

# CRS Report for Congress

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## Costa Rica: Background and U.S. Relations

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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. The current president, Abel Pacheco of the Social Christian Unity Party (PUSC), was inaugurated in May 2002 to a four-year term. Costa Rican leaders across the political spectrum support liberalized trade, and Pacheco has been a leading advocate of the U.S.-Central American Free Trade Agreement (CAFTA). Costa Rica has been an attractive environment for foreign investment. Relations with the United States have traditionally been good, although some friction arose during CAFTA negotiations. The U.S. Congress must still ratify the free trade agreement, with consideration expected in 2005. 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, and CRS Report RL31870, *The United States-Central American Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration*, by J.F. Hornbeck. 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 in 1848, 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, and there have been continuous civilian governments since then. The Constitution prohibits the creation of a standing army, although there exists a police force, Border Guard, Rural Guard, and Civil Guard.

Costa Rica scores well according to commonly used indicators of socio-economic development. The United Nations' *Human Development Report* for 2004 ranks Costa Rica 45<sup>th</sup> out of 175 countries based on life expectancy, education, and income levels. This puts the country far ahead of its Central American neighbors. Life expectancy at birth is 77.9 years. Costa Rica's population, 4 million in 2003, is the best educated in Central America, with a literacy rate of 95%.

The current president, Abel Pacheco, was inaugurated in May 2002. A leader of the center-right Social Christian Unity Party (PUSC), Pacheco won the election in a second round of voting against Rolando Araya of the National Liberation Party (PLN). Pacheco ran on an anti-corruption, good governance platform, but he and his party have since become embroiled in corruption charges, including the arrests of two former presidents. During Pacheco's first two years in office, he has been plagued with a large number of changes in his cabinet, some resulting from disagreements on economic and fiscal policies. Public opinion polls show that his support fell precipitously from around 60% in September 2002 to 31% by December 2003, with a rebound to 45% by December 2004.<sup>1</sup> In April 2003, the Constitutional Chamber, the country's highest court, ruled that an existing prohibition on the consecutive and non-consecutive re-election of presidents was unconstitutional. This change will benefit former President Oscar Arias (1986-1990), winning the Nobel Peace Prize in 1987 for his work on the peace process in Central America. Arias won the candidacy of the National Liberation Party on January 15, 2005, for presidential elections scheduled for February 2006.

## **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.<sup>2</sup> 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 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 6.9% of gross domestic product (GDP) between 1990 and 1998 in public health, 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. GDP amounted to \$18.5 billion in 2004, with a growth rate of 4%, despite a downturn in prices for two of its major agricultural exports, bananas and coffee, and a decrease in demand for computer components. 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

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<sup>1</sup> Costa Rica Country Report, December 2003; Cost Rica Country Outlook, *Economist Intelligence Unit*, April 27, 2004, and "Costa Rica: Pacheco Bounces Back in Polls.: *Latinnews Daily*, December 13, 2004.

<sup>2</sup> Global Insight, [<http://www.globalinsights.com>], 2003, accessed December 15, 2003.

2004 was 6.5%. Manufacturing represents nearly 21% of GDP, with agriculture contributing 9% and services and utilities 66%.<sup>3</sup>

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 2003 totaled \$590 million, of which 65% was from the United States.<sup>4</sup> Despite the country's efforts to attract foreign investment, a World Bank report observed that Costa Rica has heavier regulation of business than many other developing countries, which causes inefficiency, delays, higher costs, and opportunities for corruption.<sup>5</sup> 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. The export of high technology electronics grew by 52.8% in 2003, earning \$1.4 billion in revenues, and representing 22.5% of the country's total export earnings. The export of medicine and medical equipment is also important, representing 10.4% of total exports.<sup>6</sup> Other industries that are important to the economy are food processing, chemical products, textiles, and metal processing.

## U.S. Relations

Relations with the United States have been strong. President Pacheco supported the U.S. military mission in Iraq, despite Costa Rica's traditional neutrality. He came under severe criticism from the public and political leaders for this support. Former President Oscar Arias, who is running for the presidency in 2006, was especially vocal in his criticism of U.S. policy in Iraq.<sup>7</sup> 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. President Pacheco signed a statement of support for the United States in March 2003. However, he said it was an expression of support for the fight against terrorism, not in support of a military invasion of Iraq. Costa Rica has not contributed material support to operations in Iraq.<sup>8</sup>

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<sup>3</sup> Ibid., EIU, "Business Outlook: Costa Rica," *Economist Intelligence Unit - Country Monitor*, June 14, 2004, and "Costa Rica: Forecast Data," *Economist Intelligence Unit - Riskwire*, May 6, 2004.

<sup>4</sup> "Costa Rica Country Report," *Economist Intelligence Unit*, March 2004. See also United Nations Economic Commission for Latin America, *Foreign Investment in Latin America and the Caribbean, 2003 Report*, August 2004.

<sup>5</sup> See World Bank online data base, [<http://rru.worldbank.org/DoingBusiness>], accessed September 14, 2004.

<sup>6</sup> Costa Rica Industry: Manufacturing Update, *Economist Intelligence Unit*, March 23, 2004.

<sup>7</sup> "Costa Ricans Defend Neutral Tradition Against Pacheco," *Noticen: Central American & Caribbean Affairs*, April 10, 2003.

<sup>8</sup> "Costa Rica Demands Removal From U.S. Coalition List on Iraq," *Wall Street Journal*, September 9, 2004.

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 has not received funds FY2004 and FY2005. The U.S. Peace Corps has volunteers working in Costa Rica. Although Costa Rica has no military, IMET funds have been used to train law enforcement officers and coast guard personnel. The Administration has requested \$50,000 in IMET for FY2005, although it is not clear that an agreement will be reached. The country receives no direct, bilateral U.S. counterdrug funds, although State Department regional programs support strengthening law enforcement capabilities. In 2002, Costa Rica signed an agreement with the United States, yet to be ratified by the Costa Rican legislature, to establish an International Law Enforcement Academy for the training of police, prosecutors and judges from the Western Hemisphere with a focus on transnational crimes like terrorism and drug trafficking. The United States is Costa Rica's major trading partner. It annually sends approximately 50% of its exports to the United States and imports 53%. 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 and President Pacheco has been a leading advocate of the U.S.-Dominican Republic-Central American Free Trade Agreement (DR-CAFTA).<sup>9</sup> But 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.<sup>10</sup> 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.<sup>11</sup> The DR-CAFTA must be approved by the legislatures of all the parties; to date, only El Salvador's legislature has approved 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

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<sup>9</sup> Free trade agreements with Central America and the Dominican Republic were negotiated separately and then combined into one agreement.

<sup>10</sup> "Latin America Economy: What's at Stake with CAFTA," *Economist Intelligence Unit*, May 14, 2003.

<sup>11</sup> *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.

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 Montreal Protocol on Substances that Deplete the Ozone Layer.<sup>12</sup> 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 *2003 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 12% of the labor force is unionized and that some 80% of all union members are public sector employees. Unions operate independently of the government. The International Labor Organization (ILO) noted delays in addressing workers’ formal grievances and the enforcement of reparations. The Constitution and Labor Code restrict public sector workers from striking, although a 2000 court ruling clarified that public sector strikes were allowed, but only if a judge approved them in advance and found that necessary services for the public’s well-being would not be affected. There are no restrictions on private sector unions being able to bargain collectively or to strike, although few private sector employees belong to unions.

Costa Rica has a minimum wage and workplace safety regulations, although both are not always uniformly enforced. The Constitution provides for a minimum wage that is set by a National Wage Council, composed of representatives from government, business, and labor. The Ministry of Labor was reported to have enforced minimum wages in the area of the capital, San Jose but was less effective in rural areas in 2002. The State Department reports that the minimum wage was not sufficient to provide a worker and his family at the lower end of the wage scale with a decent standard of living. Costa Rican law on health and safety in the workplace requires industrial, agricultural, and commercial firms with ten or more workers to establish a joint management-labor committee on workplace conditions, and allows the government to inspect workplaces and to fine employers. The State Department reports that insufficient resources have been provided to the Ministry of Labor to enforce health and safety legal requirements.

**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 2003 noted that enforcement remains a problem with regard to the protection of copyrights, patents, and trademarks. Nevertheless, in 2002, 2003, and 2004, USTR placed Costa Rica on its less severe Special 301 Watch List, that identifies countries that deny adequate protections for

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<sup>12</sup> *Interim Environmental Review: U.S.-Central America Free Trade Agreement*, Office of the U.S. Trade Representative, August 2003.

intellectual property rights. The International Intellectual Property Alliance, a U.S.-industry organization, also cites Costa Rica's insufficient enforcement activities and levels of fines, which they argue do not deter the infringement of intellectual property. The group estimates that trade losses due to piracy in Costa Rica totaled \$17.6 million in 2002.<sup>13</sup>

**Telecommunications and Insurance.** The issue of market access to Costa Rica's telecommunications and insurance sector was problematic during CAFTA 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 use of the Internet and electronic commerce is relatively advanced, but the system is inadequate given the demand. The U.S. negotiating position was that all suppliers of telecommunications and insurance services be compatible and that there is non-discriminatory treatment between domestic and foreign suppliers. Costa Rica has long resisted calls to liberalize its telecommunications and insurance sectors. This disagreement came into sharper focus during U.S. Trade Representative Robert Zoellick's trip to the region in early October 2003 during which he stated that an open telecommunications sector was necessary in order to conclude an agreement and that a CAFTA agreement could proceed without Costa Rica. At the final round of CAFTA negotiations, Costa Rica decided that the agreement, as it stood, was not in its best interests, and its negotiators withdrew. Later comments from U.S. officials clarified that complete privatization of the telecommunications sector would not be necessary as long as the private sector could participate in some telecommunications activities, such as mobile phone and internet service.<sup>14</sup> The final agreement between the United States and Costa Rica provides for access to private network services and Internet services by January 2006, and to the cellular phone market by 2007.

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.

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<sup>13</sup> Office of the U.S. Trade Representative, *Foreign Trade Barriers Report, 2003*; and *Special 301 Watch List, 2004*. See also the International Intellectual Property Alliance's *2003 Special 301 Report*, available online at [<http://www.iipa.com>].

<sup>14</sup> Diego Mendez, "Zoellick Pushes Trade Pact; Commerce Officials from Costa Rica Demand that Telecommunications be Left Out of Treaty," *Miami Herald*, October 3, 2003; "Costa Rica Weighs Costs, Alternatives in Telecom Trade Clash," *EFE News Service*, October 3, 2003.