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Costa Rica: Political-Economic Conditions and Relations with the United States

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SUMMARY

Relations between the United States and Costa Rica traditionally have been friendly, in part because of Costa Rica's long tradition of democracy. During the 1980s, the country was a key U.S. ally when the Central American region was plagued with civil conflicts and the United States provided substantial amounts of assistance during this period. The United States is Costa Rica's major trading partner by far, while Costa Rica is the United States' thirty-seventh largest export market. Costa Rican trade practices have improved steadily in recent years, from a very protectionist and statist past, although trade and investment barriers continue to exist, including complex customs procedures, weak intellectual property rights enforcement, and unresolved expropriation cases of U.S.-owned investment. Another issue of U.S. concern is Costa Rica's export of bananas to the European Union under a special Framework Agreement which is viewed by some as discriminating against U.S. producers.

Location:	Central America between Nicaragua and Panama, and bordering the Caribbean Sea and the Pacific Ocean
Area:	19,652 sq. mi. (slightly smaller than West Virginia)
Population:	3.2 million (1994 est.)
Ethnic Groups:	European, mestizo 86%; African 3%;indigenous 2%
Life Expectancy:	76 years
Literacy:	93%
GDP:	$6 billion (1993)
GNP per cap.:	$1,960 (1992)
U.S. Aid:	FY94: $6.4 million FY95: $5.7 million (est.) FY96: $1.8 million (req.)

Sources: U.S. Dept. of State *Background Notes*, Nov. 1994; World Bank's *World Development Report 1994*; and the U.S. Agency for International Development.

POLITICAL AND ECONOMIC DEVELOPMENTS IN COSTA RICA

Costa Rica has enjoyed an unbroken democratic tradition since 1948, when Jose "Pepe" Figueres -- considered the father of Costa Rican democracy -- led a popular revolution to protest a rigged presidential election. Since then, elections for a President and a unicameral Legislative Assembly have been held every four years, under democratic conditions. The general pattern in the elections has been that the party in power has lost to the opposition party, causing an alternation between the social democratic and the Christian democratic currents in the country.

Until recently, considerable consensus existed on Costa Rica's elaborate social welfare system, with protectionist trade policies, massive social programs, and parastatal enterprises running major sectors of the economy. These features of the import-substitution model were common in Latin America at the time, but not to the extent that they were developed in Costa Rica. Following the debt crisis of the 1980s, Costa Rica gradually began adopting structural adjustment policies, with assistance from multilateral and U.S. institutions. Much of the recent political debate within the country has focused on the wisdom and pace of these adjustment policies.

In the national elections of February 1994, Jose Maria Figueres of the social democratic National Liberation Party (PLN) narrowly won the Presidency, with a 50-48% margin, defeating the candidate of the ruling Social Christian Unity Party (PUSC), Miguel Angel Rodriguez. The son of former President Jose "Pepe" Figueres, the new President had served as the Minister of Trade and of Agriculture in the PLN government of President Oscar Arias, 1986-1990, who was associated with Central American peace plans. Figueres was sworn in as President on May 8, 1994, replacing Rafael Angel Calderon of the PUSC who was elected in 1990. Elections for the 57-member Legislative Assembly were also close and resulted in the PLN winning 28 seats, the PUSC taking 25 seats, and three smaller parties taking the remaining four seats.[1]

The main point of contention in the campaign was Costa Rica's economic adjustment program, with Calderon defending his economic reform program as a success, citing the fact that the public sector deficit had been reduced significantly, rates of inflation and unemployment had declined, and impressive economic growth rates of 6-7% were registered in 1992 and 1993. Increases in agricultural production (coffee and bananas), non-traditional exports, and tourism were main areas of growth.

Figueres campaigned against the harshness of the Calderon government's economic austerity program, and vowed to introduce social programs to help the poor and the nation's small farmers. Despite these pledges, Figueres has maintained the structural adjustment policies. He raised fuel and transportation prices and deregulated prices for basic commodities, including sugar, milk, flour and bread. After months of legislative stalemate, President Figueres reached an agreement in April 1995 with PUSC leader Rafael Angel Calderon to modify the PLN plan for a tax increase, and to undertake an extensive reform of the state, in part to win the support of the multilateral development banks.

Under the PLN-PUSC pact, further developed in June 1995, the nationalized banking system would be liberalized and private banks would be allowed to grant checking accounts, the National Liquor Factory (FANAL) would be privatized, and state monopolies in insurance, hydrocarbons, and

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[1] For background on Costa Rica's Legislative Assembly, see *Central America: Background on the Region's Legislatures*, CRS Report 94-947 F, Dec. 5, 1994.

telecommunications would be ended. This pact caused division within the PLN and prompted a series of strikes in July and August 1995 in opposition to the proposed privatizations. In particular, Costa Rica's teachers union, which opposed changes to the teachers' pension system, initiated a month-long strike and ultimately negotiated a commitment from the Government in mid-August to discuss the pension plan changes.

In late August 1995, the Figures government received legislative approval for a new tax package, which included an increase in the national sales tax. The approval of the package reportedly will pave the way for a stand-by arrangement with the International Monetary Fund.[2]

U.S.-COSTA RICAN RELATIONS

Relations between the United States and Costa Rica traditionally have been friendly, in part because of Costa Rica's long tradition of democracy, and because of U.S. assistance to Costa Rica, particularly in the 1980s when the Central American region was plagued by political turmoil. However, U.S. foreign assistance to Costa Rica has been declining dramatically in recent years, from a high of $231 million in FY1985 to $77 million in FY1990, and to an estimated $5.7 million in FY1995. The FY1996 aid request is for almost $1.8 million, with $1.6 million for a Peace Corps program and $150,000 for a International Military Education and Training program. Aid will be phased out completely at the end of FY1996, and the U.S. AID mission will be closed, ending 50 years of U.S. development assistance to the country. Costa Rica will continue to receive assistance market-based loans for development programs and projects from such institutions as the World Bank and the Inter-American Development Bank.

The United States is Costa Rica's major trading partner by far, while Costa Rica is the United States' thirty-seventh largest export market. In 1994, the United States supplied almost 59% of Costa Rica's imports while it was the destination of 48% of Costa Rica's exports.[3] Costa Rica has been a beneficiary of the U.S. Caribbean Basin Initiative (CBI) -- a program designed to expand foreign and domestic investment in the nontraditional export sectors of Caribbean Basin nations -- since its inception in 1984. The centerpiece of the CBI is a one-way duty-free preferential trade arrangement for a wide range of products from Caribbean Basin nations to the U.S. market as an incentive for increased investment and export production in the region.

U.S.-Costa Rican trade has been growing steadily since 1987, with dramatic growth in U.S. exports in 1994 to give the United States a trade surplus of $221 million, after years of trade deficits. U.S. merchandise exports to Costa Rica in 1994 totalled $1.9 billion, up $320 million or 21% from 1993. Principal U.S. exports were textiles and apparel, petroleum products, and motor vehicles. U.S. imports from Costa Rica totalled $1.6 billion, 7% more than in 1993, with

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[2] Figueres Gets Most of His Tax Package. *Latin American Weekly Report.* September 14, 1995, p. 416.

[3] International Monetary Fund. *Direction of Trade Statistics Yearbook, 1995.*

principal U.S. imports being textiles and apparel, bananas, melons, coffee, beef, sugar, jewelry, and medical instruments.

Costa Rican trade practices have improved steadily in recent years, from a very protectionist and statist past. Tariffs on most products have been reduced to a range of 5-20 percent, in line with the Common External Tariff established by the Central American Common Market (CACM) (although from March-July 1995 tariffs were increased as a short-term measure to deal with the Government's deficit problem). Major non-tariff barriers were eliminated when the Costa Rican Legislative Assembly approved legislation in December 1994 to implement the Uruguay Round agreements. Under this legislation, the requirements for import licenses and permits on many products were eliminated and were replaced by tariffs.

Despite this improvement, the 1995 Foreign Trade Barriers report by the United States Trade Representative (USTR) suggests that trade barriers continue to exist. Costa Rican customs procedures are complex and cumbersome, although efforts are underway to streamline procedures by the end of 1995. In the area of intellectual property rights, copyright law is generally adequate, but it is not uniformly enforced, and piracy of satellite signals, video recordings and computer software is widespread. Pharmaceutical patents are valid for only one year, and trademark counterfeiting is widespread. In the area of investment barriers, Costa Rica has a number of unresolved cases of expropriation of U.S.-owned investments, some dating back more than 25 years. Costa Rica also restricts foreign investment in some sectors, most prominently utilities and financial services. In a recent case Costa Rica seized the cellular telephone operations of U.S.-owned *Millicom International* when the constitutional branch of the Costa Rican Supreme Court ruled that the Constitution limited telecommunications to the state. The United States and Costa Rica have been unable to conclude a Bilateral Investment Treaty that would address some of the mentioned concerns.

Rights of workers had been another issue in question in Costa Rica, but recent reforms seem to have improved the situation. In June 1993, the AFL-CIO petitioned the USTR for the removal of Costa Rica from the Generalized System of Preferences on grounds that the right of association was being denied to workers, in part because of the "solidarismo" movement in Costa Rica, which fosters employer-employee associations and discourages unions. The AFL-CIO withdrew the petition in November 1993 after Costa Rica enacted a package of labor reforms to protect workers who seek to form unions.

Costa Rica's policies concerning the exportation of bananas to the European Union (EU) is another contentious trade issue. At the request of *Chiquita Brands International* and *Hawaii Banana Industry* Association, the USTR initiated a section 301 investigation against the EU in October 1994 and then against Colombia and Costa Rica in January 1995 on grounds that EU special preferences for Latin American bananas under Framework Agreements are discriminatory against U.S. firms exporting to the EU.

NAFTA Parity for CBI Nations.[4] Caribbean Basin nations, including Costa Rica, have expressed concerns about the potential adverse effects of the North American Free Trade Agreement (NAFTA) on their economies. They are concerned that the competitive advantages they enjoy under the CBI program will be eroded, resulting in substantial trade and investment diversion from the region to Mexico.

In the 103rd Congress, the Clinton Administration proposed an "interim trade program" or so-called CBI parity in order to address Caribbean Basin concerns about trade and investment diversion, although ultimately no legislative action was taken. Under the proposal, certain CBI countries would have received NAFTA equivalent tariff and quota treatment for most textile and apparel goods. As part of the proposal, the Administration called for comprehensive eligibility criteria on intellectual property rights and investment protection.

In the 104th Congress, legislation has been introduced, the Caribbean Basin Trade Security Act (H.R. 553 and S. 529) that would provide NAFTA-equivalent tariff and quota treatment for textile and apparel articles and also for import-sensitive items (footwear, handbags, luggage, flat goods, work gloves, leather apparel, canned tuna, petroleum and petroleum products, and certain watches) for a limited period or until the CBI nation joins NAFTA or signs a NAFTA-like agreement with the United States. As marked up in March 1995 by the Subcommittee on Trade of the House Ways and Means Committee, H.R. 553 would provide for NAFTA-equivalent tariff and quota treatment for a period of 10 years (compared to 6 years as originally introduced). Moreover, the bill would allow the Administration the chance to revoke the new preferences every three years if a review concluded that a country had not made progress in improving its intellectual property and investment protections. At this juncture, the legislative fate of the CBI parity proposal is uncertain. The House Ways and Means Committee has not marked-up the legislation reportedly because of textile industry and Clinton Administration concerns about textile and apparel provisions.[5]

REGIONAL RELATIONS

Costa Rica is a member of the Central American Common Market (CACM), which also includes the other four traditional Central American states of El Salvador, Guatemala, Honduras, and Nicaragua.[6] The CACM, originally formed in 1960, flourished in its first decade, but weakened in the 1970s and nearly fell

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[4] For further information see: *Caribbean Basin Interim Trade Program (NAFTA/CBI Parity)*, CRS Issue Brief 95050; *Trade and the Americas,* CRS Issue Brief 95017.

[5] Textile, Apparel Issues Play Role in Delay of CBI Parity Markup. *Inside U.S. Trade.* September 15, 1995. pp. 5-6.

[6] For information comparing Costa Rica to its Central American neighbors, see *Central America: Comparative Background Information.* CRS Report 94-948 F. November 30, 1994.

apart in the 1980s due to financial and political crises that gripped the region.[7] By the early 1990s, however, regional conflicts had largely subsided, and the nations were able to turn their attention to the challenges of economic development. In 1990, at the seventh presidential summit of Central American leaders, the nations approved a Central American Economic Action Plan which marked the beginning of a reinvigorated economic integration process. In 1993, the Central American Integration System (SICA) was established to oversee regional integration mechanisms. At the fourteenth Central American summit held in October 1993, the region's leaders signed the "Guatemala Protocol" which laid out the gradual adoption of measures for the establishment of a regional free trade zone, a regional customs union via a common external tariff, and a common market with the free movement of labor and capital.

CACM countries have set a common external tariff ranging from a 5% ceiling on raw materials to 20% on processed goods. Financial pressures in Costa Rica resulted in the Government temporarily raising its tariff rates in March 1995. The increase was from 5% to 13% for raw materials, and from 20% to 28% for processed goods.[8] Costa Rican businessmen had criticized the increase because they it would it make it more difficult for Costa Rica to compete in regional markets, and the Figueres government ultimately rescinded the increase in July 1995.

Costa Rica and Mexico concluded a free trade agreement in March 1994 which came into force Jan. 1, 1995. Because of Mexico's financial difficulties, however, Costa Rican exports to Mexico declined by 71% in the first quarter of 1995 compared to the same period in 1994. Three other CACM countries -- El Salvador, Guatemala, and Honduras -- had been negotiating with Mexico for a free trade agreement since the summer of 1994, but Mexico's financial difficulties reportedly have prompted the Central American nations to put the negotiations on hold.[9]

Costa Rica and other Central American nations have begun consultations with Caribbean nations concerning closer economic and political ties. Similar to the CACM in Central America, Caribbean nations have an economic integration organization -- the Caribbean Community (CARICOM) -- which now includes 14 Caribbean nations. In July 1994, CACM and CARICOM joined together in agreeing to establish the Association of Caribbean States (ACS), a grouping of 25 independent nations that border the Caribbean Sea.

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[7] Saborio, Sylvia. "Central America in the 1990s: The Challenge of Trade Liberalization," in U.S. Congress. 102d Congress, 2d Session. Joint Economic Committee. *The Caribbean Basin: Economic and Security Issues.* S. Print 102-110. January 1993, p. 382.

[8] "Central America: Tariff Walls Go Up." *Mexico & NAFTA Report (Latin American Regional Reports).* May 11, 1995, p. 2.

[9] "Central America and Mexico: Disappointing." *Mexico & NAFTA Report (Latin American Regional Reports).* May 11, 1995. p. 3