, which are the main points of discord in the area (Barrantes, 2005).

Photo 5

Puntarenas mangroves and estuary
(aerial infrared photography CARTA 2005)



Pollution, deforestation, and unsound practices have put pressure on coastal mangroves, which are the breeding grounds for some fish species and also the habitat of many endangered species. Note the encroaching farmlands at the edge of the mangroves.

Source: DCS digital camera, CENAT-PRIAS.

Another dispute revolves around construction projects planned in aquifer recharge and discharge areas, such as in the Poás area. This case shows the gap between the institutional processes (municipal, state and technical) that approved the construction, and the position of the community. In February 2004, the Constitutional Court ruled against the Ministry of Environment and Energy (MINA), the Costa Rican Institute of Water Supply and Sewerage (ICAA), the National Underground Water, Irrigation and Drainage Services (SENARA), the Municipality of Poás and the National Institute of National Institute of Housing and Urban Development (INVU), overturning the agreements that approved the construction project. It also ordered the relevant government bodies to delimit the boundaries of aquifer recharge-discharge areas and undertake the planning, implementation and execution of reforestation programs. The Court also ordered a ban on the felling and removal of trees and suspended all construction permits until zoning regulations have been approved for the reserve areas, along with measures to protect springs, headwaters, aquifers and recharge areas, and other actions (Barrantes, 2005).

Hydroelectric power has also been the subject of conflict: it is estimated that nearly 27 private electricity projects, implemented in accordance with current legislation, have triggered social protests throughout the country (Alvarez, 2005). One example was the construction of the La Joya hydroelectric dam, a project challenged in 2004 by various communities before the District Council of Tucurrique, the Constitutional Court, and the Environmental Administration Tribunal. The latter ordered a temporary halt to the project until its social and environmental impacts have been more clearly determined. In addition, the Legislative Assembly's Environmental Affairs Commission agreed to conduct an inquiry into the project's possible damage to the environment and to neighboring communities' right of access to water resources (Barrantes, 2005).

During 2004 and in early 2005 a series of confrontations, blockades and protests took place in the community of Monteverde, over a concession awarded to the Rogumeca Water Consumers Association that authorized it to extract 17.65 liters/second of water from two of the area's principal rivers, to irrigate various plantations. Local residents and community groups denounced the concessionaires, who claimed to be smallholders, alleging that they could in fact be tourism entrepreneurs (Noticias Monteverde, 2005). The Ombudsman's Office called on MINAE to stop awarding water concessions while the inquiry is under way (Barrantes, 2005).

Poor waste management in different parts of the country also gave rise to conflicts between communities and local authorities in 2004. The municipalities affected by these problems included La Unión, Tibás, Nicoya, Guápiles, and Golfito (Table 5).

Table 5

Some topics of environmental conflict, 2004

Topic	Some of the cases
Open-pit mining	Local residents of Miramar vs. the firms Ríos Minerales, Metales Procesados MRW S. A. and Glenclairn Environmental groups vs. a company interested in mining gold in Crucitas de Cutris
Pollution	Local residents of Ciruelas and Turrúcares, opposed to the pollution of the Siquiares River Local residents of Calle Flores de Belén, opposed to the pollution produced by private factories Max Peralta Hospital, opposed to sound pollution Plebiscite in San Ramón, to suspend poultry farm permits
Garbage collection	Garbage problems on the banks of the Pacuare River The community of Sámara vs. the Municipality of Nicoya, over waste collection Local residents of Guápiles, over garbage dumped in the vicinity of the former library Local residents of Tibás and Montes de Oca, over the lack of garbage collection services
Opposition	Local residents of Turrialba and several NGOs, opposed to a

Topic	Some of the cases
Open-pit mining	Local residents of Miramar vs. the firms Ríos Minerales, Metales Procesados MRW S. A. and Glencairn Environmental groups vs. a company interested in mining gold in Crucitas de Cutris
to hydroelectric projects	hydroelectric plant on the Pacuare River Local residents of Tucurrique, opposed to the La Joya hydroelectric project
Shark finning	PRETOMA and NGOs, calling for a ban on shark finning and the unloading of shark fins in private docks
Wildlife management and conservation	APREFLOFAS against the Simón Bolívar Zoo Administrative Foundation and the Santa Ana Conservation Center, over the condition of cages and the overcrowding of animals. APREFLOFAS, calling for a permanent ban on hunting. Communities along the San Carlos river, over fish deaths caused by discharge from the ICE reservoir and molasses spill.

Source: Based on Mora *et al.*, 2005, and journalistic sources.

Formal opportunities for environmental reporting and control

In the 1990s, there was an expansion in the number of bodies through which the State and civil society can exercise oversight over environmental management; others were created to allow citizens and institutions to file complaints related to the enforcement of environmental legislation and environmental rights. An example of the former is the creation of SETENA³⁴ in 1995 and DIGECA³⁵ more recently in 2003; the latter includes establishment of environmental tribunals and expansion of the authority of existing judicial bodies.

The *Tenth State of the Nation Report* noted that after a decade in operation, SETENA was still not fully consolidated and lacked sufficient autonomy and technical capacity to efficiently carry out its functions as called for under the law. In June 2004, new regulations were published for submitting and evaluating environmental impact assessments (EIA). The purposes were to deal with concerns and shortcomings that affected responsiveness, clarify the regulations for different assessments, strengthen internal organization, boost citizen participation and strengthen interinstitutional coordination. Another aim was to reduce the work load of the Secretariat by ranking projects and concentrating on those of greater environmental significance (Barrientos, 2005). The new regulations were to significantly reduce response time and, according to SETENA authorities, improvements are already evident: between November 2004 and May 2005 some 1,200 cases considered of low environmental impact were processed within ten days of receipt by SETENA (E: Madrigal, 2005). The Secretariat's output rose from resolving 841 cases in 2003 to 1,390 in 2004. The variety of evaluation instruments also increased, as shown in Table 6.

³⁴ SETENA: Secretaría Técnica Nacional Ambiental (National Environmental Technical Secretariat).

³⁵ DIGECA: Dirección General de Gestión de la Calidad Ambiental (General Directorate of Environmental Quality Management), under the Ministry of Environment and Energy (MINAE).

Table 6

Requests for evaluation, by type of SETENA decision, 2003-2004

Petition	2003	2004
Dismissed	41	21
Preliminary environmental characterization	1	0
Confirmed	4	0
Sworn statement of environmental commitments	351	539
Environmental assessment	12	45
Environmental impact assessment	155	213
Hydrological assessment or water analysis	3	0
Not viable	8	2
Environmental management plan	243	348
Master plan	2	1
Environmental management assessment and plan	0	12
Forwarded to the administrative environmental tribunal	0	5
Unresolved	21	204
Total	841	1,390

Source: SETENA, 2005.

With regard to the legal bodies that receive legal complaints on environmental matters, a review was made for this Eleventh Report of the cases dealt with by the Constitutional Court and the Environmental Administrative Tribunal (TAA) in 2004, in order to characterize the plaintiffs and the issues reviewed by those bodies (Solano and Torres, 2005).

The TAA was created in 1995 as a semiautonomous body of MINAE; its rulings exhaust the administrative process to address violations of legislation protecting the environment and natural resources and its decisions are binding. In 2004, the Tribunal received 400 complaints, of which 131 were examined for this report. Of these, 69 were declared without merit, suggesting that many failed to meet minimum requirements, or that the capacity to file complaints correctly with the necessary evidence is still lacking in the country. Of the cases examined, most plaintiffs were individuals (39%), followed by public institutions (29%), local organized groups (20%), municipalities (9%), and private firms (3%). Most of the complaints were filed against private firms (43%), followed by individuals (35%), and had to do with construction projects, earthworks (16%), and the illegal felling of trees (15%).

The second legal body studied was the Constitutional Court, which was created in 1989. For the purpose of this analysis, a review was made of all the cases (70) submitted in 2004 that addressed environmental issues. Most plaintiffs again were individuals (64%); the rest were private firms, local organized groups, NGOs, public institutions, and municipalities. Surprisingly, municipalities were the most frequent targets of complaints (47%), followed by national public institutions (32%). As in the case of the TAA, the most common complaints concerned building projects (16%), followed by water pollution (14%), damage to natural resources, and other violations of the environmental protection law (13%). Of all the complaints submitted, 32 were accepted and concluded with sentences ordering

payment of costs and damages, 13 were accepted in part, 19 were dismissed, and four were rejected.

An important measure for protecting natural resources is to strengthen the institutional bodies responsible for environmental control and reporting. To be able to do a good job expeditiously, they must have suitable funding and instruments. However, although their duties have been increased in recent years, they have not received sufficient funding to fulfill these obligations effectively.

XIV. Events that turn into disasters

Improved risk management is needed.

The frequency of disasters recorded in 2004 in the *Desinventar-La Red* database confirms the trend identified for the last decade: floods, landslides, and strong winds are, in that order, the most common disasters recorded in the country, excepting Guanacaste province (Table 7). In total, 72 of the country's 81 cantons were adversely affected to some degree by an event involving hydro-meteorological or geological phenomena. The canton of Desamparados reported the highest number of events (61), a pattern that has been developing over the years.

Table 7

Number of events recorded in the *Desinventar* database, by province

Province	Total events	Floods	Landslides	Strong winds	Other
San José	264	141	92	15	16
Alajuela	123	86	28	9	0
Cartago	105	52	41	12	0
Heredia	78	59	10	6	3
Guanacaste	14	13	1	0	0
Puntarenas	104	82	16	1	5
Limón	61	38	7	16	0
Total	749	471	195	59	24
Percentage	100%	63%	26%	8%	2%

Source: *Desinventar-La Red*, 2005.

Of all these events, floods were the most frequent in 2004 and caused major damage in several parts of the country. In Sarapiquí, San Carlos, Turrialba, and Jiménez, rains in the first half of May affected 130 communities and forced 2,190 people to seek refuge in shelters. A total of 89 levies, 50 bridges, and several feeder roads, stretches of highway and sewage pipes were among the losses. In addition, 37 schools and 1,028 homes were flooded, and four people drowned. In October, floods struck 15 communities in the cantons of Corredores, Golfito, Buenos Aires, and Osa, affecting nearly 3,000 people. In early November, a cold front produced floods and landslides, hitting the cantons of Sarapiquí, Cartago, Matina, and Limón especially hard, and affecting approximately 1,500 people (CNE, 2005). Some 25% of the floods gave rise to problems with the sewerage systems, in 67 cantons.

The most important earthquake of 2004 occurred on 20 November in Quepos, with a magnitude of 6.2 degrees on the Richter scale, caused by the activity of a local fault line. This event triggered the only declaration of a state of emergency that year. In total, the estimated cost of this disaster exceeded 2 billion colones, with road, housing and education infrastructure suffering the greatest losses. Damages of varying severity affected 306 homes, less than 50% of their inhabitants were owners, and almost all were from low-income strata. The impact assessment revealed problems with the quality of building materials and noncompliance with building standards, in some cases aggravated by the age and poor condition of the structures. In other cases, the location of the homes on unsuitable terrain aggravated the damage.

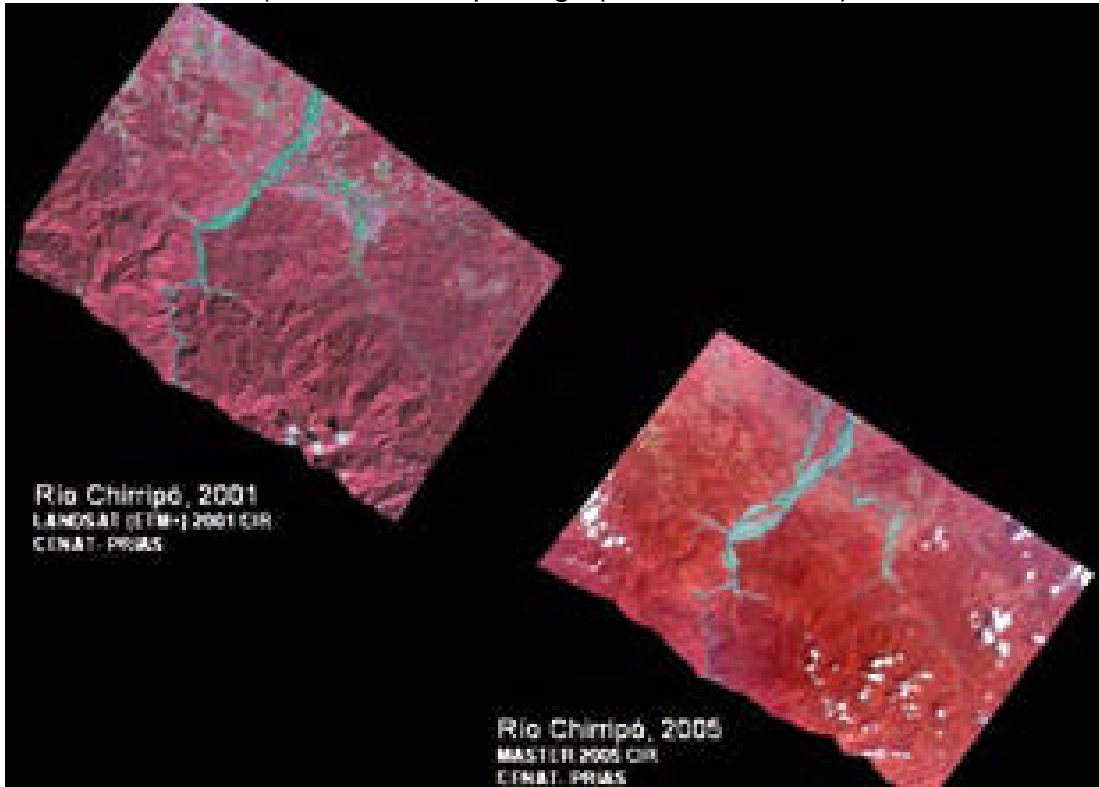
In the above cases, although emergency assistance prevented greater material damages and the loss of human lives, there is considerable room for improving risk management through preventive measures including improved sewerage maintenance and the design of buildings with likely risks in mind. In this connection, some progress has been made since 2003, when the Ministry of Housing and Human Settlements (MIVAH) issued new guidelines for developing housing projects according to technical criteria, including proximity to pollutants, type of soil, seismic faults, flood-prone areas, landslide hazards, and others. In addition, although efforts are just getting off the ground, the country's emergency response institutions are working to establish a comprehensive risk prevention and management system, and to upgrade capabilities to identify, quantify and follow-up on the effects of adverse events on communities, the environment, and productive activity.

Shantytowns in the Greater Metropolitan Area highly vulnerable to fire

Structural fires are other adverse events with great potential for damage. Several studies draw attention to the vulnerability of certain areas to that type of event, where action is urgently needed to prevent disaster. An example is the evaluation of human safety and fire hazard conditions in shantytowns of the San José Metropolitan Area conducted by the Department of Engineering of the National Insurance Institute (INS) following the December 2004 fire in the shantytown of La Carpio (Ramos, 2005). According to that report, towards the end of 2004 fire departments reported an increasing number of emergency calls from poor neighborhoods. Often, these settlements lack electricity services or their power systems are overloaded with clandestine installations, which increase the risk of fire. There are often no hydrants nearby or proper water distribution lines, and fire trucks frequently cannot reach the site of the fire because of road conditions. These areas are characterized by extreme poverty and high population density, with up to 200 people per hectare as compared to the average 100 people per hectare in middle-class neighborhoods (*State of the Nation Program*, 2004). Moreover, the dwellings are built with highly flammable materials (cardboard, wood, plastic), they are closely packed together, which facilitates the spread of flames, and there are few emergency safety zones.

Photo 6

Flooding of the Chirripó River
(aerial infrared photograph, CARTA 2005)



A comparison of two images of the Chirripó River (2001 and 2005) shows the impact of the December 2004 flood caused by severe rains in the Caribbean basin. In the 2005 image, sediments can be seen around the meanders of the river; the light gray color indicates flooded areas.

Source: DCS digital camera, CENAT-PRIAS.

Strengthening of democracy

The year 2004 was a year of setbacks for the democratic process, especially with regard to responsible political representation and the State's capacity for institutional action. The corruption scandals related to the Costa Rican Electricity Institute (ICE) and the Social Security Administration (CCSS), involving three former presidents of the Republic, generated great political unrest. These scandals revealed the weaknesses of the institutional oversight and control systems over the use of public resources. Despite the gravity and systematic nature of the actions exposed, none had been detected by the nation's oversight bodies. The "whistle-blowers" were the mass media. These events were dealt with by a judicial branch that had been strengthened internally by institutional reform and externally by growing independence from the political class.

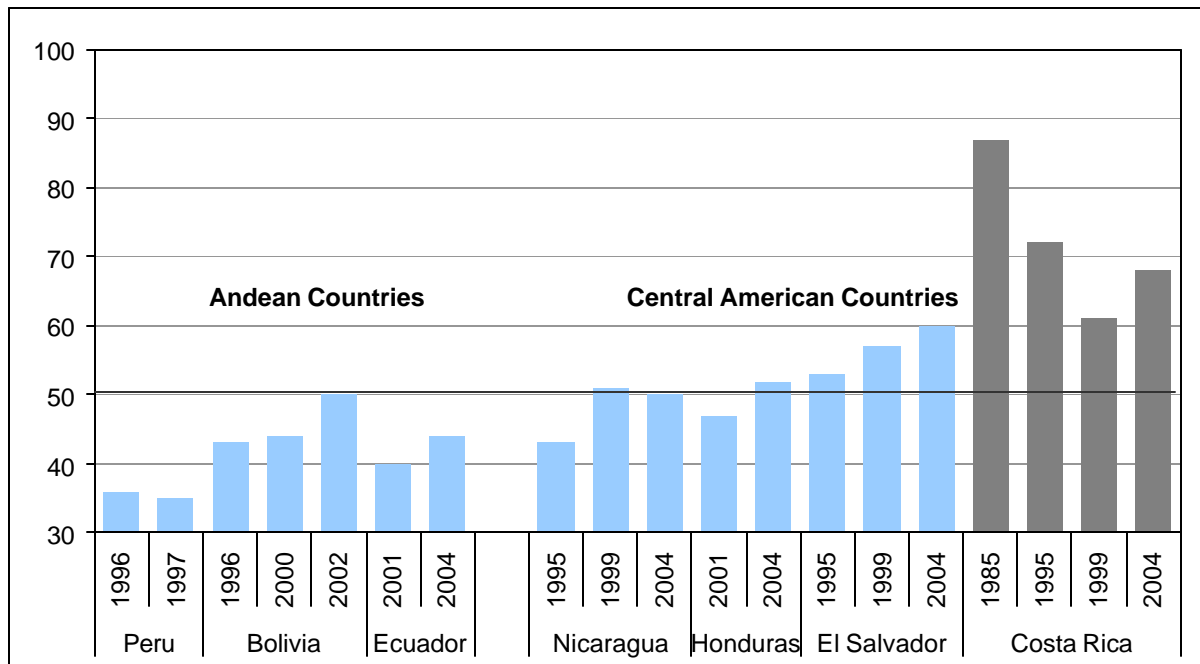
XV. Costa Ricans' perception of democracy

Citizens trust democracy and its institutions but are increasingly ill at ease with politics.

In Costa Rica, support for democracy is one of the highest in Latin America, even though this has declined considerably in the past twenty years. According to the democracy index devised by United States professor Mitchell A. Seligson, while in 2004 support for democracy stood at 68 points on a scale of 0 to 100, in the mid-1980s it was more than 85 (*State of the Nation Program, 2004*). Even so, the country ranks between 8 and 25 points higher than other nations in the region.

Figure 22

Levels of support for democracy in selected Latin American countries in recent years
(on a scale of 0-100)

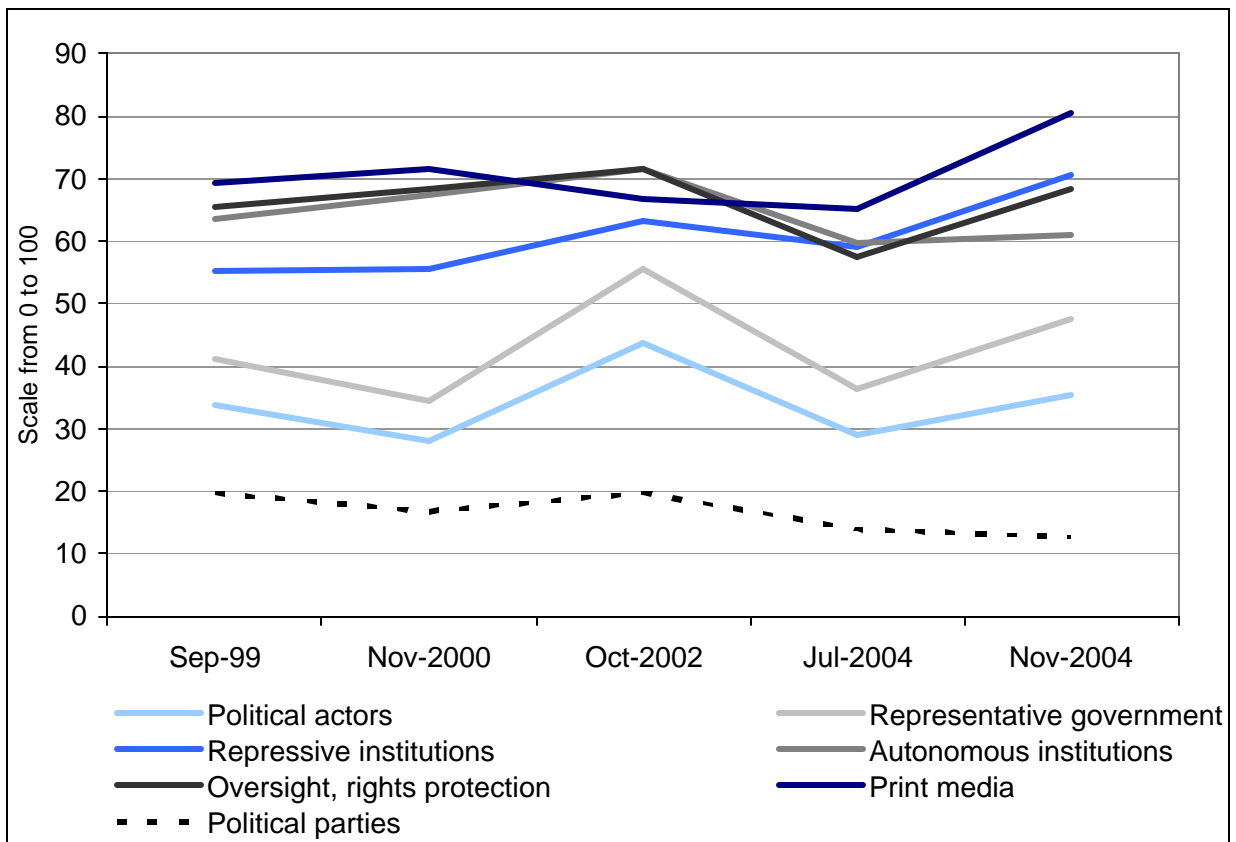


Source: Vargas, 2005, based on studies by the Latin American Public Opinion Project (LAPOP), Vanderbilt University.

In 2004, although citizen dissatisfaction with politics (both political leaders and political parties) grew, their confidence in State institutions increased, especially due to the handling of the corruption scandals. The bodies responsible for monitoring and protecting human rights, and those that fulfill the repressive functions of the State (police and OIJ³⁶) recovered an average 10 percentage points. By contrast, surveys conducted in 2004, in the wake of the corruption scandals, revealed a sharp decline in levels of confidence in political parties.

³⁶ OIJ: Judicial Investigation Agency

Figure 23
Level of confidence in different institutions



Categories

Representative government and political parties: Executive + Congress + Parties
 Representative government: Executive + Congress
 Institutions of the repressive function of the State: Judiciary branch + OIJ + Police
 Autonomous institutions: ICE + RECOPE + INS + State Bank.
 Oversight, rights protection: Comptroller General + Ombudsman + Constitutional Court
 Source: Kikut, 2005, based on Unimer-La Nación surveys

Disillusionment with political parties permeates coming elections

Political parties are preparing for the 2006 elections in a climate of partisan disillusionment, low citizen confidence, and greater indecision with regard to their voting intentions. As the elections approach, several opinion polls have revealed profound changes in the electoral climate. Preference for either of the two traditional parties (PUSC and PLN) went from strong in 1993 to being the choice of less than half the voters in mid-2005. On the other hand, new emerging parties have been unable to attract the voters that have deserted the traditional parties.

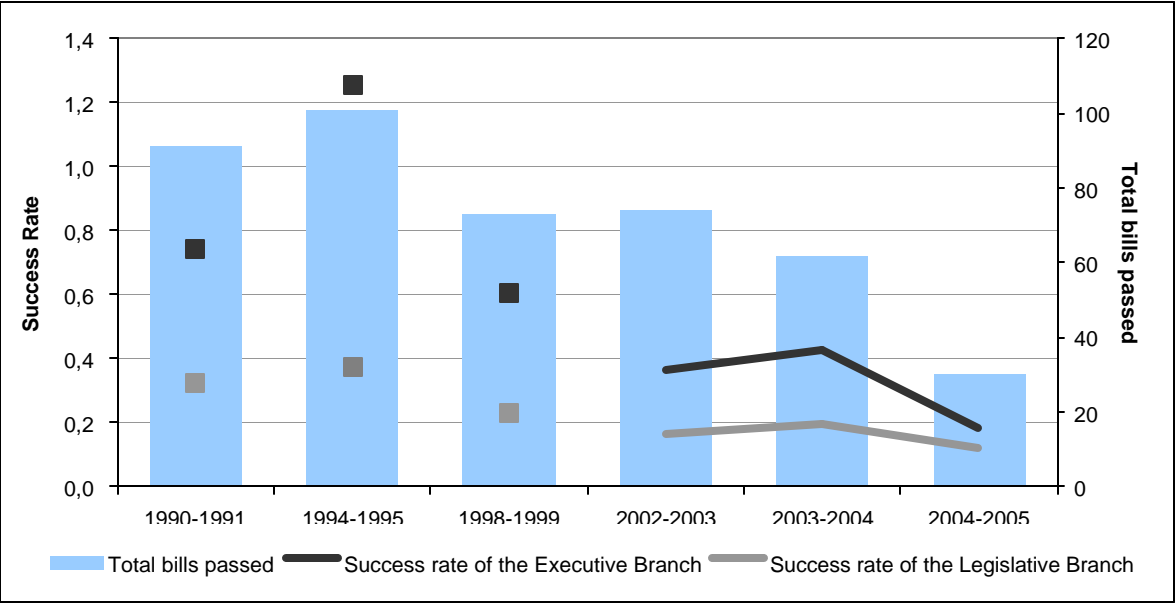
During the 1993-2005 period, most citizens went from being completely certain of voting in the next election to expressing serious doubts about doing so. The last two opinion polls show figures on voter abstention that are similar to the percentages recorded for the 1998 and 2002 elections.

Voter disillusionment with the political parties has not discouraged the emergence of new parties. A total of 27 new political parties registered to participate in the 2006 national elections: five at the national level, 10 at the provincial level, and 12 at the local level, for a grand total of 53 parties.

XVI. Erosion of parliamentary performance

Erosion of legislative performance practically produced a paralysis of the parliamentary process in 2004-2005, significantly obstructing the development of non-partisan agreements on new legislation and producing the lowest legislative output of the past fifteen years. During the present administration, although an average of 396 new bills was introduced into the legislative pipeline each legislative period, the National Assembly has been able to process fewer and fewer of them. Actions by internal party bodies are increasingly dispersed, standing committees meet and vote less often, while “mini-plenary” committees meet more often but agree on fewer initiatives (Figure 24).

Figure 24
Successful approval of bills submitted by the executive and legislative branches, by legislative period



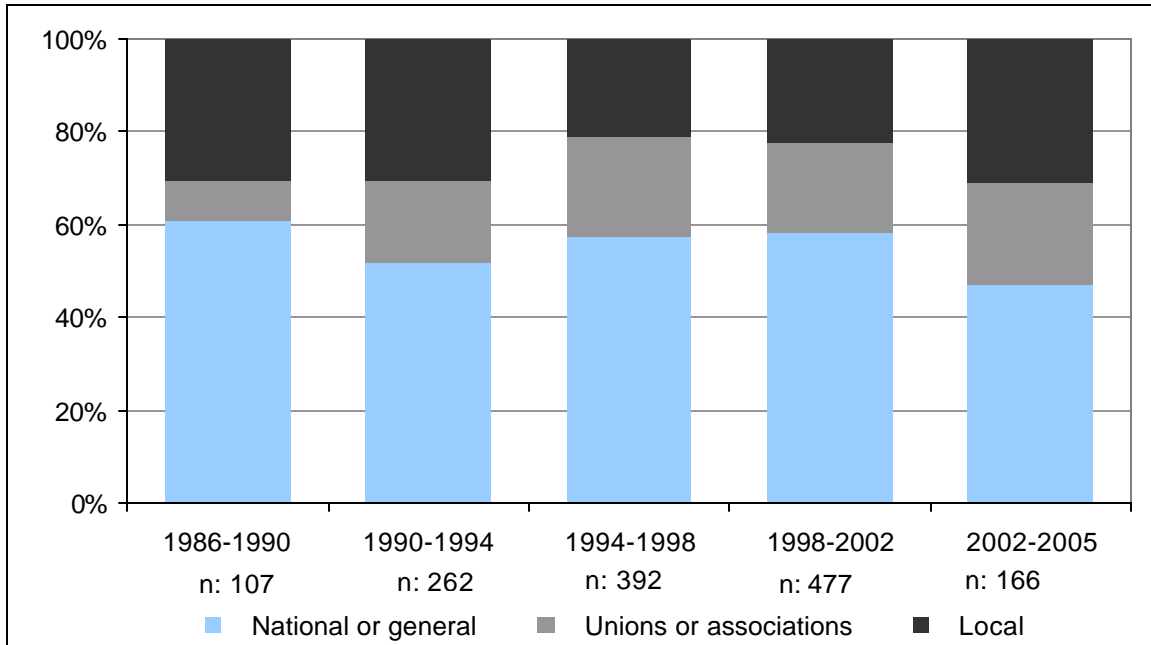
Note: The success rate is calculated as the quotient between the number of bills submitted and the total passed.
 Source: Prepared by authors with data provided by the Legislative Assembly.

In the 2004-2005 legislature there was a reversal of the downward trend in the average duration of the legislative process, although the bills passed were less complex. In an environment characterized by limited action by the Executive Branch and difficult negotiations between parties, legislators tended to agree more easily on bills targeting specific communities, trade associations, unions, and

groups; passage of this type of legislation grew from 39% in the 1986-1990 period to 53% in 2002-2005 (Figure 25).

Figure 25

Bills passed by type of beneficiary, by administration ^{a/}



a/ Categories: National or general: laws whose application is meant to benefit the entire population. Unions or associations: bills targeting social organizations or specific population groups, such as teacher unions and professional associations. Local: legislation with a specific territorial and population coverage, such as approval of municipal taxes.

Source: Legislative Assembly, Statistical Information Center.

Furthermore, in 2004, legislators continued the practice, already pointed out in earlier Reports (*State of the Nation Program*, 2003 and 2004), of legislating more rights for the population and committing the State to new obligations with the citizens without allocating the necessary resources and providing the material basis for putting them into effect. This custom has persisted even though the Legislative Assembly has been unable to reach a decision on expanding the State's fiscal base so as to provide a long-term solution to the fiscal deficit and the domestic debt.

The current Congress has made progress in two areas: consultations with civil society, and using legislative powers for political oversight. In the past, the standing legislative committees most frequently heard from business associations and labor organizations. That situation has changed significantly, as the number of hearings involving other sectors grew from 19 in 1998 to 63 in 2002.

XVII. Greater citizen participation in matters of public interest

2004: A year of intense social mobilization

The year 2004 was especially active for civil society organizations, which voiced their demands to authorities through a variety of social protest mechanisms, although they continued to rely on peaceful demonstrations and verbal protest. Two mass media outlets studied for this report registered a total of 648 collective actions,³⁷ which is significantly higher than the 589 recorded in 2000 –year of the “ICE Combo”– and the 417 recorded in 2003. The year 2004 was noteworthy for the partnerships forged among civil society organizations to strengthen the force of their demands and engage in collective action. This type of strategy was used in 40% of the protests and collective actions, while in 2000 it was used in 16% of the cases, and in 2003, 31%. The most intense mobilization occurred in August, when several fronts joined forces to protest, bringing greater political impact to bear on the government.

Table 8

Collective action registered in March 2000 and August 2004

Type of action	March 2000	August 2004
Mass assembly or demonstration	8	0
March	10	6
Blockade	191	97
Strike	2	0
Stoppage	3	19
Public statement	21	4
Meeting with authorities	5	6
Meeting or assembly	1	0
Threat	1	0
Acts against property	3	0
Invasion of property	1	0
Hunger strike	2	0
Slow-down	0	16
Total	248	148

Note: For both years, the table shows “situations of high mobilization.” In the case of the “ICE Combo” (2002) the protests lasted longer than those over Riteve-CAFTA (2004). During the whole of 2002, 589 collective activities were reported, while in 2004 a total of 648 took place.

Source: Mora, 2005.

The focus of demands in 2004 was on approving or rejecting legislation, regulations, plans and decrees; particularly significant was the opposition to the monopoly awarded for the technical inspection of motor vehicles. Workers, mainly public sector, were the leading actors (accounting for 41% of collective actions), followed by business associations (15%), and neighborhood groups (10%).

³⁷ Understood as actions by two or more individuals organized formally or informally to voice a conflict with relevant authorities.

Workers of the informal sector accounted for 6% of protests, increasing their participation over 2000 (2.5%) and 2003 (2.2%). Social protest was basically expressed through public statements (42%) and street demonstrations (30%), particularly blockades (18%), mass assemblies and marches.

XVIII. Political corruption in Costa Rica

The corruption scandals that have surfaced in Costa Rica over the past twenty years reveal the vulnerability of the public procurement system when collusion exists between institutional authorities and the commercial interests of private suppliers and contractors. Investigation into this matter found that in Costa Rica it is impossible to determine the amount expended by the State on its purchases, which is key to any monitoring system. Moreover, in some institutions, a significant but varying portion of procurements is done by direct purchase, which is subject to even less control. An examination of the processes that led up to the scandals of 2004 reveals three important points: first, in recent years legal mechanisms were established that allowed certain purchases to bypass normal regulatory controls (as in the case of the CCSS); second, unadvisable discretionary margins exist in several stages of the administrative procurement process (especially in relation to the formulation of contractors' terms, and the determination of when and how the terms are to be met); finally, the oversight and control system is critically dependent on the performance of the agencies charged with this task; if they are deficient, it will create an enabling environment for wrongful action. In this connection, it is important to note that over the past twenty years, numerous laws have been enacted to regulate procurement, control and oversight processes. This, supplemented by constitutional jurisprudence, can serve in the future as valuable weapons in the struggle against corruption.

Nonetheless, the inability of oversight and control bodies to detect acts of corruption continues despite the significant changes made in Costa Rican legislation. In this regard, we cannot speak of regulatory neglect. In the past decade, some twenty anti-corruption laws were enacted, more than the total approved between 1948 and 1985. Moreover, national standards have been brought into line with international standards set forth in such instruments as the OAS-sponsored Inter-American Convention against Corruption, especially with regard to proceedings (criminal), although not with regard to preventive measures. In addition, the oversight and control bodies charged with monitoring public action were strengthened or assigned new competencies, particularly the Office of the Comptroller General of the Republic, which has been given more than 200 new functions. Although these legal changes have not improved the prevention of corruption, they have indeed provided the judicial branch with new and valuable instruments for pressing charges. Once the scandals of 2004 came to light, the Legislative Assembly reacted swiftly by passing the Law Against Corruption and Illicit Enrichment in Public Office, which had been in the legislative pipeline for several years. This law introduces thirteen new criminal offences and is already being criticized; its constitutionality has also been challenged.

National legislation does not properly or sufficiently regulate several of the scenarios addressed by international standards. For example, regulations on

campaign financing are remiss regarding electoral primaries; in some public institutions, the principle of suitability is not regarded as the main criterion for hiring personnel; in victim and witness protection, only precautionary measures are contemplated, which could prove insufficient in the event of significant danger; and regulations are still needed regarding the access to, use of, and control of public subsidies to private firms. Furthermore, two crimes covered in international legal standards on private sector corruption have not been addressed at all: bribes and breaches of a company's code of conduct.

Beyond these considerations, however, the main weaknesses of this reform process are not regulatory in nature; rather, the process needs to strengthen institutional capacities by allocating more funds and assigning experienced personnel to oversee the performance of public functions. Although there has been an increase in authority to exercise administrative oversight and control, while this Report was being written it was impossible to ascertain that this authority was being used more often. In addition, although the information available is inconclusive, it suggests there are serious constraints on the ability to penalize corruption under criminal law. Between 1987 and 1997, crimes involving misconduct in public office amounted to between 2% and 2.7% of the total number of complaints received by the Attorney General's Office; since 1998, they have not even amounted to 2%. Most complaints concern abuse of authority. Even though a specialized unit was created (the Attorney General's Office on Economic Crimes and Corruption), only one out of every five complaints filed between 2002 and 2004 had to do with crimes committed in the performance of public duties. Since it was created, the Office on Economic Crimes has sent an average of twelve cases a year to the criminal courts. Finally, in addition to the low capacity to detect wrongful acts, the ability to punish them is apparently limited. Since the new Criminal Code went into effect in 1998, only one in every 100 individuals accused of some crime in the performance of public duties has been sentenced to prison.

XIX. Juvenile criminal justice

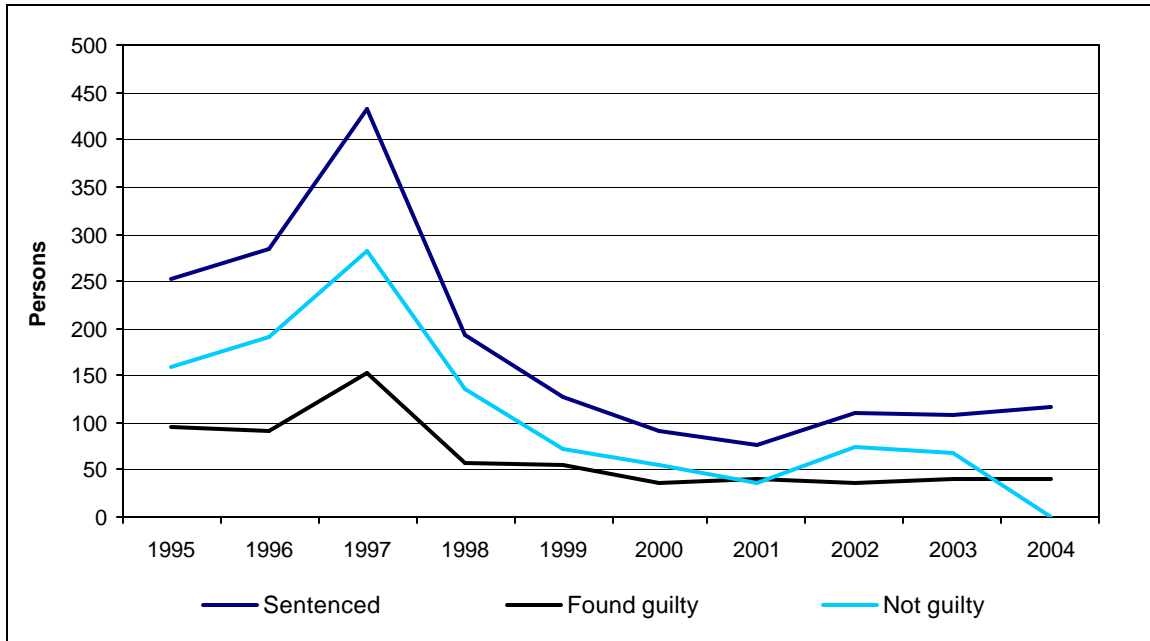
In the matter of juvenile crime, the number of cases brought before the courts held steady at an average of around 11,600 per year over the past three years, after the rising trend seen between 1997 and 2001.

Since the Juvenile Criminal Law entered into force in May 1996, records show that 65% of cases have corresponded to felonies, 25% to misdemeanors, and 10% to traffic violations. Some 83% of accused minors are male. In 2004, the net number of cases filed fell for the second consecutive year and was only slightly higher than in 2002 (Solana, 2005).

The most important finding in this area is that the incidence of crime among youths is no greater than among adults; on the contrary, the annual growth of cases involving youths is one tenth that of adults. Increases in criminality have been greatest in the coastal provinces (Guanacaste, Puntarenas and Limón). In the case of Limón (Table 9), although the incidence of juvenile crime is low in relation to the national total –the felonies and misdemeanors committed in that province barely account for 8% of the total reported for the entire country– in the last four years Limón has accounted for 35% of all the homicides committed by minors (Solana, 2005).

Figure 26

People tried for crimes committed in the performance of public duties



Note: A single case may involve one or more individuals.

Source: Solana, 2005.

Crimes against property account for 43% of the illegal acts committed by youths. Theft is the most frequent, with some 2,200 cases of theft by minors reported each year. This is followed by violations of the Law against Psychotropic Substances (19%), most of them related to drug possession for personal use. Between 25 and 50 minors are accused of homicide per year, although on average only 15 are convicted. There has also been an increase in the number of suicide attempts, with the annual average rising from 45 in the 1999-2001 period to 78 in the 2002-2004 period. Sex crimes have soared, doubling between 2000 and 2004. Among those offences, sexual abuse and rape were the most common.

Table 9

**Minors found in violation of the Juvenile Criminal Law, by province, in 1997
and 2004**

(per 100,000 inhabitants)

Province	Rate per 100,000 inhabitants		% increase
	1997	2004	
Total	242	321	32.6
San José	280	370	32.1
Alajuela	217	258	18.9
Cartago	253	327	29.2
Heredia	224	293	30.8
Guanacaste	185	287	55.1
Puntarenas	226	331	46.5
Limón	202	301	49.0

Source: Solana, 2005.

Until 2002, the percentage of convictions ranged between 59% and 68%; in 2003, it declined to 53%, and in 2004 it fell further to 45%. In 2004, for the first time, more minors were acquitted than convicted (369 as opposed to 309); the reluctance of victims and witnesses to appear in court is offered as an explanation. Almost half of all those convicted are placed on probation. The strongest measure is internment in a specialized center; this sentence is imposed on between 40 and 70 minors a year (less than 1% of accused minors), largely for the crimes of homicide, rape and aggravated theft. A comparison of adult and juvenile crime shows that the percentage of cases filed by province is practically the same for both. Between 13% and 15% of the offences committed by both adults and minors are crimes against life.

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ⁱ Data provided by the Program webmaster, from the last monthly reports.

ⁱⁱ This section is based on the document “Consideraciones acerca de la dimensión propositiva del Informe Estado de la Nación” [Considerations on the possibility of putting forward proposals in the State of the Nation Report], reviewed by the Program’s Administrative Council on 8 March 2005.

ⁱⁱⁱ The usefulness of the Report has been recognized by very diverse actors: international cooperation agencies have used it to set their cooperation priorities; government agencies have used its analyses to undertake actions or modify existing ones; civil society organizations and political parties have formulated proposals on the basis of its conclusions; universities have articulated research policies; and other countries have adopted the Report’s methodology for conducting their own assessments.

^{iv} Some of the reasons follow: i) Pursuant to the original Framework Agreement governing the State of the Nation Report, and the new 2002 Agreement, the objectives of the Report do not include the design of public policy. ii) The Report’s conceptual framework calls for a research strategy based on the question: how has the country performed vis-à-vis the shared aspirations for sustainable human development? This question emphasizes the evaluation of processes and not the proposal of solutions. iii) The value of the Report lies precisely in supplying reliable, timely and overall information and analysis to very diverse sectors of the population, so that they can become more aware of the real circumstances of the country. Although there is overall agreement with the assessment, the different sectors ascribe very different solutions to the problems. If the Report

proposed solutions, it would lose one of its distinguishing features: its diversity and pluralism, which enables it to serve as a point of convergence for the citizens. If it were to take sides on any position, it would be playing the roles of both judge and party. iv) In a representative democracy, the Report does not have the mandate to replace the functions of political and institutional actors.

The State of the Nation Program is not a political stakeholder, it does not represent any particular sector, nor is it an interpreter of the national interest. Therefore it would not behoove it to make proposals that would have to be promoted (and in opposition) to others formulated by political actors. v) Over the years the Report will accumulate recommendations and then have to monitor their adoption (and implementation) by public and private entities. Since its proposals are not binding, many of them (if not most) can be expected to not be adopted. This would undermine the Report's present influence. Furthermore, if the Report continues to be produced on an annual basis, it would be difficult to sustain the pace of designing serious and well-founded proposals to solve the country's complex problems. vi) Finally, preparation of the Report is a complex research process involving dozens of researchers and hundreds of participants in validation workshops. Each year more than 38 sources of institutional information are critically checked and more than 400 bibliographic references are processed. This has been done with limited human and financial resources which, until 2003, very unstable, as they depended, for the most part, on international cooperation. In addition, once the Reports are published, more than 100 dissemination and training activities are carried out, all with a modest budget and with very short deadlines, which demands very intense efforts and dedication to the work. Under these conditions, incorporating a new, complex and highly specialized task (to formulate solutions to the country's problems as a general and essential task of the Program) would be untenable.