

WHAT PRICE EQUITY?

A Macroeconomic Evaluation of Government Policies in Costa Rica

FUAT M. ANDIC

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A MACROECONOMIC EVALUATION
OF GOVERNMENT POLICIES IN COSTA RICA

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CONTENTS

	Page
PREFACE	IV

PART ONE: THE DEVELOPMENT OF THE ECONOMY

I. Population	3
II. Output and General Economic Performance	5
III. Sectoral Development	10
IV. External Sector	12
V. Employment and Wages	16
VI. Labor Productivity	19
VII. The Public Finances	21
VIII. Money, Prices, and Inflation	23
IX. Equity and Efficiency: A First Glance	25

PART TWO: PUBLIC POLICIES FOR DEVELOPMENT

I. Introduction	33
II. Trade and Industrial Policies	34
III. Fiscal Policy	39
IV. Credit Policy	48
V. Public Investment and Investment Management	50
VI. Costa Rica and the Central American Common Market .	51
VII. Conclusions	58
APPENDIX	61

PREFACE

In the process of development, very few countries have succeeded in going beyond a mere increase in per capita income and successfully combined growth with equity. The two, in more cases than not, remained as objectives of development planning for economists and in the voluminous development plans; but rarely were they put into practice.

Costa Rica is an exception. For over two decades this country achieved not only a very respectable per capita income growth, but also made sure that the benefits of economic development did not elude the poorest of the country. Further to its credit, Costa Rica combined growth and equity within a setting that is truly democratic. A rare achievement in this day and age, which justly earns the country the nickname of the "Switzerland of the Americas."

Despite its past success in combining growth with equity, Costa Rica appears to be heading into problematic waters in the eighties. The growth rate is negative; many sectors are sagging; and the economy has begun to show signs of inefficiency. One can detect several reasons for such a tendency. Some are typically cyclical and totally beyond the control of the government and its policies. Others are precisely the result of public policies. In other words, the trade-off between equity and efficiency has clearly come to the surface and seems to be inescapable.

This study is a modest effort in analyzing the efficiency and equity problems within the context of Costa Rica's economy. It is divided into two parts. The first describes and analyzes the overall development of the economy during the past two decades. The second assesses critically the government development policies and institutions. The general conclusion arrived at is that the economy suffers from serious inefficiencies which are now beginning to hamper the development efforts and eroding equity.

My interest in Costa Rica was rekindled recently when I was invited by the Agency for International Development to join the

team to evaluate the foreign aid performance and the country's development. This study is a revised and somewhat expanded version of my report submitted to the Bureau for Program and Policy Coordination of USAID. It is published by the Institute of Caribbean Studies with the permission of the Agency.

I would like to thank Robert Pratt, Humberto Esteve, Eduardo Tugendhat, Christine Adamezyk, (all members of the team), who read an earlier version of the draft and made very valuable suggestions. I, however, remain solely responsible for errors and omissions. No doubt, without their assistance and interest these would have been more numerous and grievous.

Fuat M. Andic
San Juan, Puerto Rico
August 1982

PART ONE

THE DEVELOPMENT OF THE ECONOMY

Costa Rica, a Central American country, borders Nicaragua and Panama, and has both Pacific and Atlantic coasts. Its area is 50,400 km², of which 42% is arable land and pasture and 30% forest. In terms of natural resources Costa Rica has practically no mineral resources and no navigable rivers. Water resources however supply about 90% of its electricity needs.

I. POPULATION:

In 1980, the total population of Costa Rica was estimated to be 2.28 million. According to the 1963 and 1973 censuses and the projection made by the InterAmerican Development Bank, the population is distributed among the country's seven provinces as follows:

TABLE I

POPULATION (in thousands)

<u>Provinces</u>	<u>1963</u>	<u>1973</u>	<u>1980^a</u>
San José	488	695	863
Alajuela	241	326	391
Cartago	155	205	239
Heredia	85	134	166
Guanacaste	143	179	211
Puntarenas	157	218	273
Limón	<u>68</u>	<u>115</u>	<u>144</u>
TOTAL	1,336	1,872	2,285

SOURCE: *Population Census, 1963 and 1973*

a. Inter American Development Bank projection, from *Population and Urban Trends in Central America and Panama* (Washington, D.C.: Inter-American Development Bank, 1977).

Costa Rica has a fairly high rate of population increase. About ten years ago the growth rate fluctuated around 2.5%. This figure represents a favorable decline compared with the decade of the sixties when the growth rate was 3.7%, and with the second half of the sixties when it was 3.1%. The rate of increase declined to 2.4% in 1975, but rose again to 2.8% by the end of the decade.¹ The decline in the population growth rate is mainly attributed to the decline in the birth rate. Two factors are predominant in explaining this phenomenon. One is the relatively high rate of industrialization and urbanization; and the other, the notable increase in the levels of education in general, and in the rural areas in particular.

Urbanization has been fairly rapid since 1960. In 1963, 35% of the population were living in urban areas; in 1981 the percentage had increased to 46%. The statistics on economic activity tell us that Costa Rica is not a typically rural country; for in 1979, only 21% of the economically active population worked in the agricultural sector, and the tertiary sector employed 46.6%. At least 70% of the population live in the Central Valley, which represents 7% of the total area of the country. San José, Alajuela, Cartago, and Heredia, cities in the Valley, have already lost their rural character and are fast becoming typically urban areas. Immigration from rural to urban areas contributed to the change in the rural character of Costa Rica of the fifties.

The notable increase in the level of education can be judged by the fact that school attendance rates are very high, primary education for example ascending to 100%. Simultaneously, between 1960 and 1970 the percentage of population with secondary education increased from 8.0% to 13.7%, and those with tertiary education rose from 2.0 to 3.7% respectively, while those without education declined from 19.0% to 13.6%.²

These demographic changes have had important consequences for the age structure, in that the proportion of the younger age groups has been declining since 1970. Nevertheless, Costa Rica's population continues to be basically a young one with obvious resource use implications in public services, such as education, training, employment generation, housing, and the wide social arena.

1. Population characteristics are as follows: Birth rate 28.0 per thousand, death rate 5.0 per thousand, and infant mortality 37.6 per thousand of live births.

2. ECLA, *Statistical Yearbook for Latin America*, (Washington, D.C.: ECLA, 1979), Tables 36 & 38.

II. OUTPUT AND GENERAL ECONOMIC PERFORMANCE

Costa Rica's GDP grew on the whole at very satisfactory annual rates up to 1977³ the exception was 1975 which marked the crisis generated by OPEC's drastic change in its pricing behavior. The annual real rate averaged 5.1% in the first half of the sixties and rose to 8.1% in 1972. Hence, overall, Costa Rica fared rather well as compared to many of its neighbors in the South Western Hemisphere. In constant (1970) prices GDP grew from C 3.4 billion in 1960 to C11.2 billion in 1980. In U.S. dollars the real growth was from \$633 million in 1960 to \$1.9 billion in 1980. There has been a concomitant but somewhat uneven growth in per capita output. Excluding 1975 (when in fact per capita output declined by 0.4%), the annual real rate of growth in per capita output averaged 3.2% between 1960 and 1979. In fact, it was above 5% in 1972, 1973 and in 1977. But in 1980, once again it registered a decline, this time of 1.9%.

1. GENERAL TENDENCIES: 1960-1970

The performance of the Costa Rican economy during this decade has been determined to a large extent by the performance of its exports, the fluctuations registered in export prices, and the developments in international markets. Export volume and price fluctuations were counteracted through public expenditures, which succeeded in maintaining the economy on a fairly even keel. The decline in exports was always countered with increases in public expenditures. As a result, the economy evolved on a sustained growth path with price stability, but at the expense of budgetary and balance of payments problems.

On the whole, gross domestic investment expanded at the real annual rate of 8% and rose from 17.5% of GDP in 1960 to 20.5% in 1970. The growth in private domestic fixed capital formation has been at a rather steady rate, but public capital formation showed a phenomenal increase in the first half of the decade, which explains 30% of the total increase over the decade. However, in general, there has not been an appreciable change in the breakdown of gross fixed capital formation between the two sectors: private fixed capital for-

3. The 1979 to 1981 crisis will be explained below.

mation continued to contribute approximately three-fourths of the total.

During the first five years of the decade, investment increased much faster in manufacturing than in any other sector.⁴ Understandably, this was due to Costa Rica's effective entry to the Central American Common Market (CACM) and the resulting expansion of the market for Costa Rican manufactures. In 1966 prices, value added in manufacturing rose by 51.3% from 1960 to 1965, while in agriculture the increase was only 16.8%. The situation was reversed in the second half of the decade when the expansion of the agricultural sector absorbed an increasing share of aggregate investment.⁵ This was mainly due to developments in banana cultivation, where value added in 1966 prices increased by 160.0%. There was a significant increase in coffee (42.2%) and sugarcane (54.3%) while the remainder — cocoa, rice, beans — either stagnated or declined. Towards the end of the decade, investment in construction and housing became rather prominent; in no year between 1965 and 1970 did the share of such investment fall below 52.5%.⁶ As expected, the great majority of public investments were allocated to the basic infrastructure (transportation, power, communications) and to social sectors (education, health, water and sewerage, housing, and urban development). During the decade about one-half of public investments were allocated to the former and two-fifths to social sectors.

It should be pointed out that the relatively high capital formation which took place during the period could not have been absorbed had there not existed an abundant labor force with sufficient skills and a relatively high level of education. As a result, GDP could expand without widening income disparities and the government was able to allocate a substantial part of its expenditures to health and education. This, in turn, raised the social welfare indicators and further increased the productive capacity of the labor force.

4. BID, Depto. de Desarrollo Económico y Social, *Informe socioeconómico de Costa Rica*, (Washington, D.C.: 23 de junio de 1976), pág. 14.

5. *Ibid.*

6. *Ibid.*, Appendix Table AE-5.

2. GENERAL TENDENCIES: 1970-1975.

The Costa Rican economy was able to maintain its dynamism during the early part of the seventies when the real annual growth rate of the GDP averaged 7.5%. In 1974, however, the rate fell to 5.5% and in 1975 it plummeted to 2%, which caused per capita output to decline.

Several factors have contributed to this turn in growth; they have all affected the performance in the external sector, and through the linkages, the main industrial sectors of the economy. First, is the increase in international commodity and raw material prices, including especially oil. As a result, costs of the inputs into agriculture, especially fertilizers, and industry rose, and production in both sectors decelerated. Secondly, internal problems began to surface in the CACM. This, combined with world developments, from which all CACM members suffered, caused the regional trade to decline and Costa Rica, who had seen its manufacture exports expand into the region, had to face a reduced demand in the industrial sector. Thirdly, in 1970 and 1971, when the rate of growth in exports had declined rather significantly, the government pursued an anticyclical policy to maintain growth in output and employment. This consisted of indirect measures of recognizing incentives to private investment, of liberalizing credit to the private sector, and of directly increasing public expenditures. Only after 1975 in contrast, did the government adopt a stabilizing fiscal policy which was less expansionary: it restricted monetary and credit expansions and strived to reduce the monetized portion of the budget deficit.

Although, as a result, the rate of increase in imports was contained and the balance of payments deficit somewhat reduced, structural difficulties in agriculture and industry could not be avoided. These were the results of the import substitution policies implemented in previous years and were brought to light with the crisis caused by world developments. Agriculture had been making use of production techniques extensive in the use of land, and industry depended heavily on imports of raw materials and semi-finished goods. The extensive use of land apparently came to a level of exhaustion, and industry, which basically flourished within the protection of import substitution policies, was adversely affected by the high cost of reduced imports and declining export earnings.

3. GENERAL TENDENCIES: 1976-1981

While 1974 and particularly 1975 were markedly problematic years for Costa Rica, from 1976 onwards, the economy resumed the growth rate of the sixties. Once again, the growth source was mainly, but not exclusively, connected with the external sector: export prices, especially those for coffee, improved, thanks to the famous coffee boom. In addition construction, trade and public sectors were revitalized, and to a lesser extent, industry and public utilities sectors.

Examined from the standpoint of growth, these developments were relatively favorable. But less so when it is noted that first, the budget deficit jumped from ¢ 366.9 million in 1975 to ¢ 2,263.6 million in 1979 (a six-fold increase); and second, the balance of trade deficit almost tripled from ¢ 217.6 in 1975 to ¢ 601.6 in 1979, despite the improvement in exports. The strain of inflation began to be observed very seriously in 1977 and especially in 1978 as demand outpaced supply.

In 1979, the tide began to turn against Costa Rica. For almost two decades Costa Rica had pursued an economic policy the central objectives of which included the improvement of the social services and primary education. This explains, in part, why the country's social indicators are among the highest in Latin America. Efforts to consolidate this considerable progress in social matters have been supplemented in recent years by increases in wages supplemented by a family allowances policy, which undoubtedly helped raise the average standard of living.

But, the measures had their consequences. Public expenditures rose very rapidly and the budget deficits continued to grow. The increase in real wages and the growth of credit channelled towards consumption generated a greater demand for consumer goods, especially luxury articles. Faced with inadequate domestic supply, imports rose steadily and the pressures to import inputs increased.

The developments in 1980 and 1981 deserve a more detailed analysis.⁷ In 1980 serious imbalances occurred in the domestic as well as the external sectors. Investment in the private sector contracted markedly: both residential construction and machinery and equipment purchases were sharply curtailed. These were the major

7. The following paragraphs draw heavily from IDB, *Social and Economic Progress in Latin America, 1980-81* (Washington, D.C.: IDB, 1982), 217-24

determinants behind the 5.3% fall in gross domestic investment. In addition growth in exports (1.5%) lagged behind that of the previous year (4.0%). As a result, the real growth rate in Costa Rica's GDP decelerated sharply, falling to 1.2%, the lowest in the past two decades. The deficit in the public sector rose to a height of 12% of GDP; consumer prices rose by 18.1%, twice the rate of the previous year and a loss of \$215 million was registered in the foreign reserves. A standby credit agreement was signed in March 1980 with the International Monetary Fund (IMF) to back up a two-year stabilization program, which called for a reduction in public expenditure, an increase in fiscal resources and the restriction of the external indebtedness of the public sector, as well as of domestic credit.

The Costa Rican government was unable to comply with the limit requirements of the stabilization program. As a result the IMF agreement was not put into effect.⁸ By mid-year the international reserves of the banking system were exhausted; the Central Bank contracted emergency loans to meet overdue private foreign obligations. To curtail the demand for foreign exchange, one-half of the purchases of foreign exchange for imports and export earnings was allowed to be transacted in the free market; surcharges and advance deposit requirements were imposed on the imports of manufactured consumer goods, capital goods of all types, and construction material.

Despite the serious economic problems, the government continued its efforts to improve the living conditions of lower income families. The family allowance program, for example, accounted for approximately 9.0% of the total government budget to finance school meals, rural housing, and non-contributory pensions for indigent beneficiaries.

The year 1981 proved to be the worst year of the two decades. In real terms GDP declined 3.6%. Manufacturing activities almost stagnated; and construction activities declined very sharply. Meager increases in other sectors were unable to stimulate the economy sufficiently. Coupled with a decline in exports (3.1%), worsening of the terms of trade, shrinking foreign reserves, Costa Rica acquired all the characteristics of a strained economy.

8. The negotiations were reopened in June 1982.

III. SECTORAL DEVELOPMENT

The Costa Rican economy experienced some drastic changes in the structure of its industrial sectors. Agriculture was the predominant sector in 1969 (26.2% of GDP); its share declined to 19% in 1981. In fact, the value added of the sector had been declining since 1979. Manufacturing (including mining) occupies today the important position gradually being vacated by the primary sector and accounted for 11.3% of the GDP in 1960, but 22.6% in 1981. The remaining sectors of the economy have maintained a remarkable stability over the years. Construction activities have not maintained increasing significance with economic development in the aggregate value added of the economy. The share of this sector oscillated between 5% and 7.0%. Public utilities represented about 2.0% of the GDP, financial institutions about 2.2%, transportation and communications 5%, and public administration around 12%.

Growth in the various sectors has been very uneven. Agriculture always subject to several exogenous factors, from climatic conditions to international market conditions, maintained a 4.3% real rate of increase until 1973. The value added declined in 1974. Since then the sector as a whole has not really recuperated, although individual crops have performed differentially, aided by measures taken by the government. The aggregate value added in the sector grew at meager rates since 1975 and actually declined in 1979 and 1980. Accelerating the coffee improvement program by distributing high yielding varieties to coffee growers; strengthening the "training and inspection" program through which technology is transmitted to producers; providing improved seeds to farmers, in particular rice, corn, beans and cocoa; expansion of programs for the control of foot-and-mouth disease; all helped coffee and rice output to increase. But banana production was affected by strikes; sugar production declined, and excessive slaughtering affected cattle breeding adversely. The value added declined by 1.2% in 1980.

Industrial value added enjoyed a fairly rapid real growth up until 1975 of about 10% a year on the average. Deliberately pursued policies of import substitution (high tariffs on finished goods and exemption for capital equipment), the creation of the CACM, the generous fiscal incentives offered and the open-door policy adopted vis-a-vis foreign investment, coupled with the initial economic expansions following the gradual dismantling of the intra-regional trade barriers, contributed significantly to the sector's accelerated

growth from 1960 to 1975. Food and textiles, traditional consumer items, accounted for a large share of industrial production; but a certain degree of diversification took place with the establishment and growth of the chemical, pharmaceutical, and engineering industries. Industrial exports to CACM member countries and Panama constituted the bulk (approximately 80%) of Costa Rica's total industrial exports. Hence the sector's development depended not only on favorable economic conditions in the country but also on regional income growth.

The 1974-1975 world crisis drastically curtailed the expansion of the industrial sector. Industrial output continued to be constrained by traditional structural problems, such as the limited size of the domestic market, resulting in the inefficient production of many lines of commodities with implications which were not remedied by the uncertainty as to the future of the CACM, and the high import intensity of the sector caused by operations geared primarily toward the final stages of consumer goods on the one hand, and to the production of chemicals, pharmaceuticals, and metals on the other. Nevertheless, because special incentives were received from the government in the form of exemption from customs duties, elimination of credit ceilings on exports, and subsidized interest rates on export financing, the real value added of the sector continued to grow.

There was a marked slowdown in the growth of the sector in 1979, 1980 and 1981, when value added expanded by 1.4%, 2.6%, 1.1% respectively. The unfavorable development was primarily due to the depression in both domestic and foreign demand and to the lack of credit. If industrial activity recovered slightly in 1980, this was mainly due to the increase in regional demand, particularly in the case of Nicaragua. Industries destined for domestic consumption which use a larger share of national inputs registered an extremely meager increase.

The construction sector was most dynamic in the seventies, but grew only modestly in the past few years with value added expanding by 10.8%, twice the rate in 1979. The rise in 1980, however, was mainly due to public infrastructure projects, namely the hydro-electric dam at Corobicí and other electricity networks. Private residential construction in fact declined due to speculative ventures and flight of capital. In 1981 the growth in the construction sector was markedly negative.

Adverse economic conditions affected all other sectors and slowed down the growth rates during the past three to four years. Public administration was no exception.

IV. EXTERNAL SECTOR

The performance of the domestic sectors is to a large extent determined by the performance of the external sector. Exports of goods and services are more than one-third of the GDP and are the main source of economic growth. Imports represent about 40% of the GDP, and the breakdown reflects the high degree of the dependence of the economy in general, and of manufacturing in particular, on imports of intermediate and capital goods.

The high commodity concentration of exports makes the Costa Rican economy very vulnerable to world price fluctuations. Whenever world prices rise and export earnings increase, the domestic sectors are favorably affected and thus expand. On the contrary, contractions occur in the rest of the economy and government is forced to take counter measures to mete out the cyclical fluctuations. Price swings combined with output fluctuations have resulted in significant revenue fluctuations. Although a certain amount of diversification has occurred in the structure of the exports over the past 20 years, in that manufactured products now occupy a significant share of the exports, four basic agricultural commodities continue to dominate the export structure, though their importance has declined from 85% of total commodity exports in 1960 to about 50% in 1980. Nevertheless, the high commodity concentration prevails, and their importance in total export earnings rapidly transmits the swings in their prices to the domestic economy, thereby creating external payments difficulties.

TABLE 2
COMPOSITION OF EXPORTS (%)

<u>GOODS</u>	<u>1960</u>	<u>1970</u>	<u>1975</u>	<u>1980</u>
Coffee	52.3	29.4	19.6	24.2
Bananas	23.3	27.8	29.2	19.8
Sugar	2.1	4.8	8.6	2.8
Beef	4.9	7.9	6.6	6.9
Manufactured Goods	1.2	18.5	25.2	34.4
Other	<u>15.2</u>	<u>11.6</u>	<u>10.8</u>	<u>9.9</u>
TOTAL	100.0	100.0	100.0	100.0

SOURCE: *Banco Central de Costa Rica.*

The balance of payments has been consequently seriously affected by the changes in the terms of trade which began to deteriorate during the sixties and significantly worsened during the seventies, and with the exception of 1977 and 1978 has been consistently against Costa Rica, as can be observed from the following table.

TABLE 3
TERMS OF TRADE

<u>YEAR</u>	<u>INDEX</u>
1960	101.1
1965	107.6
1970	91.3
1971	90.3
1972	87.5
1973	90.5
1974	76.6
1975	78.9
1976	84.7
1977	116.8
1978	104.6
1979	91.4
1980	89.4
1981	81.4

SOURCE: ECLA, *Statistical Yearbook 1979*, for the years 1960-78; COUNSEL, *Reperorio Económico*, (San José, 1982) for the years, 1979-81.

Over the 20-year period, exports grew at an annually compounded rate of 15.9%; while imports grew at the higher rate of 17%. This was in great part due to both the growing import intensity of the manufacturing sector encouraged by an import substitution policy, and the increase in consumer items resulting from overall economic growth. This has had important consequences for Costa Rica's external trade position. When in 1960 to 1962 industrial raw materials constituted 22% of total imports, that share had climbed to about 37% in the 1974 to 1981 period. Granted the ratio of this latter period was affected by the spectacular increase in oil prices, nevertheless, the import needs of the manufacturing sector to a great extent account for Costa Rica's trade deficits. The result was a rigidity in the balance of payments, since curtailing imports to

reduce the external deficit necessarily reduces the level of economic activity. Moreover, given the demand structure and price volatility of agricultural crops, their export earnings fluctuate and by no means reach the level to satisfy the foreign exchange demands of the industry. The result has been a chronic and ever-deepening deficit in the balance of current account which grew at the annually compounded rate of 23.9% over the past 20 years.

While during the earlier years of the last two decades a considerable but varying part of the imbalance in the current account could be balanced with direct foreign investment, in the immediate past only a small portion of the deficit has been so covered. The strain on the country's reserves has increased and the *colon*, which had been maintained relatively stable over the years, had to be devalued.⁹

TABLE 4
DOLLAR VALUE OF COLON
(\$1 = colons)

<u>YEAR</u>	<u>VALUE</u>
1951-1972	5.635
1973	6.650
1974-1980 (Sept.)	8.570
1980-1981	11.300-35.800
1982	36.050-48.5 ^a

SOURCE: IMF, *International Financial Statistics*; and COUNSEL, *Repertorio Económico* (San José, 1982).

a. Figures as of 1 June 1982.

The devaluation of the *colon* was not a remedy adopted to redress the current account deficit, due to the inherent import-intensive industry structure, the slack of growth in regional income to encourage the export of manufactures, and the inelasticity of world demand for traditional exports, coupled with the decline in international market prices of some of them, such as sugar. Since the flow of direct foreign investment and other external capital was inadequate to meet the deficit on current accounts, debt financing

9. As of 1 June 1982.

began to play a more prominent role in paying the excess of imports over exports. As a result, the country's debt profile deteriorated fairly rapidly. Currently, it is estimated that the debt service alone amounts to approximately 25-30% of the exports of goods and services. This makes the external sector and the balance of payments a very weak and highly vulnerable aspect of Costa Rica's economy in general.

Costa Rica's flow of merchandise trade is governed by three market areas: the United States, industrial Western Europe (especially West Germany and Holland), and the CACM. The rela-

TABLE 5
COSTA RICA, DIRECTION OF TRADE

	<u>1963</u>	<u>1965</u>	<u>1970</u>	<u>1975</u>	<u>1980</u>
	(% of Total Exports)				
U.S.A.	56.0	51.1	41.2	35.8	34.7
Ind. W. Europe	32.6	26.3	21.4	20.6	27.7
Latin America	5.5	19.9	23.3	29.0	32.7
Out of which CACM	4.1	16.3	19.9	22.2	26.7
	(% of Total Imports)				
U.S.A.	59.5	39.9	34.8	34.3	35.5
Ind. W. Europe	28.6	28.2	23.0	16.9	12.8
Latin America	8.5	14.0	26.0	23.3	26.0
Out of which CACM	3.3	8.3	21.7	16.5	17.0

SOURCE: IMF, *Direction of Trade*, Yearbooks, several issues

tive importance of the first two has fallen consistently over the years. The United States has seen its share in both exports and imports dwindle from about two-thirds in 1963 to about 35% in 1980. Industrial Western Europe provides a market for about 28% of Costa Rica's exports but provides only 13% of its imports. The Latin American market has gained significantly in importance. When only 5.5% of Costa Rican products were destined to these markets in 1963, about one-third of total exports are shipped there today. A similar development is observed in imports. Within Latin America, CACM provides and also obtains the lion's share of the exports to

and imports from Latin America¹⁰. However, while exports to CACM have constituted 85.4%, 76.6% and 81.7% of Costa Rica's exports to Latin America in 1970, 1975 and 1980 the share of imports from the CACM have declined from 83.6% to 70.8% and 65.4%, respectively. Nevertheless, Costa Rica's trade with CACM has been deficitary on the whole since 1963, with the exception of small surpluses in 1965, 1977 and in 1980. Trade with the CACM has been the fastest growing area of Costa Rica's external trade.

V. EMPLOYMENT AND WAGES

Costa Rica has a relatively small labor force and a fairly low rate of unemployment. The size of the labor force was estimated to be 796,000 in 1981, and the participation rate only 34.5%. During the second half of the decade of the seventies employment grew faster than the labor force, reducing even further the pressure of unemployment especially until 1978 and 1979. The participation of women in the labor force has increased at a rapid pace.

The low rate of unemployment by no means implies that there is no slack in overall labor supply.¹¹ A substantial degree of underemployment is said to exist both in rural as well as urban areas.¹² Since agricultural wages are lower than industrial wages and there is more underemployment in agriculture than in industry, the agricultural sector can be expected to continue to serve as the net labor supplier to the secondary and tertiary industries.

The major problems are however, the differences between the sectors in terms of educational and skill profiles and the impediments these create for a smooth flow of labor from the primary to secondary and tertiary sectors. Nearly one-third of the industrial workers have secondary or even higher level education as compared with 7% in agriculture; 80% of the industrial workers are classified as skilled/semi-skilled, whereas in agriculture, the ratio is 12%.

The redeployment of labor from agriculture to industry will therefore require substantial training. Hence, Costa Rica's problem.

10. Costa Rica imports oil from Mexico and Venezuela.

11. The unemployment rate began to increase after 1980. It reached 8.8% in 1981 and is expected to increase further during 1982.

12. Victor Hugo Céspedes, Claudio Gonzalez, Ronulfo Jiménez y Eduardo Lizano, *Costa Rica: Una economía en crisis* (San José, 1981), págs. 115-16.

TABLE 6
LABOR FORCE, EMPLOYMENT, UNEMPLOYMENT

	<u>1963</u>	<u>1973</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
Labor Force (000)	408.1	584.9	688.5	726.7	753.3	768.1	796.0
Labor Force							
% of pop.	29.6	31.3	33.3	34.2	34.5	34.2	34.5
Employment (000)	379.9	542.2	656.8	693.3	716.4	722.8	726.7
% in public sector	13.3	15.3	17.6	18.7	18.5	19.7	19.6
% of labor force							
in urban areas	37.0	43.4	47.0	47.5	47.8	48.3	48.8
Open unemployment	6.9	7.3	4.6	4.6	4.9	5.9	8.8

SOURCE: Victor Hugo Céspedes, Claudio González, Ronulfo Jiménez, y Eduardo Lizano, *Costa Rica: Una economía en crisis* (San José, 1981), Tabla 49.

TABLE 7
SECTORIAL DISTRIBUTION OF EMPLOYMENT (%)

SECTORS	<u>1963</u>	<u>1973</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
Agriculture	49.7	38.2	33.6	30.3	28.7	27.4	27.8
Industry	11.7	12.9	15.8	15.2	16.3	16.3	15.6
Construction	5.5	6.9	6.4	7.4	7.4	7.8	6.8
Basic Services	4.8	5.5	5.5	6.1	5.7	6.6	5.7
Commerce	9.9	14.7	17.5	17.8	17.7	18.1	18.1
Other	18.4	21.8	21.8	23.2	23.9	23.8	26.0

SOURCE: Céspedes et al., *Costa Rica: Una economía en crisis*, Tabla 53.

in contrast to many LDC's, is not remedying open unemployment, but one of sectoral shift, redeployment and training. It is worth noting in this context that public sector employment has grown the fastest between 1976 to 1978 (12.4% per annum as opposed to 6.0% for the whole economy); but this tendency appears to have ceased in recent years. Under the circumstances, the disparities between the education of the entrants into the labor force and the skill demand by the economy acquires all the more importance. Consideration of educational priorities and the implementation of effective planning mechanisms, especially in the Ministry of Education are indispensable.

Wage levels are of special relevance, especially when viewed within the framework of Costa Rica's export drive and balance of payments situation. Wage levels, as such, are not terribly out of line in comparison to Costa Rica's competitors (Hong Kong, Singapore, Taiwan, etc.) and are lower than those prevailing in Mexico, Brazil, and some Latin American countries.¹³

Important, however, are the public policies relating to the determination of the wage rate and labor costs, that is to say, minimum wage legislation and the payroll taxes. Costa Rica's minimum wage legislation does not appear to exert a great deal of pressure on the wage rates, since the minimum wage rates are considered maxima rather than minima. The exception is banana cultivation. Even the manufacturing sector is relatively free of regulatory intrusion, for indices of manufacturing salaries over a long period of time appear to behave independently from the salaries set annually by the National Council of Salaries.

Social charges, however, are quite a different matter. Social security contributions and payroll taxes amount to 26% of wages and salaries and raise labor costs to the employer and consequently have a dampening effect on labor demand. In the long run, there is no doubt that they distort the relative factor prices, make labor expensive relative to capital, and lead to overcapitalization, hence to inefficiencies in terms of employment loss and import increases.

13. Within CACM however industrial wages were the highest in Costa Rica. According to IBRD (*Agricultural Survey of Costa Rica*) in 1974 the daily wage in Costa Rica was \$2.42, in El Salvador \$1.63, in Guatemala and Honduras \$1.99, and in Nicaragua \$2.16. Social charges were also highest in Costa Rica.

TABLE 8
STATUTORY PAYROLL TAX RATE AS
% OF WAGES AND SALARIES

Payroll Taxes	<u>26.00</u>	
Employer contributions		<u>18.50</u>
Social Security Adm. (sickness)		6.75
Social Security Adm. (disability, old age)		4.75
Social Assistance Inst.		0.50
National Apprenticeship Inst.		1.00
Community Development Bank		0.50
Family Assistance Program		5.00
Employee Contributions	<u>7.50</u>	
Social Security Adm. (sickness)		4.00
Social Security Adm. (disability)		2.50
Community Development Bank		1.00

On the other hand, social charges finance the health and social security systems which benefit the worker and thereby improve the equity in the system. The question becomes one of a trade-off between equity and efficiency, where inefficiencies in terms of employment loss themselves may have undesirable equity implications. The defence can be made of financing these services from a general tax, for example, income tax, which would maintain equity without distorting factor prices or sacrificing efficiency.

VI. LABOR PRODUCTIVITY

Productivity is the relationship between outputs of goods and services and the inputs of basic resources of labor, capital and land. The growth in the ratio of outputs to inputs is especially important to raise per capita output, since resources usually grow at a much slower rate than population. Moreover, productivity growth helps save scarce resources, mitigates inflation by offsetting resource price increases, and increases the international competitiveness of domestic production. Granted productivity changes alter the economic structure, cause the reallocation of resources and the displacement of labor and thereby raise policy issues as to how to deal with the costs related to the ensuing change. Yet, these usually are a small fraction of real output increases caused by productivity.

Increases in output per unit of input reflect not only the increased productive efficiency of one single input but also the changes in the amount and quality of the other inputs combined

with the one whose productivity is being assessed. Thus, the yield per acre may increase in agriculture because of more labor and/or capital per acre. Increased labor efficiency may also be due to the use of more capital goods per worker and to rates of utilization of fixed plant and to the improvements in the technology and organization of production.

The measurement of productivity is very complex. Both outputs and inputs need to be measured in physical terms. Moreover, a change in productivity proper is that part of the change which is not explained by changes in the inputs included in the output/input ratio. Efforts have been made to narrow this residual, nevertheless the defence can be made of the measurement of productivity and its change without adjusting the inputs for changes in quality and efficiency.¹⁴

Using an extremely simple device of calculating the ratio of value added (constant prices) by sectors to the number of employment in each sector, without adjusting for hours worked, shifts of production, quality and quantity of inputs or any other qualifying characteristics, it is found that in all sectors, but one, labor productivity increased between 1963 and 1973. Total labor productivity — GDP divided by total employment — grew at the compounded annual rate of 3.1%. Growth has been highest in industry and agriculture. The high rate of productivity growth in industry is attributable to the rapid formation of capital. Increased mechanization, acreage, and the implementation of advanced techniques, fertilizers, better seeds in agriculture, together with sustained labor emigration to the cities, have brought about the high rate of productivity growth in agriculture.

For Costa Rica's economy, as it was for many LDC's without oil resources, 1973 to 1974 was a crucial turning point as the impact of increased oil prices slowed down productivity growth. Over the 15-year span of 1963 to 1978, rates fell to 2.2% for overall labor productivity growth, and to 3.7% and 3.5% in agriculture and industry, respectively. The slow rate was especially pronounced from 1973 to 1978 when productivity declined in industry (-0.3%) and more so in the public sector (-4.2%). Overall labor productivity growth was no more than 0.6% during these five years.

14. Edward F. Denison, *Accounting for the United States Economic Growth, 1929-1969*, (Washington, D.C.: Brookings Institution, 1974).

TABLE 9
GROWTH OF LABOR PRODUCTIVITY
(Average Annual % Change)

<u>Sectors</u>	<u>1963-73</u>	<u>1963-78</u>	<u>1973-78</u>
Agriculture	4.9	3.7	1.4
Industry	5.5	3.5	-0.3
Construction	0.3	0.9	2.2
Utilities	4.4	3.5	2.1
Commerce	-2.8	-1.5	1.0
Public Sector ^a	0.8	-0.9	-4.2
TOTAL	3.1	2.2	0.6

SOURCE: Banco Central de Costa Rica, *Encuesta Nacional de Hogares, Empleo y Desempleo* (San José: Banco Central, 1979).

a. Includes personal and communal services.

The general tendency obviously has been one of declining productivity growth, which is but one of the factors contributing to the current inflation.

VII. THE PUBLIC FINANCES

Costa Rica's public finances can be characterized by the tax system which is of unitary elasticity with respect to output changes and by an expenditure system which places heavy emphasis on social services wherein transfers and subsidies play a not unimportant role.

Taxes constitute about 90% of overall government revenues, with taxes on income accounting for roughly 17-20% of total taxes, and taxes on domestic transactions about one-third. Taxes on international trade constitute about 25% of tax revenue. Over the years, taxes on income have come to play a relatively lesser role (20.7% in 1973 and 16.9% in 1979) in the tax structure, while that of social security taxes has almost doubled (14% in 1973 to 27.3% in 1979).

The growth in the country's economic activity has not resulted in a more than proportionate increase in overall tax revenue, which is indicative of the rigidity of the tax system resulting from the several exemptions recognized within the framework of development efforts, the liberalization of tariffs within the regional trade which accounts for close to 20% of Costa Rica's total merchandise imports, and from the statutory structure of the individual taxes as such.

Almost 80% of the Central government's budget is allocated to health, education and welfare. Defence is a negligible item. Education alone accounts for about 25%; social security and welfare programs account for another 25%. Economic services and subsidies also represent one-fourth of expenditures. These broad items have consistently been of similar magnitudes over the past several years, which reflects the social priorities attributed to them.

The distinction of expenditures by economic categories also shows a remarkable constancy. Throughout the last decade two-thirds of the current expenditures consisted of goods and services, 80% of which were wages and salaries. Interest payments were about 8% and the share of subsidies rose from 24% in 1973 to 27% in 1979, and capital expenditures relatively stable at 18-20% of total expenditures. Four fifths of the capital expenditures are for acquisition of fixed capital assets. The rest, transfers.

The current budget of the Central Government on the whole has had surpluses over the years, which were utilized to finance capital expenditures. However, since 1978, the current budget has also become deficitary at a galloping rate, and the deficit in the total budget has more than doubled from 1978 to 1980. As percent of total expenditures, the public deficit has varied from 13.9% to 41.7%, the latter being the deficit ratio reached in 1980.

TABLE 10
CENTRAL GOVERNMENT DEFICIT
(C million)

Year	Curr.Rev.	Curr Exp.	Surp./Def.	Cap.Exp	Surp./Def.
1973	1,590.8	1,565.5	25.3	407.2	-381.9
1974	2,321.9	1,994.0	327.9	568.1	-240.2
1975	2,913.0	2,748.0	165.0	593.4	-428.4
1976	3,522.2	3,500.0	22.0	1,080.8	-1,058.8
1977	4,297.6	4,160.7	136.9	1,035.0	-898.1
1978	5,647.7	5,987.6	-339.9	1,277.8	-1,617.7
1979	5,916.3	7,117.6	-1,201.3	1,581.6	-2,782.9
1980	5,258.3	6,747.3	-1,489.0	2,288.6	-3,771.6

SOURCE: IMF, *Government Finance Statistics Yearbook*, (Washington, D.C., 1981).

VIII. MONEY, PRICES, AND INFLATION

Costa Rica enjoyed relative price stability during the sixties and the first two years of the seventies. Consumer prices rose at the annual average rate of 2.3% during the sixties by 3.0% in 1971, and by 4.6% in 1972, but the inflationary pressure became acute in 1973 and 1974 when the index jumped by 15.3% and 30.0%, respectively. Although the increase subsided in 1975, it was still at a double digit rate of 17.4%. A sharp decline occurred in the rate of price increases from 1976 onwards; but as of 1979 inflation once again began to accelerate, and in 1981 it reached the annual rate of 37.0%.¹⁵

Contrary to the case of other Latin American countries, inflation in Costa Rica does not appear to be rooted in structural imbalances. No doubt, certain structural traits are found in the external sector which is vulnerable to volatile world price movements and in the industrial sector which heavily depends on imported materials and equipment. Nevertheless, the ownership or the perspective of capital formation cannot be said to be conducive to generate inflationary forces.

Three decisive factors determine the development of prices in Costa Rica. One is imported inflation. The country has been severely affected by the spectacular rise in the prices of industrial commodities, including oil. Both domestic prices and export prices have risen and added to the inflationary pressure. The second is the slow growth in agricultural output, as discussed earlier, on which Costa Rica heavily depends for its exports. The third is the persistent increase of liquidity in the system as a result of budget deficits - a large portion of which was and is monetized, of a liberalized domestic credit system, and of continuous increases in the supply of money.

Money supply increased at the fairly steady and reasonable average rate of 7.0% during the sixties, with the exception of 1967 when it climbed at the annual rate of 33.8%. Similarly, quasi-money - time and savings and foreign currency deposits - rose at the same rate. But from 1971 onwards monetary expansion accelerated at high double digit rates, frequently exceeding 24%. The acceleration

15. Calculated on December to December base the inflation rate reaches the level of 65% for the period of 1980 to 1981.

TABLE 11
CONSUMER PRICE INDEX
(1975 = 100)

Year	Index	Annual Increase (%)
1960	41.9	2.1
1965	46.5	
1970	52.7	2.6
1971	54.3	3.0
1972	56.8	4.6
1973	65.5	15.3
1974	85.2	30.0
1975	100.0	17.4
1976	103.5	3.5
1977	107.8	4.2
1978	114.3	6.0
1979	124.8	9.2
1980	147.4	18.1
1981	202.0	37.0

SOURCE: IMF, *International Financial Statistics, Supplement on Price Statistics* (Supplement Series No. 2), (Washington, D.C.: IMF, 1981); and IMF, *International Financial Statistics* 35, no. 4 (April 1982).

TABLE 12
MONEY SUPPLY AND DOMESTIC CREDIT
(Annual Rates of Increase, %)

Year	Money^a	Quasi-Money^b	Domestic Credit
1971	29.0	80.7	33.6
1972	14.1	32.2	16.2
1973	24.3	15.9	10.5
1974	19.2	66.5	50.6
1975	24.1	61.7	40.7
1976	30.3	48.1	22.3
1977	25.2	30.1	26.3
1978	24.0	30.2	29.2
1979	10.4	57.0	41.6
1980	17.1	15.4	24.2
1981.I	29.3	25.6	19.6
1981.II	24.7	43.4	16.0
1981.III	35.9	35.5	6.6

SOURCE: Computed from IMF, *International Financial Statistics Yearbook* (Washington, D.C.: IMF, 1980) and IFS 35, no. 4 (April 1982).

- a. Currency outside banks and demand deposits.
b. Time and savings and foreign currency deposits.

became especially acute in the third quarter of 1981 when both money supply and quasi-money expanded at 36% compared to the same period of the previous year.

IX. EQUITY AND EFFICIENCY: A FIRST GLANCE

1. INCOME DISTRIBUTION

Costa Rica compares fairly favorably with the rest of Latin America in the distribution of incomes, as well as in the formation of a middle class, a very important factor in the maintenance of socio-political stability. Although a significant improvement cannot be observed in the relative position of the families between 1961 and 1974, a fairly solid middle income group is nevertheless evident.

Unlike many LDCs, personal income distribution statistics and studies on intertemporal changes are available in Costa Rica. The data refer to 1961, 1971 and 1974. In the 13 years in between, those families that formed the 2nd, 3rd, and 4th quintiles increased their share in the incomes from 34.0% to 43.6%, while the share of the top decile declined from 44.0% to 35.8%. Thus, there has been a swelling in the middle income groups, but extreme poverty still exists as evidenced by the low share of the bottom decile.¹⁶

TABLE 13
INCOME DISTRIBUTION

Family Groups %	% of Income		
	1961	1971	1974
Bottom 20	6.0	5.4	4.6
2nd 20	7.8	9.3	8.9
3rd 20	9.8	13.7	13.7
4th 20	16.4	21.0	21.0
Top 20	60.0	50.6	51.8
Top 10	44.0	34.6	35.8
Top 5	35.0	22.8	22.1

SOURCE: Univ. of Costa Rica, *Encuesta sobre la distribución del ingreso* (San José: 1973), and ILO/Ministerio del Trabajo y Seguridad Social, *La distribución de los ingresos personales. La encuesta de los hogares de 1974*. (San José: 1978).

16. Universidad de Costa Rica, *Encuesta sobre la distribución del ingreso* (San José, 1973). A slight inequality increase is observable between 1971 and 1974. However income distribution studies are seldom strictly comparable; hence the discrepancies may very well be due to some definitional and statistical problems.

The swelling of the middle income groups has been at the expense of the top decile, for in 1974 the ratio of the share of the lowest incomes to that of the top decile continued to be about one-tenth, while the ratio of the share of middle incomes to that of the top decile rose from 57.0% to 85.0%.

Several factors are responsible for the heavy weight middle incomes have come to occupy in the overall distribution. First, the public employment and upward mobility opportunities created by the expansion of industrial activities. Second, there is sufficient evidence which suggests that industrial property is not concentrated in the hands of an oligarchic class, as seems to be the case in some Latin American countries. Thirdly, the land tenure pattern clearly indicates that middle size farms are of importance in the overall land distribution, which more often than not is not the norm in Latin America.¹⁷ Fourthly, industrialization has brought about a shift in occupational categories to the extent that middle level employees have increased in importance in the economic activities, that is to say from 15% in 1950 to 24% in 1971. Fifthly, the population growth rate has declined, and the decline has been more pronounced in middle income groups. Finally, it is indeed possible that middle income groups have been able to take greater advantage of the educational services provided than the lower income groups. This is quite plausible considering that the majority of the poor live in the rural areas, whereas superior educational services in terms of quantity and quality are likely to be provided to a greater extent in the relatively industrialized areas.

Despite limitations on the degree of equity achieved during the 10 years in question, the reduction in income disparities appears to

17. The percentage distribution of land holdings in Costa Rica remained stable during the period of 1955 to 1973 as observed from the following table.

Farm Size ha.	1955		1973	
	Farms	Surface	Farms	Surface
1-20	66.1	5.1	61.8	7.7
20-200	31.1	38.4	33.8	37.7
200-1000	2.4	21.5	3.9	29.4
1000 and more	0.4	29.7	0.5	25.2

Concentration ratio measured by Gini coefficient for both periods: are 0.752 and 0.758 respectively. See Manuel J. Carvajal, *Report on Income Distribution and Poverty in Costa Rica*. USAID/Rural Development Division. (Washington, D.C.: USAID, 1979).

be much more significant in Costa Rica than in most Latin American countries.

TABLE 14
INCOME DISPARITY COMPARISONS

	Income Share of Bottom 40%	Income Share of Top 20%	Gini Index
COSTA RICA	13.5	51.8	0.416
Argentina	16.6	50.9	0.437
Chile	13.0	55.8	0.506
Venezuela	8.2	65.4	0.622
Colombia	10.1	60.1	0.557
Brazil	9.2	61.5	0.574
Mexico	11.2	56.9	0.524
Panama	9.8	59.4	0.557
El Salvador	10.1	58.1	0.539
Ecuador	14.7	46.9	0.426

SOURCE: N.C. Kakwani, *Income Inequality and Poverty* (Washington, D.C.: IBRD, 1980).

2. INDUSTRIAL CONCENTRATION

Costa Rica's industrial structure is fairly highly concentrated, a few establishments generated the major share in employment and output. The tendency towards higher concentration has increased from the sixties to the seventies, and under present conditions it can tentatively be concluded that it is likely to increase in the future.

TABLE 15
EMPLOYMENT CONCENTRATION
(% of employment in establishments with)

	1 - 4 persons	5 - 9 persons	10 - 49 persons	50 or more persons	TOTAL
1963	31.9	11.9	28.3	27.9	100
1975	6.4	6.4	20.9	66.4	100

SOURCE: ECLA, *Statistical Yearbook for Latin America 1979* (Washington, D.C.: ECLA, 1979), Table 68.

TABLE 16

VALUE ADDED CONCENTRATION
% of value added in establishments with

	1 - 4 persons	5 - 9 persons	10 - 49 persons	50 or more persons	TOTAL
1963	12.01 ^a	9.1	28.8	50.1	100
1975	2.1	3.9	14.9	79.1	100

SOURCE: ECLA, *Statistical Yearbook for Latin America* (Washington, D.C.: ECLA, 1979), Table 68.

a. Including establishments without remunerated personnel not classified elsewhere.

From 1963 to 1975, there was a remarkable increase in both employment and value added concentration. In both areas there was a drastic decline in the importance of mainly small firms, while large firms became more prominent. Thus firms with 50 or more employees now dominated employment and output generation.

The industrial subsectors which generate the largest value added and employment are in fact dominated by one or two firms. But there is less evidence that the export sector is dominated by large firms. Medium-size firms tend to export a greater proportion of their production to the world markets, while larger firms' exports are concentrated in the regional market. On the whole, however, manufacturing and export activity are dominated by a few large firms, but with encouraging participation of medium-size firms.

As a result, Costa Rican production activities are characterized by oligopolistic tendencies, and the market is neutral to, if not biased against, the development of medium-size firms. Given the limited size of the domestic and regional markets, the policy should be to discourage oligopolistic practices, if competition is to be stimulated, efficiency increased, use made of existing excess capacity, prices reduced, and exports to world markets encouraged. Simultaneously, it is also necessary and imperative that encouragement be given to small firms, especially those involved in textiles, who are unable to capture markets and also face supply difficulties, so that they can, succeed in attracting foreign buyers.

The increase in industrial efficiency is all the more desirable when it is noted that industry earns less foreign exchange than agriculture, but its export earnings are far more stable than

agriculture. In addition, protected under the umbrella of import substitution policies, the foreign exchange demand of the import-intensive industry surpasses that of agriculture.¹⁸ Hence efforts to improve efficiency will have to be coupled with the orientation of its products towards exports. Volatile agricultural prices, on the one hand, rapid growth in industry's foreign exchange demand, on the other, are the prime causes responsible for the chronic balance of payments problems plaguing the country.

The import substitution policy of the past two decades is largely responsible for the foreign exchange crises as well as the inefficiencies in the market structure. Entrepreneurs have been encouraged to install excess capacity. Low interest rates have subsidized the purchase of capital goods; duty exemptions on imports of machinery and equipment, tax exemptions on reinvested profits, generous capital consumption allowances have in effect lowered the price of capital below its social opportunity cost. All this, coupled with high payroll charges, has distorted relative factor prices in favor of capital and has effectively reduced the demand for labor.

As a result, manufacturing has become capital intensive, manifesting itself today as excess capacity, that is, inefficiency. Manifestations of excess capacity can be found in the low intensity of utilization. About two-thirds of the industrial firms are reported to work one shift, 10% two shifts, and only about 20% three shifts.¹⁹ Obviously, in the presence of economies of scale, protected and limited domestic markets tend to develop oligopolistic structures.

The policies affecting the market mechanism are discussed in the subsequent part.

18. Well informed sources maintain that for every \$100 exported manufactured goods, \$80 worth of intermediary products must be imported.

19. Daniel M. Schydrowsky, *Capital Utilization, Growth and Employment*, Boston University Discussion Paper, No. 22 (Boston: Boston University, 1976).

PART TWO

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PART TWO

PUBLIC POLICIES FOR DEVELOPMENT

I. INTRODUCTION

Since the early sixties Costa Rica has pursued an inward looking economic policy with heavy emphasis on the development of import competitive industries, the expansion of regional trade, and assuring an equitable growth. The provision of physical infrastructure was a key element within this overall approach. Roads were constructed, for example, to increase mobility within the country and to reduce regional imbalances. Costa Rica leads in electricity generation in Central America and is outstanding in rural electrification. Potable water and sewerage services are available to the urban poor. Housing construction and development was encouraged and the *Instituto Nacional de Vivienda y Urbanismo* became a principal arm of the government.

Costa Rica has the lowest illiteracy rate in Central America: 16% as opposed to approximately 55% in the other countries of the isthmus. Public health services are far superior to those in many LDC's and the nutrition level is high. Efforts in land reform and settlement of poor families have reduced inequities to a large degree, especially in rural areas, although squatting has not been totally eliminated. In the labor field a minimum wage policy sets the levels category by category; differences between actual and decreed wages are not significant.¹

Accompanied by a significant industrial expansion in 1960 to 1970, these policies have been instrumental in enhancing an equitable growth in Costa Rica as is evidenced by the income distribution figures given in Part One of this study. But the improvement in

1. For details see P.W. Rourke, *Equitable Growth: The Case of Costa Rica* (Washington, D.C.: USAID, 1979), pp. 36-52.

equity, especially after the mid-seventies, has been at the expense of efficiency. That equity has been maintained or improved subsequent to 1975 cannot be sustained with hard data. But it is an apparent logical deduction from the fact that overall the government has not basically altered its policy towards redistribution and equity. The decline in efficiency, on the other hand, is evident from many changes in the economy.

In the first place, the rate of growth of labor productivity declined from the mid-seventies to the eighties. Growth in the overall economy slowed down appreciably and unemployment increased. Increased industrial concentration, overcapitalization and excess capacity all indicate that productive inefficiency has begun to characterize most Costa Rican operations.

An a priori case can be made that the government, through its policy of excessive spending, regulation, and protective measures, has in fact damaged efficiency. Supply imbalances exist; growth slowed down, and public policies have become ineffectual in eliminating the imbalances and encouraging a reasonable rate of growth. This part of the study analyzes and assesses four separate but interrelated areas of government action: trade and industrial policy; fiscal policy; credit policy, and public investment and management policy.

II. TRADE AND INDUSTRIAL POLICIES

1. TARIFFS

Tariffs have been the key instrument with which the import substitution policy has been implemented. For almost two decades, the tariff policy has applied a series of charges to imports from outside the region, and exempted from some or all charges imports of raw materials, intermediate inputs and capital equipment required for domestic manufacturing activity. The net result has been a high level of effective protection of the final goods, an overvalued exchange rate, encouragement of industries competing with imports, and discouragement of export activities.

There are four types of import charges:

- a). those specified in the Common External Tariff (CET) of the CACM;
- b). surcharges on the tariffs under the San José protocol of 1970;
- c). charges on selective consumption items;
- d). temporary import surcharges.

The CET was instituted right at the very inception of the CACM and consisted of ad valorem and specific duties. The San José protocol, signed at the time when CACM members were facing serious balance of payments difficulties, instituted a 30% surcharge on specific and ad valorem duties. The taxes on selective consumption items were introduced in 1972 and applied both to intra- and extra-regional trade. The rates were higher on the latter and frequently the difference margin rather high. Temporary import surcharges apply to 156 products imported from outside the region with rates ranging from 10% to 50%.

The duties administered in a cascading fashion, cause a hidden but important element of protectionism. It is estimated, for example, that tariffs on manufactured imports nominally amount to 106%.

2. EXEMPTIONS

Based on the infant industry argument of protectionism, CACM countries, exempt from duties imports of raw materials, intermediate inputs and capital goods from outside the region of the integrated market. In addition, the Common Market Agreement provides income tax exemptions and deductions for certain types of capital expenditures.

The principal beneficiaries under the Agreement are:

- a) Group I — Producers of industrial raw materials, capital goods, and producer goods or semi-manufactured products whose output is destined to the CACM members. Installed capacity must be at least 50% of the regional demand.
- b) Group II — Producers of consumer goods who generate significant foreign exchange benefits and have a high domestic value added content.
- c) Group III — Packing, canning, and mixing industries and those that are specially listed in the Agreement.

The exemptions from customs vary from 50% to 100% and are granted for 3 - 10 years depending upon the classification of the industries as new or existing and into which Group they fall. Group I enjoys a 100% exemption on imports of raw materials, fuels and lubricants and semi-manufactured products for 3 - 5 years and a 50% exemption for an additional period of 5 years. Group II enjoys a 50% exemption for 5 years. Both groups are exempt from income taxes, the first for 8 years, and the second for 6 years. They are also

100% exempt from the tax on net worth for periods ranging from 4 to 10 years depending upon whether the industry is new or already in existence when exemption was granted.

According to the law the exemptions are supposed to cease at the end of the prescribed periods. But extensions have become the rule rather than the exception, and hardly any extension request has been denied. The net result of the tariffs, combined with exemptions, has been a revenue loss for the fisc on the one hand, and a strong effective protection for manufacturing industries, on the other.

3. EXPORT INCENTIVES

There are three distinct types of export incentives:

- a). *Certificados de Abono Tributario (CAT)*,
- b). *Certificados de Incremento de las Exportaciones (CIEX)*,
- c). Duty-free import provisions (drawbacks).

The CATs were instituted in 1973 and are awarded to firms exporting non-traditional exports to countries outside the CACM. They provide a tax credit of 15% of the f.o.b. value of the exports and are negotiable in the open market. The CAT awards have grown substantially. During the decade of the seventies they increased 50-fold, a sign of the Treasury's premium to inefficiency and an indicator of artificially sustained exports.

The CIEX system of export incentive is of much less importance. It is a scheme which provides a tax credit to those firms that increase their exports from one year to the next. This is a new provision, and therefore it is too early to evaluate.

The drawback scheme provides import duty exemptions to those firms using imported inputs in the products they export. It applies to intermediate inputs as well as to capital equipment. The system is very complicated and cumbersome, and considered to be ineffective.

A further export promotion policy is that of financial incentives which take the form of cheap credits to a variety of productive activities. The mechanism to implement the incentives is extremely complicated and involved, differentiating the interest rates according to sub-sectors, size of loans, firm size etc. The policy has led to unnecessary accumulation of fixed capital and high leveraging in firms' financial structures, without particularly promoting exports.

Side by side with export promotion policies, which are ineffective and misleading, the Government of Costa Rica levies *export duties* which are clear cut disincentives. Major traditional exports are levied at the highest rate (9.25% on coffee and 18% on sugar, for example). All other exports pay 1%. The original purpose of the duties was to secure revenue to the government, however, it is rather uneconomical to suggest that a levy on Costa Rican exports would augment the foreign exchange earnings of the country.

It is very difficult to calculate the effective protective rates and pinpoint with exactness the pro or the antibiases embedded in the system. However, certain conclusions can be drawn.

- a). Overall, the effective tariff rates are very high. Estimates vary from 164% (Brookings) to 101.4% (SIECA), but they indicate that Costa Rica has the highest effective rate in the region.²
- b). If the effective rates of protection of the domestic industry are combined with the effective rates of subsidy for exports, an anti-export bias appears against especially efficient firms.
- c). The incentives for industrial development clearly favor import substitution activities to the detriment of the ability to take advantage of export opportunities.

4. EXCHANGE RATE POLICIES

Many economists view exchange rates as a more effective policy instrument in promoting exports. Such a view has been consistently disregarded in Costa Rica and the use of subsidies has been preferred, with far from satisfactory results. Costa Rica so far has not implemented an exchange rate policy with the specific objective of promoting exports. Its history of exchange rates, devaluations and multiple vs. single exchange rates clearly shows that the measures were not taken with the intention of expanding exports.

2. W.R. Cline and E. Delgado, *Economic Integration in Central America* (Washington, D.C.: Brookings Institution, 1978,) pp. 702-703; and SIECA, *Anteproyecto del sistema tarifario uniforme* (Guatemala, 1978).

Costa Rica has experimented several times with multiple exchange rates: 1960 to 1961, 1967 to 1969, 1971 to 1973 and once again since 1980. During these periods exports were consistently granted the less favorable lower official rate, which assisted the substitution of imports to the detriment of exports. When the devaluations took place, the Common Market partners brought pressure on Costa Rica to recognize the official rate of exchange for its imports from the CACM. Granted Costa Rica's membership in the CACM imposes certain rigidities on its exchange rate policies, nevertheless, all other policies failing, Costa Rica had no other recourse but to reckon with the liberalization of exchange rates.

The disparities between the official rates of exchange and the "various" free market rates took a dramatic turn during the period of 1979 to 1981. Until September 1980, the monetary authorities sought to maintain an artificially low exchange rate through external borrowing and use of reserves, while the free market was already beginning to climb from the 65.74 per US\$ which prevailed in 1978 and 1979 (versus 8.60 official rate) to 9.01 in July 1980, 14.43 in December 1980, 17.29 March 1981 to a high of 37.79 by December 1980 when the official rate was finally devalued to 20 per US\$. Throughout this period the actions of the monetary and other governmental (including the Legislature) authorities can be interpreted as basically motivated by internal (to Costa Rica) considerations on prices and inflation and the country's ability to repay its foreign debt, rather than to the need to create new exports.

It is of importance not to examine exchange rates in a vacuum, but to place them within the proper context of local costs and price movements. This is, because in a country like Costa Rica, where the inflation rate is faster than the trading partners, the fixed or official exchange rates create further havoc on exports. If prices rise more rapidly in the exporting country — as was the case in Costa Rica — exporters find to their dismay that costs are rising and that they are losing their traditional markets. They can remain in business, as it were, if their nominal earnings increase when the value of the national currency is reduced vis-a-vis the strong currencies or the dollar.

Costa Rica's case was totally contrary to this premise. The three devaluations between 1961 and 1979 were far from being policies to adjust the national currency vis-a-vis the dollar in order to help exports which were losing ground because of inflationary pressures in the economy; rather they stemmed from the inten-

tions, explicit or implicit, to curtail imports. As a result, while exports did not benefit from the meager exchange rate policy, further distortions were injected into the system.

The conclusion to be drawn from the discussion of the foreign trade and exchange rate policies is that they have slowly, but surely, distorted the market; overcapitalization imbalanced the relative factor prices and stifled exports. The economy became inefficient. It is very difficult, if not impossible, to derive the equity implications of these policies. One can only suggest in passing that in every likelihood consumer welfare declined due to the higher market prices and to the possibly lower quality of consumer goods.³

III. FISCAL POLICY

The public sector has played in the past and continues today to play an important role in Costa Rica's development process. Public expenditures have been a determining factor in shaping the country's physical infrastructure and human capital formation. This is accepted almost axiomatically by all, but should not lead one to sustain unequivocally that the budget is necessarily conducive to equity and efficiency. To assess both requires a careful scrutiny of taxes and public expenditures.

The following discussion refers to the overall equity and efficiency implications of the two sides of the budget, but exclude considerations of the efficiency in fiscal administration as such or the cost effectiveness of each government outlay.

I. TAXES

About fifteen years ago the tax structure characteristics of the LDCs could have been expressed by the blanket statement that indirect taxes constitute the major portion of their total tax revenue, indirect taxes referring to taxes on foreign trade, domestic

3. Economic literature is abundant in assessing the costs (national income foregone and use of scarce resources) and benefits (saving of scarce foreign exchange and development benefits of industrialization) of protected industrialization. See for example, F. Andic, S. Andic, and D. Dosser, *A Theory of Economic Integration for Developing Countries* (London: Allen & Unwin, 1971); B. Balassa, et al., *The Structure of Protection in Developing Countries* (Baltimore: Johns Hopkins University Press, 1971); and J. B. Nugent, *Economic Integration in Central America* (Baltimore: Johns Hopkins University Press, 1974), for merely three entries.

production and internal transactions. Yet after two "development decades" the ratios of taxes to domestic product are basically still as low as they were 20 years ago. The average ratio now stands at 15%; direct taxes are between 2-3%, and indirect taxes 12-13%. Indirect taxes continue to weigh heavily within the overall tax collection.⁴

TABLE 17
SHARES OF TAX REVENUE

(Selected years)

	1971	1972	1975	1980
Total Taxes/GDP	12.1	12.0	13.2	12.0
Direct Taxes/GDP	1.4	3.0	3.0	2.8
Indirect Taxes/GDP	9.4	9.0	10.2	8.8
Direct Taxes/Tot.T	24.1	25.1	22.9	24.3
Indirect Taxes/Tot.T	75.7	74.9	77.1	73.0

SOURCE: Banco Central de Costa Rica.

Costa Rica is no exception to this rule. The ratio of total taxes to output continued to be around 15% and the ratio of direct taxes only 3%.⁵

Costa Rica reformed its archaic taxes in early 1972 when changes were made in the general sales tax, the selective consumption taxes, as well as in taxes on income. The general sales tax now distinguished between essential and non-essential goods. A general rate of 5% was established and supplementary rates of 10 - 50% were added. Although the income tax was made progressive, larger deductions were allowed. Taxes on profits were also made progressive.

4. For details see F. Andic and S. Andic, "Public Finance, Development and the Third World," in *Secular Trends of the Public Sector*, ed., H.C. Recktenwald, (Paris: Editions Cujas, 1978), pp. 34ff.

5. If export taxes were included, this ratio would increase to a little over 5%. Whether or not export taxes are in fact direct taxes is a controversy not resolved in the literature.

TABLE 18

IMPORTANCE OF TAX REVENUES
(Selected years)

	1971	1972	1975	1980
Total Taxes/GDP	11.6	13.6	20.1	12.0
Direct Taxes/GDP ^a	2.3	2.7	2.7	2.9
Indirect Taxes/GDP ^b	8.9	8.6	8.6	8.8
Direct Taxes/Total Rev.	23.0	19.9	16.1	24.0
Indirect Taxes/Total Rev.	77.0	63.1	59.2	73.3

SOURCE: Banco Central de Costa Rica.

a. Taxes on income, profits, capital gains.

b. Taxes on domestic consumption and Int'l trade.

The system was reformed once again in June 1976. The corporate income tax rate was raised, a 3% tax on net assets of bearer shares of corporations was introduced, and sales of real estate values above C 2,000,000 were subjected to a progressive tax of 1-4%. The almost exclusive purpose of the reform was to increase current resources for higher education. Although the resulting revenue increase was totally earmarked for this expenditure item, the reform law also earmarked additionally 30% of the proceeds of the income tax to higher education. It is worth noting in passim that earmarking creates a certain amount of rigidity in expenditures and tends to decrease public sector savings.

One very striking element in Costa Rica's tax structure is the higher yield consumption taxes produce for the fisc. This is partly due to inflation and partly to rate increases. Direct taxes, on the other hand, never really gained any significant importance. The reaction of the overall tax system to economic growth is basically neutral. The tax elasticity has been unitary, because of preferential exemptions to a variety of activities and of the specific nature of some of the indirect taxes.

The distributive effects of the tax system (as well as those of the public expenditures) can fortunately be quantified thanks to an incidence study carried out using the 1974 income distribution

data.⁶ The study reveals that both taxes and expenditure change the distribution towards more equity, public expenditure being more effective than taxes.

TABLE 19
INCIDENCE OF THE BUDGET

INCOME GROUPS ^a	TAXES	EXPENDITURES
Low	27.0	56.0
Middle	41.0	27.0
High	32.0	10.0

SOURCE: Banco Central de Costa Rica.

a. Low: 52.3%, Middle: 39.2%, High: 8.4% of families.

The data indicate that while low income groups were paying 27% of taxes, they were receiving 56% of public expenditure benefits. On the other hand high income groups were paying 35% of taxes but receiving 16% of public expenditure benefits.

From the point of view of the efficient allocation of resources the picture may be altogether different. In this context it should be kept in mind that exemptions, though part of the tax system, can be considered as tax expenditures. The immediately preceding sections have already discussed the resource misallocation such exemptions give rise to. Let us now look at the allocative effect of particular taxes.

It is generally recognized that allocative efficiency is better served when the consumption of goods to be discouraged are taxed, irrespective of national origin. To begin with, import substitution policies do not adhere to this premise. Moreover, higher taxes on imported goods — import duties combined with sales taxes — no doubt add to the pressure towards inefficient import substitution exerted through the tariff and the exemption system.

Low tariffs, exemptions, overvalued exchange rates, and relatively easy financing terms have led the economy to over-

6. ECLA/Ministerio de Hacienda de Costa Rica. *Incidenca fiscal y distribución del ingreso en Costa Rica* (San José: Ministerio de Hacienda, 1977).

capitalization. The income tax system is far from remedying the situation. Rather, the incentives the system contains, as such, favor capital intensive technology. Although, as judged by statutory rates, business taxes appear to be fairly high, a series of measures in fact reduce their effectiveness to minimal levels.

This is not a phenomenon peculiar to Costa Rica alone. Studies on many other countries have shown that the formulation of tax policy has paid very little attention to the kind of capital investment fostered or to the proportions in which it is combined with other inputs. As a result, the tax policies of many LDCs have widened rather than narrowed the divergence between actual and shadow factor prices, making capital less and labor more expensive.⁷

A policy of this nature may not have had appreciable effects on the Costa Rican economy simply because open unemployment was not a major problem, since in the final analysis the public sector absorbed much of the unemployed, and underemployment is always conjectural. However, since the tax system as such appears to be conducive to misallocating the resources between the sectors and in determining the capital-labor ratios utilized, a close look into the system becomes imperative.

2. EXPENDITURES

Public administration in Costa Rica is separated into three levels: The Central Government, the Municipal Governments, and the autonomous agencies.

a). *The Central Government*

The main source of Central Government revenue are the taxes (about 95%). However, with a substantial share of the revenues earmarked for specific outlays, a high and rapidly increasing proportion of public current revenues does not accrue to the Central Government. For example, virtually all the proceeds of excise taxes are earmarked to local governments and autonomous agencies, and over one-third of all direct tax revenue is earmarked for higher education.

7. See R. Bird, *Taxation and Development* (Cambridge: Harvard University Press, 1970), pp 126-27; and S. Andic, *Some Aspects of Taxation in Less Developed Countries* (Baden Baden: Nomosverlag, 1982), pp 44-45.

The natural outcome of this procedure is first the limitation of the role the Central Government budget plays as fiscal policy instrument, especially from the efficiency standpoint. Secondly, it reduces the possibility of public savings. Thirdly, it tends to increase bureaucracy and inflate the public sector. The enormous increase in current expenditures (basically wages and salaries) should, therefore, come as no surprise. In 1971, for example, the Central Government employed 34,900 persons, while in 1975 the figure stood at 45,300. In 1981 it was 63,900. Productivity, as discussed earlier, declined. This was a natural outcome of the rapid expansion of the government's hiring an increasing number of civil servants to accommodate the growth in the provision of social services. The public sector may have increasingly become an employer of last resort for university students who are unable to find jobs in the private sector.

TABLE 20

CENTRAL GOVERNMENT EXPENDITURES (%)

	1971	1975	1980
Current Expenditures	76.2	80.8	76.5
Wages & Salaries	44.4	43.5	45.4
Goods & Services	6.5	8.2	3.9
Interest	7.8	6.5	10.2
Transfers to Pub.Sec.	10.6	14.9	27.4
Transfers to Private Sec.	6.9	7.7	27.4
Capital Expenditures	28.8	19.2	23.4
Fixed Cap. Formation	16.6	14.1	13.7
Other Cap. exp.	7.2	5.1	9.7

SOURCE: Banco Central de Costa Rica.

The functional distribution of central government expenditure has been undergoing some significant changes. While expenditures on social and community services have been basically increasing their shares, economic services and the gross debt service have been declining.

It would not be wrong to state that the Central Government has been quite successful in promoting equity. The increase in social services is a case in point. Moreover, acting as the employer of last resort, it further enhances equity by reducing unemployment. As

will be seen subsequently, other government agencies have also contributed to equity. That government expenditures are the prime movers of equity is a fairly common phenomenon among the LDCs.⁸

Efficiency, however, is likely to have suffered both within and without the public sector. Growing public employment and declining productivity indicate that the Central Government is not cost effective. Moreover, there is a strong need to control the hiring of school teachers and allow a reallocation of resources to other sectors, such as agriculture. This strongly suggests that the Central Government's budget tends to misallocate human resources, hence creates inefficiencies.

b). *Municipal Governments*

Municipalities in Costa Rica have been losing very rapidly their relative importance as a result of the expansion of nation-wide utilities, autonomous agencies, and the family assistance program. The revenue sources of the municipal governments are limited. Real estate taxes and fees constitute the bulk. Since they are of negligible importance within the overall economy they will not be discussed further. This does not mean, however, that local taxes and expenditure decisions have no implications for equity and efficiency within and without the boundaries of the municipalities.

c). *Autonomous Agencies*

i. The *Family Assistance Program* initiated in 1974 was designed to improve the living conditions of the poorest 20% of the population in rural areas. The emphasis is on health, nutrition, rural housing and land settlements, education and training and also on providing direct cash benefits.

The program operates in a very *sui generis* manner. The operation of all sub-programs is entrusted to established public entities, such as various ministries and the Social Security Administration. The program derives its revenues from earmarked taxes and payroll taxes.

The program definitely has an important equity impact. It is estimated, for example, that as a result 1.4% of the GDP was

8. See, for example, F. Andic, "Poverty and Tax Incidence in Malaysia," *Public Finance Quarterly* 5, no.3 (1977). This is also a prime finding in R. Bird and Luc de Wulf, "Taxation and Income Distribution in Latin America," *IMF Staff Papers* 20, no.3 (1979).

transferred from other segments to the lowest 20%. The efficiency implication of the program lies in its financing by payroll taxes which tend to increase the price of labor and lead to further capitalization. This is not desirable within the context of the Costa Rican economy.

ii. *The Social Security Fund (CCSS)* is the most important autonomous entity in Costa Rica. CCSS has been increasing its coverage and today includes independent workers. In the early sixties it covered about 30% of the workers; today the coverage reaches approximately 80%. The bulk of the Fund's income is derived from payroll contributions with which it finances two programs: the health and maternity insurance program and the old age and disability program. The former has been almost always deficitary, while the latter yields substantial savings. The deficit in the health program is basically attributed to the Central Government's failure to make its full contribution.

Undoubtedly, a wide coverage of social security benefits helps to enhance equity. Several aspects must be considered in judging its efficiency implications. First of all, the old-age and disability program is currently generating considerable savings (55% of all non-financial savings), but this saving is not fully utilized for the internal capital formation of the country. This may not be considered totally healthy, especially since the country still relies on external financing. Secondly, to the extent that the population grows older, the demand on old age pension funds will also grow. This could lead to an overall squeeze of government finances.

iii. *Higher Learning Institutions.* There are basically three higher learning institutions in Costa Rica:⁹ The University of Costa Rica, the National University, and the Technological Institute. These institutions have expanded rapidly during the mid and late seventies as a result of the intended expansions in secondary education. Higher education is almost totally financed out of the general budget. In the mid seventies, the current transfer to the two universities amounted to ₡167 million or 7.5% of the revenues of the Central Government.

9. There are also some private higher learning institutions and remedial schools.

Again, from the efficiency and equity points of view several points can be made. *Prima facie*, one can conceive of free (or negligible tuition) education as enhancing equity, especially since the bulk of the students receive scholarships. However, a close scrutiny indicates that high income family students also benefit from the scholarships and pay very low tuition. Seventy percent of the students with scholarships were members of families in the top 40% of the income scale. Hence, by however small a degree it may be, the general budget is subsidizing the rich, leading to a loss in equity which the government tries so hard to maintain. It is also common knowledge that many of the graduates are unable to find jobs in the private sector, and it is the public sector that ends up employing them, whether their services are needed or not. This is not an efficient utilization of human resources. Several ways of avoiding the inefficiency may be devised. One would be restructuring the fees and putting an end to the indirect subsidization of the rich. Another would be trimming down the educational expansion to size; a third would be to design the education program in conformity with the skill demands of the various economic sectors.

iv. *The Costa Rican Electricity Institute (ICE)* is responsible for the electrification of the country, as well as for its telecommunications system. ICE's capital expansion programs were not solely financed from the public budget, but relied considerably on external loans. ICE also relies on user fees.

v. *The National Production Council (CNP)* is responsible for the execution of price stabilization and agricultural promotion policies through market interventions. It also operates a national liquor factory. The Council's budget has always been deficitary. Part of this deficit is covered from the profits from the liquor monopoly and part from the profits of the state oil refinery. The remainder has been met by the Central Bank.

It has been argued that erroneous pricing policies coupled with mismanagement are responsible for the Council's large deficit. Although agricultural price supports could be considered as contributing to the overall equity in the country, the practice whereby its deficit can be financed by the government via the Central Bank, where the Council is authorized to make unlimited drawings, certainly leads to serious misallocation of the public sector resources. This is not an efficient way to run any autonomous agency.

vi. *Corporación Costarricense de Desarrollo* (CODESA) is a public investment agency involved in major productive investments in the areas such as cement, alcohol, aluminium and transport. The operations are mostly financed directly by the Central Bank and the *Corporación's* deficit represents about 15% of the public sector deficit. The enterprises initiated by CODESA were originally intended to be sold to the private sector in due course. However this intent has never materialized.

vii. *Refinadora Costarricense de Petróleo* (RECOPE) is the government owned refinery with exclusive rights to import, refine and distribute oil. In the past, RECOPE generated important financial surpluses through higher than international prices which were transferred to the public sector. The present operations however are deficitary, and responsible for 25% of the public deficit.

viii. The National Water and Sewerage Service (ICAA), FECOSA and JAPDEVA are three other autonomous institutions worthy of mention: The latter two are responsible for the railways and the ports. The railways are chronically deficitary, while the ports make some profit. The sewerage service also runs at deficit, which, as usual, is covered from the budget of the Central Government. The institution is beleaguered by managerial problems, as well as by the inadequacy of rates and tariffs.

As in most LDCs, Costa Rica's autonomous agencies are deficitary; they are employment padded and inefficient. They are of paramount importance in terms of resource and investment allocation, but under these circumstances cause misallocations. If the original intent of generating growth with equity is to succeed, these agencies must be reorganized into efficient entities. Otherwise, in the final analysis, it will be equity that will suffer.

On the whole, therefore, earmarking on the one hand, budgetary deficits on the other, inefficiently operating autonomous agencies on the third, combined with overemployment in the public sector spell out a poor performance for the Costa Rican Government.

IV. CREDIT POLICY

Credit and monetary policies in Costa Rica basically accommodate the fiscal deficit. In the early sixties, fairly restrictive credit policies were followed due to balance of payments difficulties. As of

TABLE 21**PUBLIC SECTOR PERFORMANCE**

(% of GDP)

	1965-70	1976-80
Tax Revenue	14.8	8.1
of which Central gov't	(11.4)	(12.9)
Public Savings	2.4	3.6
of which Central gov't	(-0.1)	(1.1)
Capital Revenues	1.1	0.4
Capital Expenditures	5.8	8.0
Overall Deficit	-2.3	-4.0

SOURCE: Banco Central de Costa Rica.

1970, the measures were relaxed when the ceilings on certain loans were raised, and agricultural and manufacturing credit, and to a certain extent livestock credits, rose fairly rapidly. During that year credit expanded by 11.3% and money supply grew by 11%. The increase in the money supply originated mainly from internal sources. More liberal bank credits led to pressure on existing real sources which the increase in domestic supply was unable to offset.

From the early seventies until today the Costa Rican Government has followed, by and large, an expansionist policy. Faced with the dilemma of forestalling the creation of excessive liquidity or of maintaining the level of financial support, the monetary authorities opted for the latter. By and large, more than two-thirds of the credit expansion in the mid-seventies was the result of the increase in loans which the banking system granted to the private sector. During the latter part of the decade these proportions were reserved.

Although the absolute magnitude of the credit to the public sector was less important than that to the private sector, the rate of growth of the former was much faster. During the years 1977 to 1979, the Central Bank credit to the public sector increased at an annual rate of 28%. Since the rate of interest on time deposits was 5 percentage points higher than that of government bonds, the demand for government bonds declined. On the other hand, having approached close to the legal limits set on public borrowing, the government had no other recourse than to seek finance from the banking system.

The excess demand for the credit on the one hand, the inefficiencies and distortions created by the long established norm of maintaining savings and lending rates at low levels, on the other, finally forced the government to undertake a major reform in 1978. The interest rates were raised and the lending rates of the financial institutions were liberalized (LIBOR plus a correction factor). The immediate effect of these policies was positive in that time deposits increased. But inflationary expectations and devaluations caused the positive effect to be of short duration. In addition, uniformity could not be maintained in the structure of the lending rates. Several subsidized credit lines began to operate.

From the point of view of resource allocation several perverse results ensued. There are two major financial institution groups in Costa Rica: Commercial banks (nationalized) and *Financieras* (private). The lending base for the former are demand and savings deposits, and for the latter time deposits. The change in the interest rates was such that the deposits in the *Financieras* increased and the commercial banks starved, and yet, subsidized credits were supposed to be financed through commercial banks. On the one hand, the demand for subsidized credit increased, as might be expected, on the other the lending sources of the commercial banks declined. This was the first distortion.

The second distortion came as a result of increased delinquency rates. Since farmers feared that a new credit had to be financed with higher rates, they became very lax in repaying their debt. In the final analysis the government agreed to extend credit to the farmers at the 8% rate of interest, who in turn (at least some of them) deposited the sums in higher yielding time deposits. Pressure mounted from other sub-sectors for the recognition of preferential credit to them as well.

The credits did not really go to where they were destined. While some sectors starved for credit, others had an abundance of it. All in all, the policy led to the misallocation of resources, thus decreasing the efficiency in the economy.

V. PUBLIC INVESTMENT AND INVESTMENT MANAGEMENT

Public sector investment performance is one sure way of assessing the public policy strategies towards economic development. In Costa Rica the strategy has been to provide the necessary

economic infrastructure in order to facilitate the rapid increase of private investment on the one hand, and to provide the social infrastructure of the social welfare services, on the other.

Public investment increased quite rapidly over the past years, from 4.4% of the GDP in 1967 to 7.5% in 1981. A large portion of this investment (63% in the period 1967 to 1970 and 56.1% in 1975 to 1978 and 71.2% in 1979) was for infrastructure and the rest for social services and productive sectors. It is interesting to note that prior to the creation of CODESA (1974) investment for industrial activities represented less than 2% of total public investment and thereafter this share has always been above 10%. Public investment in the agricultural sector on the other hand has fluctuated rather widely within the range of 1 to 16%.

Undoubtedly basic investments in infrastructure not only contributed to economic development in terms of communications, transportation and market integration, but at the same time enhanced equity, be it indirectly, by rural electrification and other basic entities and by allowing higher labor mobility.

On the other hand several criticisms have been made of the public sector investment. It is generally recognized that maintenance is rather poor, hence efficiency declines rather rapidly. In more cases than not economic criteria have been subservient to technical criteria. Technically well designed projects are seldom subjected to cost-efficiency considerations. CODESA for example has never been profitable. A gasohol production facility (CATSA) which is technically a most modern one (purchased from Brazil) is economically a losing proposition since it cannot utilize more than 25% of its capacity, a limitation imposed by the cane production in the country.

VI. COSTA RICA AND THE CENTRAL AMERICAN COMMON MARKET

The implications of the economic policies implemented by the Costa Rican government cannot be fully assessed unless such policies are related to the overall policies of the Central American Common Market (CACM) of which Costa Rica is a member.

CACM is the culmination of sustained efforts involving a series of treaty negotiations beginning in the fifties. The first integration agreement — the Multilateral Free Trade Treaty — was signed in

1958. This was replaced in 1960 by the General Treaty (also known as the Managua Treaty) which created the CACM. Guatemala, El Salvador, and Nicaragua signed the Treaty in 1960, Honduras in 1961, and Costa Rica in 1963.

The overall objective of CACM was to bring about a vigorous change in the traditional structure of the member countries. This called for accelerated economic and social progress, sustained and balanced economic growth, modernization of the economic and social structure, improvement in standards of living, and strengthening the economic ties with a world which tends more and more towards the formation of blocs of continental dimensions.

From its inception CACM, therefore, placed great stress on the development of regional and domestic industries protected from the competitive external world, that is to say, on the creation of import-competing industries. The instruments originated in the establishment of a free trade area among the signatories of the Managua Treaty, with a common external tariff vis-a-vis the rest of the world, a mechanism for tax incentives and harmonization (which is as yet to be implemented), a regional development bank, Central American Bank for Economic Integration (CABED), and a Central American Clearing House.¹⁰ The main purpose was to increase the size of the national markets and assure the free movement of goods among members.

Costa Rica's industrial and trade development policy has been in accordance with the general aims of CACM. Rather than committing itself to an import substitution effort limited to the small national market, it embarked on a regional industrialization drive protected by the tariffs and investment incentives of the common market.

Measured by its impact on industrial growth, CACM's import substitution strategy succeeded. But, given the present conditions in the region, the strategy's potential for further growth is limited. The success of the industrial performance will require a new emphasis on exports to non-CACM countries.

Costa Rica's initial success with the regional import substitution strategy is reflected in the trends in its industrial production

10. For a chronology of economic integration in Central America see Miguel S. Wionczek, ed., *Economic Cooperation in Latin America, Africa, and Asia: A Handbook of Documents* (Cambridge: MIT Press, 1969).

and regional exports. Net industrial value added, increased from \$67.7 million in 1960 to \$85.3 million in 1963, the year Costa Rica joined the bloc. By 1968, value added had reached \$135 million, which represented an annual average growth of 9% between 1960 and 1968. Rapid industrial growth continued until 1978, at a 7.4% annual rate between 1969 and 1973, and 1978. By 1978, industrial value added had soared to \$370 million (in 1970 prices).

Industrial exports, particularly those to the regional market, expanded in a similar fashion during these years. In 1960 they amounted to \$2.4 million, almost all of which went to neighboring countries. By 1968, exports to the CACM had grown to \$33.6 million, representing an annual growth rate of 39%, granted measured from a small base. The annual growth in regional exports averaged 15% between 1968 and 1973, 17% between 1973 and 1979, but jumped to 48% in 1980, because of political developments in Nicaragua.

Until very recently, industrial development of Costa Rica had depended almost exclusively on the domestic and regional markets. Only 7% of industrial exports was directed towards countries outside the common market in 1968. There was a gradual change from then onwards, for by 1973 industrial exports outside the region had risen to 10%, and in 1978 they were 16%.

However, the limitations of an import substitution policy, despite the increase in size of the common market, became increasingly evident in the last few years. Industrial value added increased annually by only 1.1% from 1978 to 1981, and in 1981 industrial output actually declined. Simultaneously exports to the CACM declined by 11.9%.

Both short- and long-term factors have contributed to this sudden reversal in industrial performance. Among the short-term problems are the political and economic crises in Costa Rica. However, several long-term factors have become increasingly important. Particularly significant is the saturation of the more obvious import substitution opportunities. Most consumer products and many intermediate goods are now produced in Costa Rica and/or the region. Remaining opportunities for the production of capital or intermediate goods would not be economically viable, even with government support, because of the capital investment requirement and the limited size of the regional market.

As both governments and industrialists began to realize the limits of the CACM, increasing attention was given to exports to non-CACM countries. Consequently, exports to countries outside

the region increased from \$2 million in 1969 to \$8.7 million in 1973 and \$58.1 million in 1980. This growth appears to be particularly rapid in recent years, as exports to the CACM have generally faltered. Although relative growth is fairly high, the actual value of such exports is still quite low.

The free movement of goods among the member nations of the common market and the setting up of a common external tariff around the bloc may have created trade for the bloc as a whole¹¹ and may have diverted part of the trade with the rest of the world to intra-regional transactions. But in Costa Rica's case, increased exports to the CACM market have been accompanied by increased imports from the rest of the world, as indicated in Table 22.

TABLE 22
COSTA RICA: DIRECTION OF TRADE (%)

Countries	Exports to		Imports from	
	1970	1980	1970	1980
El Salvador	4.5	15.2	6.1	4.5
Guatemala	4.8	6.4	6.5	6.7
Honduras	5.0	2.8	2.2	1.3
Nicaragua	5.6	12.2	6.1	2.2
Rest of the World	80.1	73.4	79.1	85.3
TOTAL	100.0	100.0	100.0	100.0

SOURCE: IMF, *Direction of Trade*, Annual Statistics 1969-1973, and Yearbook 1982 (Washington, D.C.: IMF, 1982).

In 1970 Costa Rica shipped 20% of its total exports to the regional common market; in 1980 this share had increased to 26.6%. During the same period the relative importance of the imports from the CACM decreased and those from the rest of the world gained in significance. In 1970, 79.1% of Costa Rica's imports originated outside the region; in 1980 this share increased to 85.3% and was one of the factors which aggravated the foreign exchange constraints.

11. For an early assessment see W.T. Wilford, "Trade Creation in the Central American Common Market," *Economic Inquiry* (March 1970).

Overall, Costa Rica's exports to the CACM increased by 48.5% during the decade when total exports—intra-and extra-regional — increased by only 34%. On the other hand, imports from the rest of the world expanded by 35.8% while those from CACM grew by 21.9%.

The impact of the increased trade can be viewed in three ways: conventional welfare gains, non-conventional welfare gains, and dynamic effects. Conventional welfare gains are those which are usually associated with trade exclusively and emphasize the competitiveness in products.¹² As a result, where trade creation dominates trade diversion, the customs union or the common market will enhance welfare. In this respect it could be suggested that such welfare gains were of importance in the CACM within the agricultural sector, whereas they were rather minimal in industry.

The concept of non-conventional welfare gains arose from the dissatisfaction of the standard customs union theory in its application to developing countries. These refer to gains accrued from industrialization and employment of labor wherever the opportunity is low, exploiting the economies of scale, and saving foreign exchange.¹³ Such gains can be considered to have been important in CACM's industrial sector, but rather insignificant in agriculture. Dynamic effects are those which are associated with the structural transformation of the economies, encouragement of investment, and increased competition.

The common external tariff of the common market was designed to create a high barrier for the imports of final goods to the region, and a low barrier — in fact many times a negative protection — to inputs required by the manufacturing industries. In addition, there was a great degree of diversity and non-uniformity in the application of the rates, which ranged from subsidization to protection, automatically following the customary bureaucratic negotiations without consideration for efficiency criteria or comparative

12. The classic work on the subject is J. Viner, *The Customs Union Issue* (New York: Carnegie Endowment for International Peace, 1950).

13. For a selection of writings on this aspect, which integrates development theory with customs union theory, see: R.F. Mikesell, "The Theory of Common Markets as Applied to Regional Arrangements Among Developing Countries," in *International Trade Theory in a Developing World*, eds. R. F. Harrod and D.C. Hague (London: Macmillan, 1963); C.A. Cooper and B.F. Massell, "Towards a General Theory of Customs Union for Developing Countries," *Journal of Political Economy* (October 1965); and F. Andic, S. Andic, and D. Dosser, *A Theory of Economic Integration for Developing Countries* (London: Allen & Unwin, 1971).

advantages of various industrial activities. Moreover, the very same incentives reduced the price of capital relative to labor, led to a high degree of capitalization, increased the capital-labor ratio, and blocked the effective increase in employment of labor.

As a result, although regional integration caused rapid industrialization, significantly increased the share of manufacturing in total output, and rapidly led to brisk activity in intra regional shipments of manufactured goods, the cost of the strategy was high in employment alternatives foregone and in the loss of foreign exchange. For the price of capital was relatively low and the increased imported-capital-and-input requirements of the domestic manufacturing industries could not be met out of insufficient foreign exchange receipts from exports of traditional agricultural products.¹⁴ In fact, Central America as a whole lost, in 1980, \$760 million of its monetary reserves despite exchange controls and regulations.

As discussed in the previous sections of the present study, the formation of the common market has been of benefit to Costa Rica, but to the same limited degree that it has been for the region as a whole. Costa Rica's food imports from the region increased notably (rice from El Salvador and beans from Honduras and Nicaragua), but its own agricultural exports to the region were not affected appreciably, since those are customarily exported to markets outside of Central America, where they are at the whim of international market forces.

Industrial exports to the CACM have accelerated. Undoubtedly, these have generated employment; but the gains in employment have been less than in other CACM member countries, because the opportunity cost of labor in Costa Rica is higher than in the rest of Central America. In addition, it has not been feasible to establish industries with a potential towards economies of scale, except perhaps the tyre factory.

Dynamic gains were particularly relevant in the initial phase of the regional market. Important impulses were felt in the economy in the form of structural transformation and industrialization. But to the extent that easy and seemingly "cost-less" import substitution leveled off, these impulses began to lose their effectiveness giving rise to heavy dependence on imported

14. It is estimated that an export output of \$100 requires \$80 worth of imports.

intermediate and capital goods. The import substitution policy, which led the economic transformation of the country, became responsible for the foreign exchange crises and the inefficiencies in the market structure. Low interest rates subsidized the purchase of capital goods; duty exemptions on imports of machinery and equipment, tax exemption on reinvested profits, generous capital consumption allowances lowered the price of capital below its social opportunity cost. Coupled with high payroll charges, these have distorted relative factor prices in favor of capital and effectively reduced the demand for labor.

Volatile agricultural prices, on the one hand, the rapid growth in industry's foreign exchange demand on the other, have been the prime causes responsible for Costa Rica's chronic balance of payments difficulties and foreign exchange shortages.

Institutionally, Costa Rica has benefited from CABEL, the regional development bank, in that it has been able to secure loans proportionately greater than other members; the only other exception is Honduras. No doubt such loans have been instrumental in the country's noted development on infrastructure, especially its transportation network.

TABLE 23
LOANS BY CABEL

Country	Loans (%)	GNP (%)	Loan-to-GNP Ratio
Costa Rica	23.6	18.7	1.26
El Salvador	14.9	19.0	0.78
Nicaragua	20.5	15.7	1.31
Honduras	22.0	11.8	1.86
Guatemala	19.0	34.8	0.55
Total	100.0	100.0	

SOURCE: CABEL

Clearly, then, CACM as a free trade area with an enlarged market and free movement of goods, has had both positive and negative effects on Costa Rica's development policy. The present brief analysis has not attempted to quantify these effects; nor has it assessed whether or not the benefits exceeded the costs. It is obvious, however, that CACM was not altogether beneficial to Costa Rica.

The additional benefits Costa Rica received from the institutional provisions of the common market should not be minimized. Costa Rica today enjoys one of the best road networks of the isthmus and a good transportation system. In addition, agricultural disease control programs financed through the regional institutions have virtually eradicated the coffee rust disease from the country's major export product. These are but few examples; the assessment of the regional common market on the development endeavors of individual members will have to make an integrated account of the impact of each and every one of them.

VII. CONCLUSION

Costa Rica's economy during the period 1960 to 1980 expanded fairly rapidly due to early industrialization and agricultural exports. The basic industrial policy pursued was that of import substitution which boosted the economy. This was in great part due to the increased export potential provided by the expanded regional market - CACM. In addition, policies such as drawbacks created re-export industries which further boosted employment opportunities. Traditional exports were mainly destined to the world market, while industrial production was concentrated in the local market as well as the other Central American countries. The economy displayed serious strains in the midseventies due, in great part, to the oil crisis and the subsequent world recession. Fortunately, however, buoyant coffee prices injected large amounts of foreign exchange into the economy during the late seventies.

From 1980 to 1981, Costa Rica's economy was in crisis. Causes of this present crisis were of a different nature. In the first place, the import substitution policies which originate in the "infant industry" argument became a permanent development policy; on the other hand, tariffs, subsidies, drawbacks, etc., distorted the relative prices of factors of production, in turn giving rise to over capitalization.

Thus a well protected regional market slowly but surely eroded the flexibility of the national economy; an inward-oriented strategy with limited competition and little inducement to innovate resulted in a series of inflexibilities, and an overvalued *colon* added significantly to these distortions. While the manufacturing industry failed to capture world markets hence providing limited foreign exchange sources, traditional exports fluctuated considerably, also

failing to provide a dependable flow of foreign exchange. Traditional exports have not, and could not, become the prime mover of the economy.

It would not be fair to blame the import-substitution policies for all the economic woes of Costa Rica. Indeed a series of additional policies must also be held responsible. Throughout the two decades under consideration, one of the Costa Rican Government's policies was to maintain the foreign exchange artificially low. Notwithstanding several mini-devaluations, until recently, the *colon* has always been overvalued. While there may be several valid "political" as well as "economic" reasons for such a policy, the net result has been detrimental to the economy.

In the first place, this policy depleted the country's foreign reserves; secondly it had adverse effects on exports, especially on traditional exports; and thirdly considerable import leakage was created. Increased personal incomes were partly spent on imported consumption goods which were, despite high tariffs, relatively inexpensive, and internal savings and profits leaked abroad. In addition, in order to strive for and maintain equity in the economy, the government continuously increased social spending. However, given the inflexibility of the revenue system, the public expenditures had to be financed by heavy borrowing and inflation. Thus at the beginning of the decade of the eighties, the Costa Rican Government found itself in another financial crisis.

While it may not be relevant at this point to discuss whether one single policy, such as import substitution, or the host of policies described earlier are indeed the origin of the present economic crisis, nevertheless, the fact remains however, that today Costa Rica's economy is still plagued with problems of inefficiencies and drastic measures must be adopted to avoid the collapse of the economy.

The necessary measures, however, will have one very serious constraint, namely the accustomed equity. The overall socio-economic policies adopted in the country, as earlier discussed in this study, emphasized equity before efficiency. To turn the economy around, policies which may forcibly sacrifice equity in the short term will be required. However a country accustomed to an equity-oriented government policy, real or imaginary, will not view kindly policies implemented to redress inefficiencies even if equity losses were to be of short duration. The result could well be political unrest and discontent. Efforts to reduce inflation and control public

sector deficit will necessitate reduced subsidies and transfers. Expanding economic activities will also mean less protection to industry and more openness. Indeed the present government's choice between equity and efficiency will be very delicate.

APPENDIX

TABLE A-I
NATIONAL ACCOUNTS

	1960	1965	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 ¹
GDP at market prices 1970 \$ (million)	3393	4658	6525	6967	7537	8117	8568	8748	9230	9945	10541	11052	11190	10787
Gross Dom. Product 1970 prices \$ (million) factor cost	3222	4137	5799	6192	6699	7215	7615	7775	8204	8893	9361	9823	9945	9587
Gross Dom. Product 1970 prices \$ (million) factor cost	633	813	1139	1217	1316	1418	1496	1528	1612	1737	1839	1927	1950	na
Gross Dom. Product real rate of growth/average rate		5.1	7.0	6.8	8.1	7.8	5.5	2.1	5.5	7.7	5.9	4.8	1.2	3.6
Per capita, Income \$ constant, 1970 prices	512	548	653	684	721	757	780	777	801	842	867	888	871	na
Per capita, Income, real rate of growth		1.4	4.0	3.9	5.4	5.0	3.0	-0.4	3.1	5.1	3.0	2.4	-1.9	na

SOURCE: CEPAL, Anuario Estadístico, 1979
IMF, Financial Statistics, 1982

1. Preliminary

TABLE A II
 SECTORAL ACCOUNTS
 (GDP at factor cost, 1970 prices)

		1960	1965	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 ¹
1. Ag.	% share in GDP (a)	26.2	23.8	25.0	24.5	24.0	23.4	21.8	22.0	20.9	19.8	19.6	18.2	17.7	19.0
	rate of growth (b)	2.2	8.0		4.6	5.4	5.6	-1.7	3.0	0.5	1.5	5.0	1.2	-1.1	2.3
2. Manuf., mining	(a)	11.3	13.6	15.1	15.3	15.7	16.0	17.6	17.3	17.3	18.2	18.4	22.0	22.2	22.6
	(b)	9.2	9.3		8.1	10.5	10.2	12.7	1.2	5.8	13.0	1.0	2.7	0.2	1.1
3. Elec. gas, water	(a)	1.3	1.5	1.9	2.1	2.1	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.5	2.6
	(b)	9.1	16.2		13.1	14.4	6.0	5.3	2.3	8.7	5.4	7.0	5.1	11.8	8.3
4. Construction	(a)	5.2	5.4	4.7	5.2	5.8	5.6	5.7	5.9	6.8	6.9	7.0	5.7	6.2	4.7
	(b)	6.5	4.7		17.2	21.9	3.1	7.8	5.7	20.8	8.5	8.5	19.3	-9.4	-21.5
5. Finan. Inst. Insurance, Trade	(a)	22.2	22.7	22.2	22.4	22.1	22.4	21.9	21.4	21.8	22.6	23.0	22.6	18.1	21.6
	(b)	6.2	7.7		5.5	7.9	8.9	3.4	0.6	7.9	11.6	7.6	4.1	-1.2	16.3
6. Transp. & Commun.	(a)	4.9	4.5	4.8	4.6	5.1	5.5	5.9	6.2	6.2	6.2	6.1	6.8	7.0	7.4
	(b)	3.4	9.5		11.2	11.6	15.9	14.1	3.2	5.8	6.5	5.8	6.2	5.2	1.2
7. Ownership of Dwellings	(a)	10.6	9.8	8.4	8.2	7.8	7.8	7.8	7.9	7.7	7.4	7.2	4.2	6.8	7.2
	(b)	3.6	3.9		5.0	3.2	7.2	5.1	3.4	3.1	3.1	2.9	4.1	2.0	1.7
8. Other serv. (social, communal. Business)	(a)	5.7	6.2	5.6	5.5	5.4	5.2	5.2	5.0	4.9	5.0	4.8	4.4	4.5	4.3
	(b)	7.4	4.4		4.7	5.7	4.7	5.3	1.2	3.3	9.8	2.0	4.4	2.1	-4.8
9. Public Adm.	(a)	13.6	13.1	12.0	12.1	12.1	11.9	12.4	12.5	12.3	11.6	11.4	9.9	10.0	10.6
	(b)	4.3	5.6		8.2	8.1	5.6	9.9	3.2	3.8	1.2	4.5	5.9	3.6	1.5
TOTAL (million \$ of 1970)		3222	4136	5799	6192	6699	7215	7615	7775	8204	8839	9361	9823	9945	9587

SOURCE: CEPAL, Anuario Estadístico 1979 and COUNSEL, *Repertorio Económico*, 1982, San José.

1. Preliminary

TABLA A-III

POPULATION, LABOR FORCE AND EMPLOYMENT

	1963	1973	1976	1977	1978	1979	1980	1981
Population (000)	1379.8	1871.8	2017.9	2070.6	2125.6	2183.6	2245.4	2306.0
Population 12 years and older (000)	822.4	1209.2	1346.3	1393.5	1442.3	1492.9	1543.7	1593.0
Total Labor Force (000)	408.1	584.9	658.9	688.5	726.7	753.3	768.1	796.0
Labor Force employed (000)	379.9	542.2	617.4	656.8	693.3	716.4	722.8	726.7
Agriculture %	49.7	38.2	34.8	33.0	30.3	28.7	27.4	27.8
Industry %	11.7	12.9	14.6	15.8	15.2	16.3	16.3	15.6
Construction %	5.5	6.9	6.5	6.4	7.4	7.7	7.8	6.8
Basic Services%	4.8	5.5	5.6	5.5	6.1	5.7	6.6	5.7
Commerce %	9.9	14.7	16.3	17.5	17.8	17.7	18.1	18.1
Personal Services ^a	18.4	21.8	22.2	21.8	23.2	23.9	23.8	26.0
Annual Increase								
Employment	2.4	3.6	4.5	6.3	5.6	3.3	0.9	0.5
Agriculture	1.8	0.9	1.3	0.8	-3.1	-0.2	-3.7	2.0
Industry	2.8	4.6	9.0	15.1	1.5	10.8	0.9	-3.8
Construction	4.5	6.0	2.5	4.7	22.1	7.5	2.2	-12.3
Basic Services	4.0	5.0	5.0	4.5	17.1	-0.3	16.8	-13.2
Commerce	4.3	7.8	8.2	14.2	7.4	2.8	3.1	0.5
Personal Services	2.8	5.4	5.0	4.5	12.3	6.5	0.5	9.8
GDP/Economic, Active population (1966 prices)		12,789	12,770	13,074	13,161	13,366	13,412	13,127
Employment of Labor Force								
Private Sector	329.4	459.2	513.7	541.2	563.7	583.9	580.5	584.3
Public Sector	50.5	83.0	103.7	115.6	129.6	132.5	142.3	142.4
Central Government			48.8	54.5	56.8	56.6	62.8	63.9
Autonomous Institutions			54.9	61.1	72.8	75.9	79.5	78.5

Source: Academia de Centro América
a. Personal Services and Government

TABLA A-IV
GROSS FIXED CAPITAL FORMATION
(£ million, 1970 prices)

	1960	1965	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Gross Fixed Capital Formation	625	988	1270	1478	1547	1678	1842	1819	2250	2647	2899	3325	2947	2187
Private	527	735	980	1127	1169	1305	1430	1338	1597	1901	2090	2336	1925	1380
Public	98	253	290	351	378	373	411	481	653	746	808	992	1022	807
Growth of GFCF Annual rate	11.6	5.8	16.3	4.7	8.5	9.8	-1.3	23.6	17.6	9.5	15.1	-11.4	-25.8	
Growth, Private GFCF Annual rate	7.8	6.7	15.0	3.7	11.6	9.5	-6.5	19.3	19.0	9.9	11.7	-17.6	-28.3	
Growth, Public GFCF Annual rate	27.8	3.0	21.0	7.7	-1.4	10.1	17.0	35.7	14.2	8.3	23.8	3.0	-21.0	
GDP/GFCF	5.4	4.7	5.1	4.7	4.9	4.8	4.7	4.8	4.1	3.8	3.7	3.6	4.0	na

Source: CEPAL, *Anuario Estadístico*, 1979, and Banco Central, Unpublished Figures.

TABLA A-V

GOVERNMENT EXPENDITURES
(million ₡)

	1973	1974	1975	1976	1977	1978	1979
Total Expenditure	1972.7	2562.1	3341.4	4580.8	5180.8	7265.4	8699.2
Current Expenditure	1565.5	1994.0	2748.0	3500.0	4160.7	5987.6	7117.6
Expenditure on Goods & Serv..	1049.4	1340.4	1867.7	2338.9	2673.6	3779.7	4553.5
Wages & Salaries	875.8	1081.7	1476.6	1868.9	2166.4	3087.4	3739.2
Other Purchases of Goods & Services	192.7	281.7	424.3	500.7	529.6	723.0	848.0
Interest Payments	140.2	168.1	195.4	229.7	318.4	532.8	624.4
Subsidies & other Cur. Transf.	375.9	485.5	684.9	931.4	1168.7	1675.1	1939.7
Capital Expenditure	407.2	568.1	593.4	1080.8	1035.0	1277.2	1581.6
Percentages							
Current Exp. / Total Exp.	79.3	77.8	82.2	76.4	80.0	82.4	81.8
Exp. on G&S/Current Exp.	67.0	67.2	67.9	66.8	64.2	63.1	63.9
Wages & Salaries/Exp. on G&S	83.4	80.6	79.0	79.9	81.0	81.6	82.1
Other Purchase/G&S	18.4	21.0	22.7	21.4	19.8	19.1	18.6
Interest Pay/Current Exp.	8.9	8.4	7.1	6.6	7.6	8.9	8.7
Subsidies/Current Exp.	24.0	24.3	24.9	26.6	28.0	27.9	27.2
Capital Exp./Total Exp.	20.6	22.2	17.8	23.6	19.9	17.6	18.2

Source: IMF

TABLE A-VI
GOVERNMENT EXPENDITURES
(million ₹)

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Total Revenue and Grants										
Total Revenue & Grants	1224.0	1590.8	2321.9	2913.9	3522.2	4297.6	5647.7	5916.3	na	na
Tax Revenue	1115.1	1468.9	2204.8	2745.2	3318.1	4003.3	5046.7	5519.3	na	na
Tax on Inc., Profits, Cap. Gains	221.9	303.6	390.6	442.4	590.8	750.0	904.5	937.6	1008.5	1486.6
Social Security Contributions	168.3	206.2	394.5	637.8	797.6	722.4	1246.2	1508.8	na	na
Taxes on Property	5.8	5.9	4.5	5.0	21.6	30.3	54.0	55.0	60.4	66.2
Dom. Taxes on Goods & Ser.	478.0	646.6	791.0	947.4	1130.3	1447.8	1675.9	1668.4	2156.2	2515.1
Taxes-internat'l Trade, Transc.	226.4	287.4	598.0	681.2	741.6	1009.2	1130.2	1271.6	1387.5	2789.3
Other Taxes	14.7	19.2	26.2	31.4	36.2	43.6	52.9	77.6	na	na
Percentages										
Tax Revenue/Total Revenue	91.1	92.3	94.9	94.2	94.2	93.1	89.3	93.2		
Tax on Inc. Profits, Cap. Gains/Total Rev.	19.9	20.7	17.7	16.1	17.8	18.7	17.9	16.9		
Social Security/Tax Revenue	15.0	14.0	17.9	23.2	24.0	18.0	24.7	27.3		
Taxes on property/Tax Revenue	.5	.4	.2	.2	.6	.8	.1	.1		
Dom. Taxes on Goods & Serv./Tax Rev.	42.8	44.0	35.9	34.5	34.0	25.7	33.2	30.2		
Taxes Internat'l. Trade/Tax Revenue	20.3	19.6	27.1	24.8	22.3	25.2	22.0	23.0		
Other Taxes/Tax Revenue	1.3	1.3	1.1	1.1	1.0	1.0	1.0	1.4		

Source: IMF

TABLA A-VII
GOVERNMENT EXPENDITURES
(million *¢*)

Expenditures by Function	1972	1973	1974	1975	1976	1977	1978	1979
Total Expenditure	1508.2	1872.7	2562.1	3341.4	4508.8	5195.7	7265.4	8699.2
General Public Services	168.5	187.3	261.7	325.5	430.9	527.0	780.6	772.7
Defense	42.3	53.3	71.8	101.3	140.3	205.3	200.7	234.5
Education	426.0	533.8	709.1	925.9	1230.1	1449.5	1799.1	2131.6
Health	56.8	61.2	103.3	141.7	203.1	168.5	266.2	207.9
Social Security & Welfare	368.4	489.4	582.8	821.4	1118.3	1196.8	2077.3	2556.5
Housing & Common Amenities	33.2	108.3	61.3	58.2	51.0	105.7	139.6	224.8
Other Common & Soc. Serv.	13.8	34.9	43.1	58.8	91.8	111.7	151.7	163.2
Economic Services	327.9	398.7	519.9	622.5	1014.5	994.1	1097.4	1710.9
Other Purposes	159.9	212.4	272.8	304.7	352.7	522.5	840.1	846.2
Percentages								
General Public Serv./T.E.	11.1	9.4	10.2	9.7	9.5	10.1	10.7	8.8
Defense/T.E.	2.8	2.7	2.8	3.0	3.1	3.9	2.7	2.6
Education/T.E.	28.2	27.0	27.0	27.7	27.2	27.8	24.7	24.5
Health/T.E.	3.7	3.1	4.0	4.3	4.6	3.2	3.6	2.3
Social Sec. & W/T.E.	24.4	24.8	22.7	24.5	24.7	23.0	28.6	29.4
Housing & Common/T.E.	22.0	5.5	2.4	1.7	1.1	2.0	1.9	2.6
Other Common/T.E.	.9	1.7	1.6	1.7	1.1	2.0	1.3	2.6
Economic Serv./T.E.	21.7	20.2	20.3	18.6	22.5	19.1	15.1	19.7
Other Purposes/T.E.	10.6	10.8	10.6	9.1	7.8	10.1	11.6	9.7
Budget deficit as % of Total Exp.		25.7	13.9	17.7	26.9	19.9	25.5	32.4

Note: This table is prepared from IMF Statistics. Publications of Costa Rican Government do not conform the same classifications.

TABLE A-VIII
BALANCE OF PAYMENTS
(million \$)

Current Account	1960	1965	1970	1975	1976	1977	1978	1979	1980	1981
Trade Balance	-14.6	-49.7	55.7	-134.3	-103.1	-97.3	-185.5	-315.1	-374.3	62.5
Exports FOB	85.2	111.7	231.0	493.0	592.4	827.8	863.9	942.1	1000.9	1029.7
Imports FOB	99.8	160.9	-286.8	-627.3	-695.5	-1225.1	-1049.4	-1257.2	-1375.2	-1092.2
Services (net)	-8.2	23.9	-24.1	-935.0	-111.9	-144.0	-194.3	-255.2	-304.2	-337.3
Tourism	1.8	0.3	9.4	16.8	13.0	10.9	10.8	10.4	24.5	47.5
Net Investment Income	-3.9	-13.4	-13.6	-60.9	-71.0	-76.9	-110.4	-146.0	-216.2	-300.1
Others	-10.3	-10.8	-19.9	-51.2	-53.9	-78.0	-94.7	-119.6	-112.5	-84.7
Unilateral Transfers	4.4	5.9	5.9	10.0	13.6	15.7	16.6	12.1	14.6	26.4
Current Account	-18.9	-67.2	-74.0	-217.8	-201.4	-225.6	-363.2	-558.2	-663.9	-373.4
Capital Movement (net)	17.0									
Private Long Term		10.9	38.0	115.1	100.3	125.8	137.8	24.0	61.6	7.8
Direct Investment		0.0	26.3	69.0	60.7	63.1	47.1	42.3	48.1	45.6
Loans		10.9	11.7	46.1	39.6	62.7	90.7	-18.3	13.5	-37.8
Private Short-Term		10.5	22.7	-41.9	50.7	49.1	14.1	-45.0	69.9	-117.7
Official		24.3	11.1	132.3	128.9	178.5	216.8	425.9	402.5	360.4
Long Term		24.2	10.6	134.3	128.0	172.3	202.3	358.9	340.5	158.4
Short Term		0.1	0.5	-2.0	0.9	6.2	14.5	67.0	62.0	202.0
Errors	-0.8	14.0	-9.5	33.2	-13.8	-19.2	-46.4	78.9	-68.2	76.1
Changes in Reserves	2.7	7.5	11.8	-20.9	-64.7	-108.6	40.9	74.4	198.1	46.8

Source: IMF