COSTA RICA

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Millions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998	1/
Income, Production and Employment:				
Nominal GDP 2/	8,995.8	9,502.0	9,900	
Real GDP Growth (pct) 3/	-0.6	3.8	4.5	
GDP by Sector (pct):				
Agriculture	18.7	18.0	18.0	
Industry	21.3	21.5	21.5	
Services	52.4	53.1	53.3	
General Government	7.6	7.4	7.2	
Per Capita GDP (US$)	2,809	2,905	2,960	
Labor Force (000s)	1,278	1,330	1,400	
Unemployment Rate (pct)	6.2	5.7	5.0	
Money and Prices (annual percentage growth):				
Money Supply Growth (M2)	11.0	21.0	15.0	
Consumer Price Inflation	13.9	12.0	12.0	
Exchange Rate (Colones/US$ annual average)				
Official	208.37	233.28	260	
Parallel	208.37	233.28	260	
Balance of Payments and Trade:				
Total Exports FOB 4/	3,013.8	3,280.5	3,600.0	
Exports to U.S. 4/	1,056.4	1,370.8	1,500.0	
Total Imports CIF 4/	3,479.4	3,919.1	4,400.0	
Imports from U.S. 4/	1,559.3	1,718.0	1,750.0	
Trade Balance 4/	-465.6	-638.6	-800.0	
Balance with U.S. 4/	-502.9	-347.2	-250.0	
External Public Debt	2,859.0	3,200.0	3,500.0	
Fiscal Deficit/GDP (pct)	6.3	4.0	4.0	
Current Account Deficit/GDP (pct)	3.5	3.0	4.5	
Debt Service Payments/GDP (pct)	6.3	6.1	6.1	
Gold and Foreign Exchange Reserves	925.7	1,141.3	1,000	
Aid from U.S.	10.5	18	18	5/
Aid from All Other Sources	N/A	N/A	N/A	

1/ 1998 figures are all estimates based on available monthly data in October.
2/ GDP at factor cost.
3/ Percentage changes calculated in local currency.
4/ Merchandise trade.
5/ Estimate for FY 1998.

1. General Policy Framework

The Costa Rican economy is based on a free market system and open trading regime. There are, however, several large public sector monopolies in electricity distribution, telecommunications, petroleum distillation and distribution, and insurance. The economy is performing well, having recovered from the contraction of 1996. The government forecasts GDP growth of 4.5 percent for 1998, improving on 3.8 percent growth in 1997. The administration of President Miguel Angel Rodriguez took office in May 1998, and has declared its intention to bring private investment and competition into those parts of the economy that have been reserved for the public sector.

1998 is witnessing a significant renewal of construction of tourist facilities and increasing exports of traditional and nontraditional products. Investment and aggregate consumption have picked up considerably, but so have balance of payments anxieties, as imports continue to outpace merchandise exports by a significant amount. Despite rapidly growing tourism income, Costa Rica runs a chronic deficit on current account that, in recent years, has been financed by inflows of direct foreign investment. As international reserves began to decline somewhat in the second half of 1998, the central bank raised interest rates to encourage the repatriation of Costa Rican funds held offshore and to rein in consumption, much of which is satisfied by imports.

Years of fiscal deficits have left the government saddled with a large public sector debt, mostly financed in the domestic capital market. The government spends over 30 percent of its revenues servicing this debt. The Finance Ministry has sought to cut expenses and improve tax collection, with only limited success. Over the medium term, the government anticipates that capital raised through the sale or concession of public enterprises, along with more robust economic growth, will serve to reduce the debt and its associated servicing burden.

The new government shares its predecessor's eagerness to attract high quality foreign investment. Several high technology companies, most notably U.S. electronics giant INTEL, have set up shop in Costa Rica during the past two years, attracted by a well-educated technical work force. On the trade front, Costa Rica has publicly expressed its impatience with the pace of market opening initiatives such as the Free Trade Area of the Americas, enhancement of the Caribbean Basin Initiative, or the negotiations underway between the Central American nations as a group and other nations of the hemisphere. Exceptions to this general trend continue, however, resulting from such factors as domestic pressure to restrict foreign competition, constitutional protection of state-owned monopoly enterprises, and domestic political pressure favoring interventionist and redistributive government.

2. Exchange Rate Policy

The current exchange rate policy, originally devised in 1993, is of the "crawling peg" variety employing daily mini-devaluations. The rate of devaluation is driven by the market and is adjusted as necessary. The exchange rate is set indirectly every morning by the central bank through its sale or purchase of foreign currency, and virtually all private business is subsequently transacted at that rate. Additionally, all foreign transactions by state institutions are channeled through the central bank. Commercial banks are free to negotiate foreign exchange prices but must liquidate their foreign exchange positions daily with the central bank.

During 1997, the colon was devalued by 11.4 percent against the U.S. Dollar in line with the central bank policy of maintaining a "neutral" exchange rate policy (a rate of devaluation similar to internal price increases). The rate was increased slightly in 1998 to adjust for the appreciation of the dollar against other world currencies, with the expectation that devaluation for the year will approximate 13 percent. Freely traded dollars from tourism and capital investment continue to flow into Costa Rica, partly offsetting the impact of the trade deficit on the current account. The free and sufficient supply of foreign currency continues to be a significant factor in increasing imports during 1997 and 1998.

3. Structural Policies

On January 19, 1995, new legislation eliminated most "consumer protection" regulations that controlled prices and profit margins and prohibited price speculation. Simultaneously, antitrust legislation and rules protecting consumers against product misrepresentation and price fixing were enacted.

Purchases by state institutions must follow very detailed laws and regulations on public bidding. Local suppliers are not subsidized and enjoy no special advantages over foreign suppliers. U.S. companies often succeed in supplying pharmaceuticals, machinery, electrical and transportation equipment to public sector purchasers. There have been no recent tax modifications that affect the import of U.S. goods. Corruption was a major theme in the recent political campaign, and several important cases are being tried in the courts.

4. Debt Management Policies

Costa Rica's foreign debt totaled $2,655 million on December 31, 1997 (equivalent to 27.9 percent of GDP), a decrease of $204 million from year-end 1996. However, in order to take advantage of lower interest rates, the government is attempting to refinance about $300 million of its more costly colon-denominated internal debt with dollar-denominated foreign debt. It conducted a similar operation earlier in 1998 with $200 million of debt.

In 1997, Costa Rica paid $583 million in foreign official debt service, equivalent to 6.1 percent of GDP and 17.8 percent of merchandise exports. Costa Rica undertook several adjustment programs with the IMF and the World Bank during the past decade, as well as five Paris Club arrangements and a Brady debt buy-back scheme in 1989. Largely because of these past programs, foreign currency reserves, balance of payments considerations, and exchange rates do not currently raise serious concerns for the multilateral lending institutions. These are more concerned with the problem of the large internal public debt, which amounted to 810 billion colones ($3.3 billion) at the end of 1997. The government spends almost a third of its budget paying interest on outstanding bonds, more than it spends on salaries of public employees. The problem is compounded by the central bank's monetary policy, which results in high interest rates which boost debt service costs for the Finance Ministry.

5. Aid

U.S. Government agencies provided an estimated $18 million of assistance during fiscal year 1998, of which $13 million was for the Screwworm Eradication Program. Total military assistance was $3.2 million. Although Costa Rica abolished its military forces in 1948, the United States provides assistance to Costa Rica's civilian security forces.

6. Significant Barriers to U.S. Exports

As a condition of joining the WTO in 1994, Costa Rica replaced all import licenses or permits with tariffs. The central bank now monitors imports for statistical purposes only. Currently, the tariff on most goods is 15 percent of the CIF price, with a few items such as poultry and automobiles paying in excess of 100 percent. Solvents and chemical precursors used in the elaboration of illegal drugs are carefully regulated. Surgical and dental instruments and machinery can be sold only to licensed importers and health professionals. All food products, medicines, toxic substances, chemicals, insecticides, pesticides and agricultural inputs must be registered and certified by the Ministry of Health prior to sale.

Foreign companies and persons may legally own equity in Costa Rican companies, including real estate. However, several activities are reserved to the state, including public utilities, insurance, the production and distribution of electricity, hydrocarbon and radioactive mineral extraction and refining, and the operation of ports and airports. Also, representatives or distributors of foreign products must have resided in Costa Rica for at least ten years. Customs brokers must be Costa Rican citizens. Medical practitioners, lawyers, certified public accountants, engineers, architects, teachers and other professionals must be members of local guilds which stipulate residency, examination, and apprenticeship requirements that cannot be met by newcomers.

Legislation approved in October 1995 allowed private banks to offer demand deposits. However, private banks must be incorporated locally; branches of foreign banks are not permitted. At the end of 1998, the three state owned commercial banks still accounted for close to 90 percent of country's demand deposits. An electricity co-generation law enacted in 1996 allows some private-sector participation in the production of energy but not in its transmission. This law has since been modified to permit the private construction and operation of plants under BOT (build-operate-transfer) and BLT (build-lease-transfer) mechanism, but the operator must have at least 35 percent Costa Rican equity. There are several initiatives to open the power, telecommunications, and insurance sectors to foreign investment and competition, but it is not possible to predict when implementing legislation might be passed.

Documentation and labeling of U.S. exports to Costa Rica must use the metric system and contain specific information in Spanish. Car bumpers are subject to strength requirements. Phytosanitary and zoosanitary restrictions on the import of fresh produce, and high tariffs on certain agricultural products, significantly constrain imports of some U.S. agricultural products. The Ministry of Health must approve imports of pharmaceuticals, veterinary drugs and chemicals, and chemicals and pesticides must be legally available in the exporting country.

The law encourages the development of nontraditional exports and tourism and provides incentives for foreign investment. With very few exceptions as noted above, it does not restrict foreign equity participation. However, it limits the percentage of foreign workers that can work in an enterprise. Permits for foreign participation in management are routinely granted. No requirements exist for foreign owners to work in their own companies. There are no restrictions on the repatriation of profits and capital.

The government and other state institutions procure through open public bidding, but the law allows private tenders and direct contracting of goods and services in relatively small quantities or in case of emergency with the consent of the Comptroller General. Public bidding is complicated and highly regulated, with the result that foreign bidders are frequently disqualified for failure to comply exactly with the detailed procedures. Appeals of contract awards are common, lengthy, and costly, sometimes leading to losses when market prices change but bid prices remain fixed. Despite this, no special requirements apply to foreign suppliers, and U.S. companies regularly win public contracts. Competition is fierce among international suppliers, and frequently the winner must propose comprehensive packages that include performance guarantees and financing. Foreign companies must have a legal representative in Costa Rica in order to sell goods or services to public entities. A 1996 law simplified somewhat government procurement procedures, but the process is still relatively convoluted.

Customs procedures are often costly and complex, but they do not discriminate between Costa Ricans and foreign traders. Most large firms have customs specialists on the payroll, in addition to contracting the mandatory services of customs brokers. Customs brokers must be Costa Rican nationals. The government is automating and simplifying the system and has established a one-stop window to speed up the system.

The government's expropriation policy has caused problems for U.S. investors. The government has expropriated large amounts of land for national parks and for ecological and indigenous reserves, but compensation is rarely, if ever, prompt. Some unpaid U.S. expropriation claims date back over 25 years. While it is possible to obtain compensation through the court system, the time, effort, and costs involved can greatly diminish the net value of any settlement. Claimants also have, since 1993, recourse to international arbitration through the International Center for the Settlement of Investment Disputes (ICSID). Submission of the first expropriation case to ICSID continues in a case involving the government and a group of U.S. investors. Local arbitration has been employed since 1991. Landowners in Costa Rica also run the risk of losing their property to squatters, who are often organized and sometimes violent. In November 1997, a U.S. citizen and long-term resident of Costa Rica was killed in a dispute over an ocean front land concession granted by a municipal government. Squatters enjoy certain rights under Costa Rican land tenure laws and can eventually receive title to the land they occupy. Police protection of landowners in rural areas is often inadequate. In some cases, the government has expropriated property taken over by squatters.

7. Export Subsidies Policies

Under the 1972 Export Promotion Law, nontraditional exports to destinations outside of Central America and Panama qualified for negotiable tax rebate certificates (CATS). This program is being phased out and will be completely terminated in 1999. The Export Processing Law of 1981 permits companies in designated free trade zones to be exempted from paying duties on imported inputs incorporated into exported products. It also provides holidays on income and remittance taxes.

8. The Protection of U.S. Intellectual Property

Costa Rica belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). Costa Rica is also a signatory to the Paris Convention, Berne Convention, Lisbon Agreement, Rome Convention, Phonograms Convention, and the Universal Copyright Convention. In 1998, the U.S. Trade Representative placed Costa Rica on the “Special 301” Watch List because of deficient patent legislation and widespread copyright and trademark piracy.

Significant weaknesses exist in copyright and trademark enforcement and in the duration of patent protection. The government has charged the Costa Rican Investment and Trade Development Board (CINDE) with coordinating domestic legislative and regulatory changes required to ensure that the country is in compliance with its IPR obligations under the WTO TRIPs Agreement by the January 1, 2000 deadline.

Patents: Costa Rican patent laws are deficient in several areas. Patents are granted for non-extendible 12-year terms, less than the 20 years required by the TRIPs Agreement. In the case of products deemed “in the public interest,” such as pharmaceuticals, chemicals and agrochemicals, and all beverage and food products, coverage is for only one year. Although no patent protection is currently available for plant or animal varieties, or for any biological or microbiological process or products, the government is working on a legislative proposal that would protect such products. Costa Rica also has broad compulsory licensing requirements that force patent owners to license inventions not produced locally. All of these issues are to be reviewed by CINDE as it seeks to bring domestic patent law into compliance with the TRIPs Agreement.

Trademarks: Trademarks, service marks, trade names, and slogans can be registered in Costa Rica. Registration is for renewable for 10-year periods. However, enforcement problems are similar to those encountered with copyrights, particularly in the area of designer clothing (e.g., jeans). Another problem is the registration of famous marks by speculators, who demand to be bought out when the legitimate trademark owner comes to Costa Rica. Litigation to establish ownership can be expensive.

Copyright: Costa Rica's copyright laws are generally adequate, and market access for legitimate copyrighted goods is not restricted by anything other than the unfair price advantage enjoyed by pirated goods. On May 24, 1994, the government issued regulations that provide better protection and mandate police participation in developing criminal cases against pirates. The main problem is enforcement. The cable television industry now operates almost entirely under quitclaim agreements with foreign producers. Additionally, the major public universities recently contracted to use copyrighted materials. However, some hotels continue to pirate satellite transmission signals. Pirated videocassettes, usually duplicated domestically, are widely available and constitute at least 90 percent of the market. An authorized distributor of videocassettes has begun enforcement efforts to regularize the videocassette market.

Existing laws protect trade secrets, and Article 24 of the Constitution protects the confidentiality of communications. The penal code stipulates prison sentences for divulging trade, employment, or other secrets, and doubles the punishment for public servants. Some existing laws also stipulate criminal and civil penalties for divulging trade secrets. The burden of proof is on the affected party.

9. Worker Rights

a. The Right of Association: The law specifies the right of workers to join labor unions of their choosing without prior authorization, although some barriers exist in practice. Unions operate independently of government control and may form federations and confederations and affiliate internationally. Costa Rica has no restrictions on the right of private sector employees to strike. In 1998, the Constitutional Chamber of the Supreme Court ruled that public sector workers, except those performing essential services, have the right to strike. Many workers in Costa Rica join solidarity associations, under which employers provide easy access to saving plans, loans, recreation centers, and other benefits in return for their agreement to employ nonconfrontational methods to settle disputes. Both solidarity associations and labor unions coexist at some workplaces, primarily in the public sector.

b. The Right to Organize and Bargain Collectively: The constitution protects the right to organize. Reforms to the labor code enacted in 1993 provide protection from dismissal for union organizers and members during union formation and require employers found guilty of discrimination to reinstate workers fired for union activities. Unions in the private sector have the right to engage in collective bargaining. Nonetheless, workers in the public sector cannot engage in collective bargaining because the 1978 Public Administration Act makes labor law inapplicable in relations between the government and its employees.

c. Prohibition of Forced or Compulsory Labor: The constitution prohibits forced or compulsory labor and requires employers to provide adequate wages to workers in accordance with minimum wage standards. Laws prohibit forced and bonded labor by children. The government enforces this prohibition effectively.

d. Minimum Age for Employment of Children: The 1992 Children's Code prohibits the employment of children under 15 years of age. The Ministry of Labor issued some waivers to this provision, with the goal of working gradually toward elimination of child labor. The constitution provides special employment protection for women and youth. Children between 15 and 18 can work a maximum of seven hours daily and 42 hours weekly, while children between 12 and 15 can work a maximum of five hours daily and 30 hours weekly. The National Children's Institute, in cooperation with the Labor Ministry, enforces these regulations in the formal sector, but child labor remains an integral part of the informal economy.

e. Acceptable Conditions of Work: The constitution provides for a minimum wage, and a national wage council sets minimum wage and salary levels of the private and public sectors every six months. Workers may work a maximum of eight hours during the day and six at night, up to weekly totals of 48 and 36 hours, respectively. Industrial, agricultural, and commercial firms with ten or more workers must establish management-labor committees and allow government workplace inspections. Workplace enforcement is less effective outside the San Jose area.

f. Rights in Sectors with U.S. Investment: All labor regulations apply throughout Costa Rica, including in the country's export processing zones. Companies in sectors with significant U.S. investment generally respect worker rights, especially at plants under U.S. management and ownership. Abuses occur more frequently at plants operated by investors based outside the United States.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		(1)
Total Manufacturing		342
Food & Kindred Products	68	
Chemicals & Allied Products	124	
Primary & Fabricated Metals	15	
Industrial Machinery and Equipment	0	
Electric & Electronic Equipment	56	
Transportation Equipment	0	
Other Manufacturing	78	
Wholesale Trade		1,057
Banking		0
Finance/Insurance/Real Estate		(1)
Services		1
Other Industries		56
TOTAL ALL INDUSTRIES		1,580

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.