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Costa Rica: Background and U.S. Relations

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Abstract. Costa Rica is considered the most politically stable and economically developed nation in Central America with a tradition of political moderation and civilian government. Former President Oscar Arias (1986-1990) of the National Liberation Party (PLN) was once more inaugurated as President on May 8, 2006. Fiscal reform legislation and ratification of the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) will likely be the major focus of the first six months of President Arias's administration. Every country but Costa Rica has now approved the agreement. Relations with the United States have traditionally been good, although some friction arose during CAFTA negotiations.

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Summary

Costa Rica is considered the most politically stable and economically developed nation in Central America with a tradition of political moderation and civilian government. Former President Oscar Arias (1986-1990) of the National Liberation Party (PLN) was once more inaugurated as President on May 8, 2006. Fiscal reform legislation and ratification of the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) will likely be the major focus of the first six months of President Arias's administration. Every country but Costa Rica has now approved the agreement. Relations with the United States have traditionally been good, although some friction arose during CAFTA negotiations. For additional information, see CRS Report RL32322, *Central America and the Dominican Republic in the Context of the Free Trade Agreement (DR-CAFTA) with the United States*, by K. Larry Storrs, CRS Report RL31870, *The Dominican Republic-Central America-United States Free Trade Agreement*, by J.F. Hornbeck and CRS Report RS22164, *DR-CAFTA: Regional Issues*, by Clare Ribando. This report will be updated as events warrant.

Political Situation

Costa Rica is a politically stable and economically developed country, relative to its neighbors in Central America. Since its independence from Spain in 1821, Costa Rica has developed a tradition of political moderation and civilian government despite having had some interludes of military rule. A brief civil war that ended in 1948 led to the abolition of the Costa Rican military by President Jose Figueres, a new constitution, and continuous civilian governments since then. The 1949 Constitution prohibits the creation of a standing army, although there exists a police force, Border Guard, Rural Guard, and Civil Guard. Costa Rica is a presidential democracy with a unicameral legislature. Constitutional reform approved by the legislature in 1969 barred presidential re-election. In April 2003, the Costa Rican Constitutional Court annulled the prohibition on consecutive re-election.

Costa Rica scores well according to commonly used indicators of socio-economic development. Costa Rica has the highest level of human development in Central America according to the United Nations' 2005 *Human Development Index*, which ranked Costa Rica 47th out of 177 nations based on life expectancy, education, and income levels. From

1990 to 2002, 22% of Costa Ricans lived in poverty, with 2% living on less than \$1 per day and 9.5% living on less than \$2 per day. Life expectancy at birth is 78.2 years, and the literacy rate is 96%.¹ While the government of Costa Rica generally respects human rights, it acknowledges that the sexual exploitation of children remains a serious problem and that domestic violence against women and children is a serious and growing problem.²

The last presidential and legislative elections were held on February 5, 2006. Nobel-laureate and former president (1986-1990) Oscar Arias of the National Liberation Party (PLN) won the presidential race and was inaugurated for a four-year term on May 8. The election was so close that the Supreme Electoral Tribunal did not announce final results until March 7, after completion of a manual recount of the votes. The final tally put Oscar Arias with 40.92% of the votes compared to 39.8% for Otton Solis of the Citizens Action Party (PAC), a difference of only 18,167 votes. Voter abstention was high — nearly 35% of Costa Ricans did not vote, up from 31% in 2002.³ The Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) was a major issue in the campaign, with Arias in support of the agreement and Solis pledging to re-negotiate the agreement. Arias's PLN won 25 of the 57 National Assembly seats, the largest block of any party, and the PAC won 18. The Social Christian Unity Party (PUSC), which along with the PLN had long dominated Costa Rican politics, lost significant public support, most likely due to corruption scandals involving previous President Abel Pacheco (2002-2006) of the PUSC and the arrest of two former presidents on corruption charges. The PUSC won only 4 National Assembly seats, and its presidential candidate, Ricardo Toledo, received just 3% of the vote. Whether President Oscar Arias can get National Assembly approval of the CAFTA-DR will likely depend on his ability to form and maintain alliances with smaller parties in the legislature.⁴

Economic Conditions

With its stable democracy, relatively high level of economic development, and highly educated population, Costa Rica is viewed as having the most attractive investment environment in Central America.⁵ Some 42% of the country's land is devoted to agriculture and cattle raising, while 38% consists of jungle, forest, or natural vegetation. Its National Protected Areas Scheme encompasses 22% of the total land area and contributes to Costa Rica's growing reputation as an ecotourism destination. Until the 1980s, Costa Rica followed a development model that saw a greater role for the state in economic development. The state held a monopoly in principal elements of the economy's infrastructure. During a regional recession in the 1980s, Costa Rica borrowed heavily, to the point that it defaulted on its foreign debt in 1983. Succeeding structural

¹ United Nations Development Program, *Human Development Report 2005*, September 7, 2005.

² U.S. Department of State, *Country Reports on Human Rights Practices - 2005*, March 8, 2006.

³ "Costa Rica: Arias Finally Wins It," *Latin American Regional Report Caribbean & Central America*, March 2006.

⁴ "Costa Rica: Close Election Could Make Government Tough for Next President," *Latin American Regional Report Caribbean & Central America*, February 2006.

⁵ Global Insight, [<http://www.globalinsights.com>], 2003, accessed December 15, 2003.

adjustment agreements with the International Monetary Fund and other international financial institutions brought about a liberalization of the economy and the privatization of most of its state-owned enterprises. However, seaports, airports, railroads, sewage, water distribution, insurance, telecommunications, and energy remain state-owned.

Costa Rica has a relatively well-developed economy, and the government devotes considerable resources for social services. Costa Rica invested about 6% of gross domestic product (GDP) in public health in 2002 and public spending on education was 5% of GDP between 2000 and 2002, one of the highest rates in the developing world. Costa Rica also developed a more equitable distribution of income than its neighbors, a situation that exists to this day. In recent decades, the country has pursued foreign direct investment, the development of its export sector, and diversification from agriculture-based exports. Costa Rica is the wealthiest nation in Central America with a GDP of \$18.4 billion and a per capita GDP of \$4,328 in 2004.⁶ The economy grew by 4.1% in 2005 fueled by export growth, particularly in microprocessors, and strong performances in the tourism and international business services sectors.⁷ The country has developed a thriving computer sector in recent years since attracting U.S. companies to locate manufacturing plants there. The country's unemployment rate in 2005 was 6.6%. Manufacturing represents 21% of GDP, with agriculture contributing nearly 9% and services and utilities 66%.⁸

The country has been successful in attracting foreign direct investment (FDI), especially of high technology companies through the establishment of free trade zones. FDI from all sources in 2005 totaled \$609 million, of which 65% was from the United States.⁹ Despite the country's efforts to attract foreign investment, a World Bank and International Finance Corporation report observed that Costa Rica has low ratings of investor protection and heavier regulation of business than many other developing countries, which causes inefficiency, delays, and higher costs.¹⁰ Since 1998, Intel has constructed a number of plants to assemble computer chips, providing the country with a major export generator and employment provider. Microsoft awarded a major software development project in 2001 to a Costa Rican firm, and several other Costa Rican firms have strategic alliances with major U.S. and European companies. Microprocessor exports have been an increasingly important export accounting for 20% of merchandise export earnings from 2000 to 2004.¹¹ Other important export sectors are manufacturing,

⁶ World Bank, *World Development Indicators 2006*.

⁷ United Nations Economic Commission for Latin America and the Caribbean, *Preliminary Overview of the Economies of Latin America and the Caribbean 2005*.

⁸ "Country Report: Costa Rica," *Economist Intelligence Unit*, March 2006.

⁹ "Costa Rica Country Report," *Economist Intelligence Unit*, March 2004 and United Nations Economic Commission for Latin America, *Foreign Investment in Latin America and the Caribbean, 2005 Report*, April 2006.

¹⁰ World Bank and International Finance Corporation, *Doing Business in 2006*.

¹¹ "Country Report: Costa Rica," *Economist Intelligence Unit*, November 2005.

representing about 20% of exports in 2005, and non-traditional agriculture (pineapples, melons, fish) which accounted for 11% of total exports in 2005.¹²

Pressures on the Costa Rican economy include high oil prices, which contributed to an inflation rate of 14% in 2005, and the public debt burden, which now amounts to 55% of GDP. Nearly 19% of the national budget is financed through public borrowing.¹³ A proposed fiscal reform introduced in 2003 to extend the value-added tax (VAT) and introduce a universal income tax has not been passed, causing the government to cut discretionary spending. Spending cuts have diminished the country's ability to maintain its infrastructure and were an issue in the recently completed presidential elections. Fiscal reform legislation and CAFTA-DR ratification are likely to be the major focus of President Arias.

U.S. Relations

Relations with the United States have been strong. Ratification of CAFTA-DR is a priority of President Arias, who stressed Costa Rican integration in the global economy in his inaugural address.¹⁴ Support for U.S. policy in Iraq has been a controversial issue in Costa Rica. Former President Abel Pacheco (2002-2006) was sharply criticized by political leaders and the public for his support of the U.S. military mission in Iraq and Costa Rica's inclusion in the coalition of the willing. President Oscar Arias was especially vocal in his criticism of U.S. policy in Iraq.¹⁵ In September 2004, Costa Rica's Constitutional Court ruled that the country cannot be listed as a member of the U.S. "coalition of the willing," because it violated the country's neutrality as enshrined in its constitution. On May 19, 2006, Foreign Minister Bruno Stagno requested that the United States remove Costa Rica from all lists of coalition partners on the White House website.¹⁶ Costa Rica has not contributed material support to operations in Iraq.¹⁷

Costa Rica is not a major U.S. aid recipient. In the past, it has received International Military Education and Training (IMET) funds, but since it has not signed an Article 98 agreement exempting U.S. personnel from the jurisdiction of the International Criminal Court, it received no funds in FY2005, and an estimated \$50,000 in FY2006; \$45,000 is requested for FY2007. Although Costa Rica has no military, IMET funds have been used to train law enforcement officers and coast guard personnel. The country receives no direct, bilateral U.S. counterdrug funds, although State Department regional programs support strengthening law enforcement capabilities. The U.S. Peace Corps has volunteers

¹² "Country Report: Costa Rica," *Economist Intelligence Unit*, March 2006.

¹³ Ibid and "Country Outlook: Costa Rica," *Economist Intelligence Unit*, March 2006.

¹⁴ Manuel Bermudez, "Costa Rica: CAFTA Opponents Gear up to Oppose Ratification," *Inter Press Service*, May 8, 2006.

¹⁵ "Costa Ricans Defend Neutral Tradition Against Pacheco," *Noticen: Central American & Caribbean Affairs*, April 10, 2003.

¹⁶ Álvaro Murillo, "Stagno Insiste a EE.UU. que Excluya a País de 'Coalición,'" *La Nación*, May 19, 2006.

¹⁷ "Costa Rica Demands Removal From U.S. Coalition List on Iraq," *Wall Street Journal*, September 9, 2004.

working in Costa Rica. The United States is Costa Rica's major trading partner. In 2004 Costa Rica sent 40% of its exports to the United States and received nearly 46% of its imports from the United States.¹⁸ A sizeable portion of U.S. investment in the CAFTA countries is found in Costa Rica.

Free Trade Agreement. Costa Rican leaders across the political spectrum support liberalized trade, even while there has been internal debate on the benefits of the U.S.-Dominican Republic-Central American Free Trade Agreement (DR-CAFTA).¹⁹ Disagreements with the United States with regard to opening the state-owned telecommunications and insurance sectors delayed Costa Rica's inclusion in the agreement for several weeks. The countries of Central America now have tariff-free access to the U.S. market on approximately three-quarters of their products through the Caribbean Basin Trade Partnership Act (P.L. 106-200, Title II) which expires in September 2008.²⁰ The DR-CAFTA agreement would make the arrangement permanent and reciprocal.

While the five Central American nations agreed to present a unified negotiating position with the United States, each had its own interests and objectives. Costa Rica sought greater foreign investment in certain strategic areas, such as electronics assembly, health care products, and business service centers. While agricultural products have been important to its economy, their decreasing export value has meant that the focus instead has shifted to manufacturing. Costa Rica also anticipated that an FTA with the United States would have a positive impact both on tourism and the productivity of its export sector.²¹ CAFTA-DR must be approved by the legislatures of all the parties; to date, Costa Rica is the only country that has not approved it. There have been demonstrations both for and against the trade agreement, although labor unions have been very vocal in their opposition to it.

Environment. According to a report by the Office of the U.S. Trade Representative, Costa Rica has a broad range of domestic environmental laws. Legislation enacted in 1994 created the post of Environmental and Maritime Land Attorney to guarantee a healthy and ecologically sound environment, and to ensure the enforcement of international treaties and national laws. The Environment Act of 1995 requires environmental impact studies for most construction projects, including commercial and residential construction, and mining projects. Costa Rica is party to many international agreements, including the U.N. Convention on Biological Diversity, the Convention on the International Trade in Endangered Species of Wild Flora and Fauna, the U.N. Framework Convention on Climate Change, the Kyoto Protocol, and the

¹⁸ "Country Report: Costa Rica," *Economist Intelligence Unit*, March 2006.

¹⁹ Free trade agreements with Central America and the Dominican Republic were negotiated separately and then combined into one agreement.

²⁰ "Latin America Economy: What's at Stake with CAFTA," *Economist Intelligence Unit*, May 14, 2003.

²¹ *Agenda Integral de Cooperación*, Ministry of External Trade, Government of Costa Rica, [<http://www.comex.go.cr/negociaciones/usa/default.htm>], accessed September 16, 2003.

Montreal Protocol on Substances that Deplete the Ozone Layer.²² Costa Rica has been a pioneer of “clean air exports” in which it sells credits to companies in developed countries that need to offset their greenhouse gas emissions as part of the 1992 Rio Earth Summit and the 1997 Kyoto Protocol commitments.

Labor. The power of organized labor has declined since the 1980s. The strongest unions represent civil servants, teachers, public utility employees, and oil refining and ports employees. According to the State Department’s *2005 Country Reports on Human Rights Practices*, Costa Rican law guarantees the right of workers to join unions, and workers are able to exercise this right. The report estimates that 9% of the labor force is unionized. Unions operate independently of the government. The State Department notes a lack of enforcement of the legal requirement to reinstate workers fired for union activities, and the International Confederation of Free Trade Unions reports that there is no legal mechanism to ensure reinstatement of such employees. Employees have the right to strike when 60% of workers at the affected enterprise support such action. Costa Rica restricts strikes by employees in sectors that are essential to the national economy and health. Costa Rica has a minimum wage and workplace safety regulations, which were less likely to be enforced in rural parts of the country. The State Department reports that a worker cannot provide a decent living for his or her family on minimum wage.

Intellectual Property. Costa Rica is party to the WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS), and has enacted or amended its regulations to harmonize them with its international obligations. The U.S. Trade Representative’s Foreign Trade Barriers Report covering 2005 noted that enforcement remains a problem with regard to the protection of copyrights, patents, and trademarks. Nevertheless, USTR has placed Costa Rica on its less severe Special 301 Watch List every year since 2002, that identifies countries that deny adequate protections for intellectual property rights. Ratification of CAFTA-DR will require Costa Rica to protect pharmaceutical and agricultural chemical test data from unfair commercial use for five and ten years respectively.²³

Telecommunications and Insurance. The issue of market access to Costa Rica’s telecommunications and insurance sector was problematic during CAFTA-DR negotiations. Costa Rica’s telecommunications sector is the most sophisticated in Central America, but unlike its neighboring countries, it is state-owned, and proposals for privatization have faced public opposition. The final agreement between the United States and Costa Rica provided for access to private network services and Internet services by January 2006 and to the cellular phone market by 2007, though this has been delayed because Costa Rica has yet to ratify CAFTA-DR.

The issue of insurance was not raised until the last round of negotiations, and Costa Rica believed there was not enough time remaining to resolve differences. The United States had called for total access to the insurance industry. The final agreement calls for opening the insurance market in phases between 2008 and 2011.

²² *Interim Environmental Review: U.S.-Central America Free Trade Agreement*, Office of the U.S. Trade Representative, August 2003.

²³ Office of the U.S. Trade Representative, *2006 National Trade Estimate Report on Foreign Trade Barriers*, March 31, 2006.