

Costa Rica:

Human Development Assessment and Dilemmas

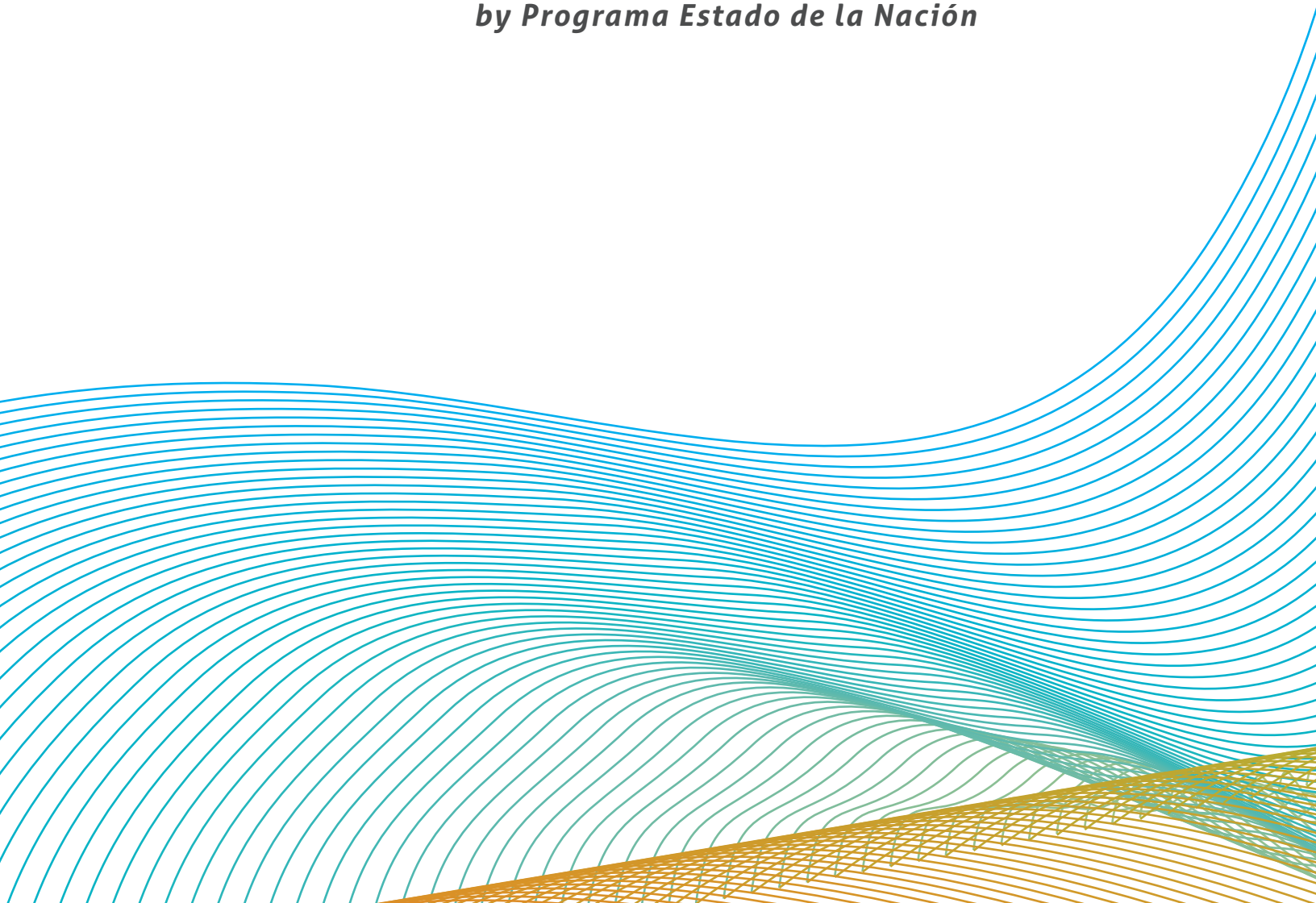
2012

*Based on the XVIIIth State of the Nation Report
by Programa Estado de la Nación*

Costa Rica:

Human Development Assessment and Dilemmas (2012)

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Foreword

This text presents an in-depth analysis of Costa Rica's recent performance in Sustainable Human Development that goes beyond conventional indicators. It aims at rendering an assessment of the country's main trends and challenges as of the latest data available. Most but not all data was updated to 2012, but in some cases the latest figure available is for 2011.

The assessment updates the main findings and analyses of the XVIIIth State of the Nation Report (2012) prepared by the State of the Nation

Program. Every year the Report updates data and analyses, unearths new topics to the purpose of improving the capabilities of citizens from all walks of life to engage in public affairs. In addition, the text places these findings on a comparative Latin American perspective.

We hope that the breadth and scope of the contents contribute to a better understanding of the country's current performance in economic, social, political, and environmental domains.

Costa Rica In Brief

Costa Rica is a small country of approximately 4.7 million people. It is one of Latin America's most open economies, and since the late 1980's has pursued an export-led development strategy. Nowadays the country has a dynamic external sector based on agriculture, services and high tech exports, making Costa Rica one of the leading technology exporters in the region—while attracting up to US \$2 billion in Foreign Direct Investment.— In terms of United Nations Human Development Index, Costa Rica ranks as a high development achiever.

A middle-income country with a Gross Domestic Product (GDP) per capita of \$9,665 as of 2012, Costa Rica has been enjoying moderate growth rates above 4% of GDP in the aftermath of the 2009 global financial crisis. Within Latin America the country enjoys comparatively high standards of living and human development levels similar to Chile and Uruguay. It has one of the most effective universal healthcare systems in the region, with infant mortality and life expectancy indicators comparable to those of developed European countries.

Costa Rica is one of Latin America's longest-standing democracies. For the past 65 years it has had no standing army - abolished in 1948. The country is well known for the stability and fairness of its electoral system, the domestic and international

commitment to the protection of human rights, and comparatively developed institutions of the rule of law - factors that have contributed to the prevalence of a distinctly peaceful society within a historically convoluted Central America.

A pioneer in environmental protection, the country distinguishes itself for an extensive system of protected parks and areas. In the past three decades it improved its forest coverage from 30% to over 50% of its territory. Roughly 90 percent of its electricity comes from clean energy sources.

For all its accomplishments, Costa Rica today faces challenging developmental dilemmas in key strategic domains of its economy, society, polity and environmental management. In the past few years, social progress has slowed down; its welfare State has experienced worrisome setbacks; basic infrastructure lags far behind the needs of a modernizing economy and citizen malaise is on the rise. On a number of social and economic indicators, the country's edge over the rest of Latin American countries has narrowed. Will Costa Rica be able to enact pressing reforms?

Table 1. Costa Rica: Long-term indicators (1950-2011)^{a/}

Indicator	1950	1960	1970	1980	1990	2000	2012
Population (thousands)	868	1,251	1,764	2,304	3,029	3,872	4,652
Urban population (%)	33.5	34.5	40.6	50.4		59.0	72.8
Poor households (%)		50.0	29.0	19.0	27.1	20.6	20.6
Income Inequality (Gini Coefficient of households)		0.310		0.352	0.464	0.487	0.518
Life expectancy at birth (years)	55.6	62.5	65.4	72.6	76.7	77.7	79.3
Infant mortality (per thousand live births)	90	68	61	19	15	10	9
Social security coverage (%)	8	15	39	70	82	88	93
Illiteracy in people over age 10 (%)	21	16	13	10	7	5	2
Average schooling, people 25 years and older (years)	3.1	3.6	5.3	5.9	7.4	8.2	8.7
Women in parliament (% of seats)			7	7	14	35	39
Forest coverage (% ground/land coverage)	72	53	31	26	22	47	52
Economically active population: Women (% total)	15	16	19	28	29	35	39
Persons employed in agriculture (%)			35	27	25	17	14
Persons employed in manufacturing industry (%)			14	16	18	15	11
Persons employed in services (%)			51	57	57	68	75
GDP per capita (dollars)	847	1,080	1,501	2,032	2,296	4,058	9,665
Exports (Goods, millions of dollars)	56	84	231	1,002	1,899	5,850	11,453

a/ Based on the year's available data or data close to the beginning of the decade. Based also on population census correspondent to each decade.

Source: Central Bank, Costa Rican Social Security Bureau, Census and Statistics Institute, Ministry of Planning, Ministry of Environment and Energy and Ministry of Public Health.

Overall Assessment: Current Country Performance

Moderate growth and financial stability, yet a weakened environmental management, a society and a political system in trouble: that is, in brief, the nation's balance sheet in 2011 and 2012 - a period in which the country's style of development and democracy were unable to usher solid progress towards advancing the human development of Costa Ricans nationwide.

The country experiences economic growth and low exchange rate volatility. Inflation rates are the lowest in recent decades, activities linked to exports and foreign direct investment performed well, and the average income of the population increased. Some protective environmental measures were put forth and criminal violence indicators declined. Furthermore, a recent population census showed improvements in access to education, health and housing, as well as in the dissemination of information technologies.

However, good news are not enough to issue a positive opinion on the country's performance. It was countered by poor performance in strategic areas for Costa Rica's human development. The country's solvency has been eroding due to the high and persistent fiscal deficits around 5% of the GDP. It forced the government to cut back on public social spending - a reversal of the expansionary trend begun in 2006. Opportunities

created by economic growth were unevenly distributed: Once again, income inequality increased; growth concentrated in small areas of the country; the population remains at the same levels since 1994, and, high levels of unemployment and informality persisted.

Furthermore, increasing and unsustainable patterns in the use of natural resources keep compromising the welfare of future generations, as reflected in the current country's carbon and ecological footprints - the highest of the decade-. Finally, 2012 saw the lowest level of citizen support for democracy in the last thirty years.

Is the coexistence of good and bad outcomes a consequence of unfortunate events? In previous editions, the State of the Nation Reports has identified the main explanatory factors of a paradox which has plagued Costa Rica's performance in Sustainable Human Development in years: 1) The emergence of a dual economy in which a dynamic modernizing sector (New Economy) is unable to pull the more traditional economic activities (Old Economy), thus widening productivity gaps and increasing social inequalities. 2) A political system that keeps expanding the legally mandated portfolio of rights without earmarking the funds required to enforce the new legislation, thus creating

expectations which the State has no ability to meet. 3) Poor and inefficient management which have resulted in poor delivery of public services and crumbling infrastructure. 4) The recurring inability to prevent and punish corruption in public affairs has fueled public cynicism. If these factors persist, advances in human development will remain inconsistent and, on average, insufficient.

Costa Rica wagers for export-driven policies based on exemptions and subsidies as the only strategy for development is falling short, a warning made some years ago by the State of the Nation Reports. Exemptions may be enough to generate economic growth and diversify the export sector but not to create a robust platform upon which the country may unleash modernization of its traditional economy as well as generalized improvements in productivity, social equality and poverty amelioration. The complexity of the country's strategic problems cannot be dealt entirely by open export-driven policies.

Along with these problems, new challenges have arisen which also exceed the belief that export led strategies suffice for promoting sustainable human development. Among the most relevant of these challenges are the lack of sustainability of the welfare State; the explicit abandonment of the environmental agenda as a public policy agenda and the deinstitutionalization of a political party system nowadays encompassing an array of weak

political organizations. This scenario is further complicated by the appearance of new dilemmas such as the earlier than predicted end of the "demographic dividend" which will make it increasingly difficult to achieve economic growth without improving productivity; the unsustainable energy matrix, unable to leverage a high and sustained pace of economic growth, and, finally, the ever increasing difficulty to provide subsidies and exemptions to allure Foreign Direct Investment, given the current high public deficits.

The demographic dividend: It refers to a historic era in which the majority of the population is of a working age and can contribute to the country's economy growth. This surge of working people has to maintain a comparatively small population of children and elders. In an opposite scenario, if a country has too many older, retired people or too many people who are too young to work, their dependence can become a drag to the economy.

Costa Rica is entering a historic period in which the easy gains in human development are over. No longer can the country piggy back on progress made during the second half of the twentieth century. Today, the issue is not whether the economic and social modernization of the last three decades transformed the country or not, or whether or not it generated new economic and social opportunities. Clearly, it did. The return to the pre-1980 agricultural

export economy is impossible and undesirable. The point is that from now on significant improvements in human development, based on economic productivity and social equity, depend on deep reforms that go far beyond economic openness and export friendly policies.

Throughout the years, key development decisions have been postponed, a behavior that has taken a toll on the country's overall standing. As noted in previous State of the Nation Reports, Costa Rica's development strategy and solutions to persistent problems require a broad social and political dialogue aimed at

crafting solid and inclusive political agreements, supported by majorities, and based on the progressive provisions of the Constitution. It is time for reforms in favor of human development.

Economic Outlook

Key Findings

- 2012 was a positive year for Costa Rica's production: its growth rate was 5,1%, close to the rates in 2010 and similar to the long-term average growth the country has experienced. The telecommunications and transportation sectors, as well as manufacturing and business services accounted for 69% of GDP growth.
- The country's growth also comes from sectors closely related to the Free Trade Zones' exports, international services, private investment and Foreign Direct Investment (FDI). Still, the economy's recovery faces external obstacles such as the slowdown of major international economies, as well as domestic ones, i.e.: the fiscal deficit.
- Costa Rica enjoys a high production capacity in its leading economic sectors, yet it is concentrated in the small, central metropolitan area of the country and few other areas.
- In 2011, the increase in the number of employed persons (87,366) was not enough to offset the increase in the labor force and the jobs lost in the "old economy". As a result, unemployment (7.7%) practically reached the same levels recorded in 2009 (7.8%). Unemployment rates in 2012 remained at this comparatively high levels (7.8%).

Old economy: The term refers to the economic model prior to the 1980s based on traditional agriculture (coffee, bananas, sugarcane, cattle) and manufacturing activities such as textiles, food processing and heavily subsidized light industry.

- In 2012, the fiscal deficit of the Government was 4,4%, up from 4.1% in 2011, both marks among the highest in Latin America. Efforts to approve a fiscal reform were once again thwarted and the government enacted cuts in public expenditures.
- Public capital expenditure and social investment fell by 35.7% and 0.5% in 2011, respectively. However, due to overall containment policies, the government was able to avoid further cuts in 2012.

- For the third consecutive year, in 2012 inflation levels remained low (around 5%). Costa Rica was one of the few countries in Latin America where inflation decreased at levels below those countries with dollarized economies.
- Costa Rica has a crawling band exchange rate regime. In 2012 the exchange rate remained flat at the lower limit of the bandwidth, which helped keep inflation low. However, it is vulnerable to the country's fiscal instability and is highly dependent on international markets.
- The current level of the exchange rate affects the solvency of some productive sectors, especially smaller companies, and undermines the external stability by way of increased trade account deficit, due to the significant increase in imports.

Economic Performance in 2012

2012 was a year of moderate growth, with stability in key monetary components, but with a sharp deterioration of the country's financial solvency. The growth and stability of the economy faces major challenges. An uncertain international scenario prevails as well as signs of slowdown in the world's major economies. The country faces internal risks on three fronts: the real, the monetary and the fiscal sectors.

The real sector is not generating enough good jobs. Unresolved structural problems are preventing generalized productivity increases and the spread of opportunities among various disadvantaged groups of the population.

The monetary sector's stability faces complex challenges such as currency appreciation, which affects the country's competitiveness, and short term capital inflows reaping from high domestic interest rates -all of which have mounted pressures on the country's exchange rate regime.

Regarding the fiscal sector, the need to contain the country's comparatively high fiscal deficits has led authorities to enact spending cuts on key public programs that would otherwise boost future production growth, and to rely on increasing public indebtedness (nowadays around 50% of the GDP, up from 40% five years ago). Pressure has been placed on interest rates, which reduces the leeway for monetary policy to act in a countercyclical manner and maintain the exchange rate stable.

Economic Outlook

Moderate economic growth in spite of turmoil in international markets

The current economic expansion that began after the 2008-2009 global financial crisis continued in 2012 despite signs of uncertainty in international markets. Production grew in great part due to the increase in exports of goods and services, the expansion of activities related to the recent opening of the telecommunications and insurance markets, and the rise in FDI. Such a boost was also largely due to the positive behavior of the United States' economy, Costa Rica's main trading partner.

The positive performance of Costa Rica's economy was led by business services (i.e., back office, call centers) and telecommunications. The business services sector has maintained positive progress throughout the last decade, whereas the telecommunications dynamism is mostly explained due to the liberalization of the market in 2010.

The economic activities encompassing free trade export zones, call centers, finance and tourism, high-tech manufacturing, non-traditional agro-exports, telecommunications and business services, all of which emerged after 1980 can be labeled as the "new economy". This new economy employs roughly 20% of the total

Telecommunications Opening:

Aside from Cuba, Costa Rica operated the last remaining State telecommunications monopoly in Latin America under the Instituto Costarricense de Electricidad (ICE). The state monopoly came to an end in mid 2009 when the country opened the telecommunications sector (Internet and mobile) to private operators. Fixed telephone lines continue to be operated by ICE while two companies became the main competitors in mobile services: Claro and Telefónica Movistar. The Superintendence of Telecommunications (SUTEL) was created in 2008 and its main function is to regulate the telecommunications sector. In addition, 104 new companies are already authorized to operate in the country, mostly offering services such as voice / television over IP, Internet access and private networks, among others.

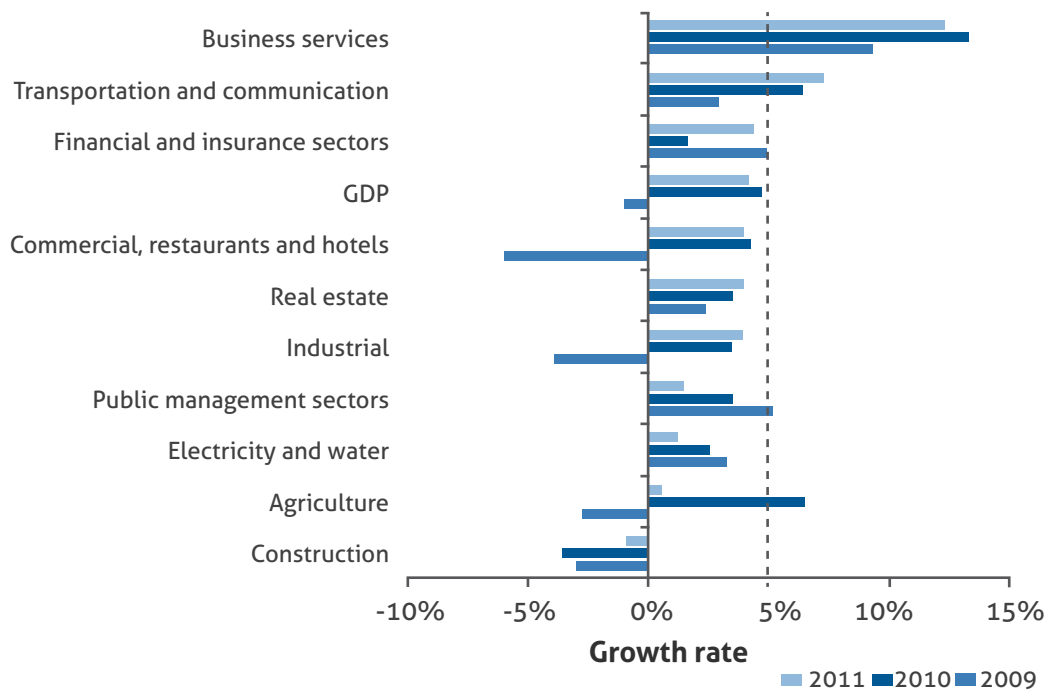
labor force, particularly high-skilled workers. In the past decades, it has been Costa Rica's main economic growth engine.

In contrast, the sectors that employ the most vulnerable population groups with low skills and levels of qualification, informality and poverty status, are less dynamic. The agriculture and construction sectors, which are part of the "old economy" –that is, the economic model prior to the 1980s based on traditional agriculture and domestic production– showed the weakest performance in the 2010-2012 period.

Exports in Foreign Direct Investment trigger growth

In the 2009-2012 period, virtually all export activities resumed their growth, and with rates very similar to those observed in the pre-global financial crisis period. The sector's positive behavior is due in great part to the support of incentives and policies that have allowed important gains in terms of product diversification and market positioning. The country's top ten export products accounted for 53.2% of total exports and headed to three traditional destinations: United States

Graph 1. Costa Rica: Growth of the economy by productive sector (2009-2011)



Note: The dotted line represents the average growth rate of the decade (2000-2010)

Source: XVIII State of the Nation Report, with BCCR data.

(38.1%), Central America (14.4%) and the European Union (17.9%). Such successful foreign trade helped boost the economy. The country's total exports of goods and services amount roughly US\$ 12 billion, which makes Costa Rica one of the highest per capita exporters in Latin America.

The largest export growth has taken place in the technological products sector, such as integrated circuits, medical supplies and power lines, as well as in Agricultural exports such as pineapples and bananas. On the other hand, a traditional country brand such as coffee has lost share in total exports, as well as standing in its main traditional markets (United States, Belgium and Germany), although it has increased presence in secondary markets such as the Netherlands and Canada.

Free Trade Export Zones contribute above 50% of total exports since 1999, after the installation of the multinational company Intel in 1998, and other foreign high-tech companies in the following years. Tourism, a Costa Rican powerhouse, has experienced a slow recovery after the 2009 global financial crisis, closely linked to the performance of the United States' economy. Visitors from the United States account for 40% of the increase in the number of tourists.

Productivity gaps between sectors and regions are widening

In spite of their key importance for overall economic performance, Costa Rica's cutting edge productive sectors -linked to export activities-

are geographically concentrated in a small central region of the country and in a few areas outside the Greater Metropolitan Area, roughly encompassing 10 of the 81 country's counties (about 22% of the national territory). These areas attract the better off, well paid, and highly skilled and productive population.

The geographical concentration of wealth and growth poses an additional challenge to public policy. The country depends on these relatively small sectors and territories, while, in turn, it must pay greater attention to the large areas of the country, linked to the "Old Economy" which have been left behind, but where most of the population lives and works. In recent decades, no government has been able to put in place effective developmental policies for the less productive regions.

Despite growth, high levels of unemployment persist

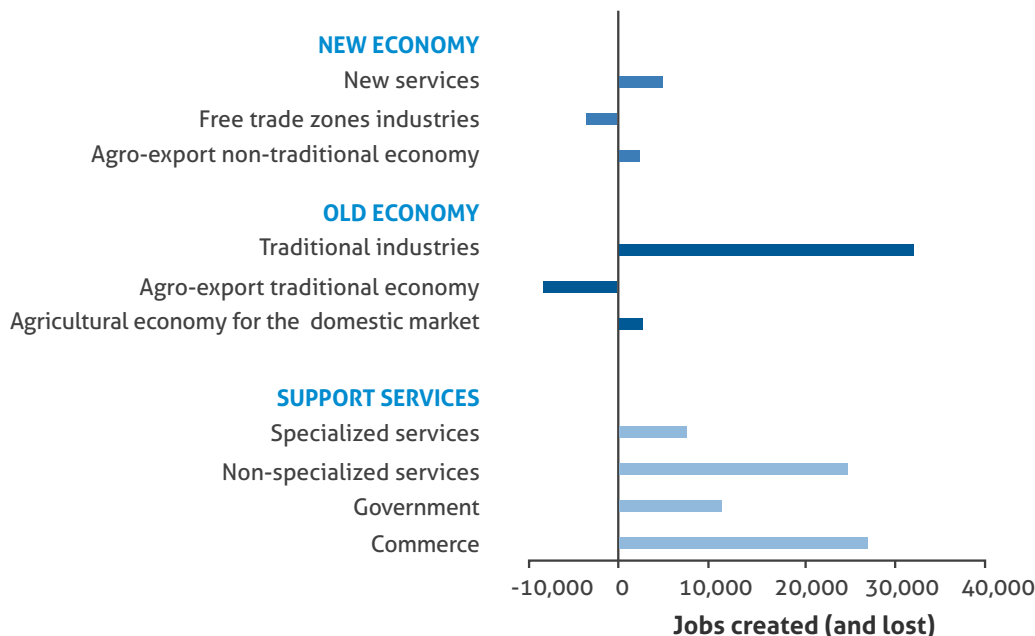
The pace and style of Costa Rica's economic growth have not countered structural problems of low productivity and inequality in the labor market, which are hurdles for the sustainability of future growth rates and could limit the country's strong export performance. The formal sector accounts for roughly 55% of total jobs, a proportion which has not improved in the last decade. Although it is comparatively high by Latin American standards, economic modernization has not been able to shrink the importance of low skilled, low paid jobs in the informal and agricultural sectors.

According to the International Labour Organization (ILO), in 2009-2011, Costa Rica's performance in the labor market was above the regional Latin America's average. As in Brazil, the Dominican Republic and Chile, the year-to-year change remained positive, although gains were smaller in 2011 than in prior years. It is worth noting that the employment rate rose in Colombia, Ecuador, Mexico and Panama, with gains that matched or outstripped previous increases. One group of countries saw a marked slowing in job creation, specifically in the generation of formal employment. In the first half of 2012, Argentina, the Bolivarian Republic of Venezuela, Jamaica, Paraguay, Peru and Uruguay were, on average, slower than in the same period of the previous year.

It is worth noting that in Costa Rica, the "new economy's" contribution to job creation was relatively meager in 2012. The jobs created were mainly in the sector of "new services" (call

centers, business services, finance and tourism, among others) but overall it had a small impact in the national labor market performance.

Graph 2. Costa Rica: Employment performance by sectors and type of economy in 2011-2012



Source: XVIII State of the Nation Report, based in Rosales, 2012, Enaho data 2011, and State of the Nation Program's methodology.

Rising fiscal deficit creates risks for growth and stability

The country achieved overall monetary stability in the 2010-2012 period, an elusive goal pursued since the early 1980s: low inflation, a stable exchange rate, lower and stable interest rates (though higher than main international interest rates), and sufficient resources to finance the trade balance deficit, in great part due to Foreign Direct Investment.

However, it is worth noting that the international economic environment and the local fiscal deficit threaten stability. The uncertain behavior of the world economy, particularly of Costa Rica's main markets, may eventually curtail demand for Costa Rican exports. Changes in current low financial international conditions as well as in capital inflows may affect the sustainability of the country's exchange regime.

Internally, the deteriorating State finances are taking a toll on stability. Since the end of 2011, the growing fiscal deficit began to push higher interest rates, which made credit more expensive, limited the scope for monetary policy to support the exchange rate, and triggered inflows of short term capitals in search of windfalls. After months of rising rates, the government implemented a mix of measures that were successful in reversing the trend. Nowadays (early 2013), domestic rates are close to the lower levels in the past five years. On the side of economic growth, scarce resources have forced cuts in strategic development spending (social and infrastructure investment). All these

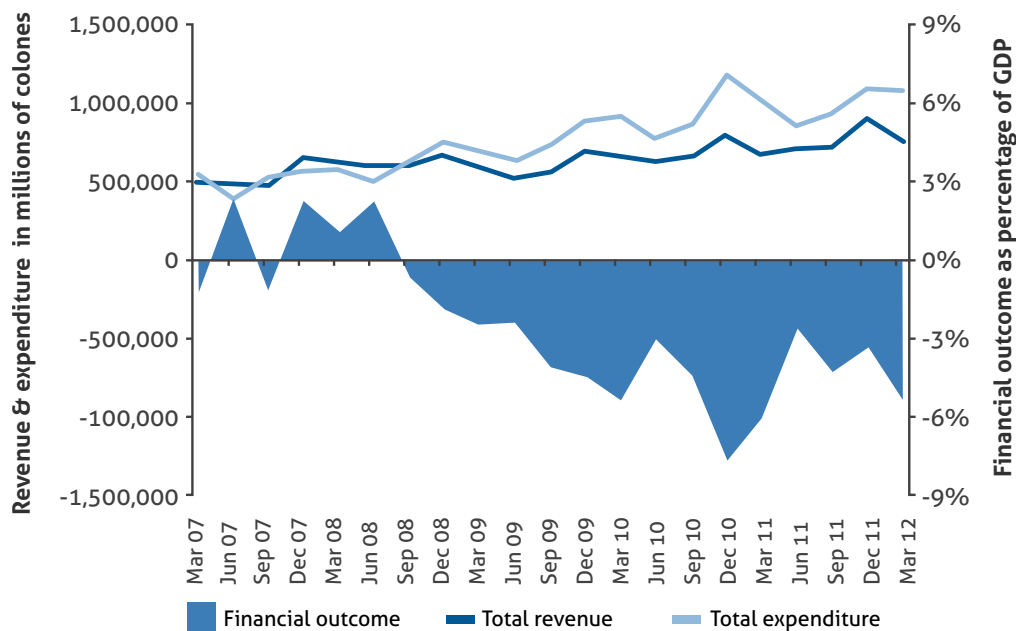
factors decrease the capability of Costa Rica's monetary policy to maintain low inflation while sustaining the current exchange rate. In 2013 the country has not been able to escape this conundrum.

The solutions proposed by the current Chinchilla Miranda Administration (2010-2014) are not very different to those applied in the past decades. The administration sought to approve a partial tax reform aiming at generating immediate revenue. Although Congress approved this reform, the Constitutional Tribunal rendered it unconstitutional. As a fallback, the administration enacted tight fiscal policies to prevent a further deterioration of the state's finances. The country has been unable to enact a comprehensive tax reform in the past two decades, even if most governments have actively pursued it.

Tax exemption regime requires thorough revision

Costa Rica has heavily relied on tax exemptions to pursue economic growth and social goals. Nowadays, 172 exemptions have been enacted by Congress. In the past two years some initiatives were set forth to estimate the resources that the State loses in order to grant such benefits. Under the country's current legislation, there are four main sources of exemptions: Law of Income Tax (Rent), General Sales Tax, Legislation related to selective consumption and fuel tax exemptions, and Free Trade Zones tax exemptions. The estimated tax expenditure of these four sources is 5.8% of GDP, equivalent to 43.3% of

Graph 3. Costa Rica: Evolution of Central Government finances (2007-2012)



Source: XVIII State of the Nation Report, with BCCR data.

all Central Government tax revenues. In order of importance, the main contribution would come from the sales tax (63%) and income tax (31%) exemptions.

The country lacks studies assessing whether exemptions' real effects match stated policy goals. A recent report revealed that current beneficiaries include a heterogeneous group, not necessarily benefitting lower income groups or sectors that have lagged behind in productivity and innovation.

The national discussion about granting tax incentives to dynamic sectors of the economy (i.e. Free Trade Zones) has brought about an unresolved tension. In comparative terms, the exempted sectors generate few tax revenues. However, many of the conditions that make Costa Rica attractive for a multinational business demand large public investments in education, training, innovation and infrastructure.

Table 2. Tax expenditures for a selected group of countries
(percentage of GDP)

Country	Estimated year	Tax expenditure ^{a/}
Great Britain	2006	28.0
Canada	2004	13.8
Guatemala	2009	10.4
United States	2008	10.3
Dominican Republic	2009	14.9
Costa Rica	2011	13.3
Chile	2009	15.3
Spain	2008	10.7
Colombia	2007	13.6
Brazil	2009	15.6
South Korea	2006	15.5
Netherlands	2006	27.7
Peru	2009	13.4
Germany ^{b/}	2006	11.3

a/ The tax collection rates refer to compulsory transfers to the central government for public purposes. They exclude fines, penalties and most contributions. The data corresponds to the year that records the assessment of the tax burden. For Dominican Republic the figure is 2008.

b/ Only includes the tax expenditure of the Federal Government.

Source: XVIII State of the Nation Report, based in Rodríguez, 2012, with data from OECD, World Bank, Fiscal Studies Program of the UNA and Ministry of Finance.

Social Outlook

Key Findings

- In 2012, poverty and extreme poverty levels remained statistically unchanged from previous years. In 2011, 21.6% of Costa Rican households lived in total poverty and 6.4% in extreme poverty, affecting more than one million people nationwide (out of 4.6 million).
- The gap between rural and urban poverty fell by one percentage point as a result of increased urban incidence (which reached 19.1%) and a slight reduction in the rural incidence (26.0%).
- Income distribution inequality continues to grow. The 2012 figure was the highest in recent years.
- The Greater Metropolitan Area boasts the best conditions in terms of access to public services, housing quality, asset holding and educational attainment. However, Costa Rica's intraregional gaps are narrower than in most Latin American countries.
- In spite of economic recovery, the unemployment rate remains high by Costa Rican historical levels (7.8% in 2012).
- Women and lowest-income people are among the hardest hit by unemployment. The unemployment rate of the population with lowest income is ten times higher than those located in the apex: 21.4% versus 2.3%.
- Workers' rights in the labor market are insufficiently enforced. According to the 2011 National Household Survey, 1 in 5 salaried workers does not receive law mandated bonuses, 3 out of 10 do not enjoy paid holidays or are covered for work injuries or illness, and about half do not receive payment for overtime.
- Costa Rica's public social expenditure fell by 0.5% between 2010 and 2011, which on a per capita basis is equivalent to a decrease of 1.6%. The slowdown is noteworthy in light of the upward trend that had been observed since 2006. Despite this slowdown, the country still invests heavily in social policies.

Social Performance in 2012

In 2012, Costa Rica continued to show progress in human development, especially in health and education average indicators. However, there were also setbacks in social equity and cutbacks in expenditures allocated to social programs.

The XVIII State of the Nation Report alerts of a decoupling between economic modernization and growth on the one hand, and access to opportunities for wellbeing, on the other. The country's social integration is eroding as increasing income inequality and protracted poverty levels create barriers difficult to overcome between groups and sectors.

The country seems to be running "out of gas" to address the widening social inequality, a developmental problem. The immediate challenge is to prevent that public budget cuts push segments of the population into poverty and vulnerability- a challenge that becomes more complex due to the rapid ageing of the population and the slow progress in expanding the segment of highly skilled laborers within Costa Rican work force.

Social Outlook

Costa Rica's society is rapidly ageing

In the last twelve years, the elderly population of Costa Rica has been growing at an annual rate of 3.7%, a pace 2.5 times higher than the overall population growth. This group comprises approximately 8% of the population and by 2050 an estimated one in five people will be elderly, compared with less than one in ten today.

The country has experienced a gradual increase in the proportion of households with an elderly person among its members and the percentage of those with two or more elderly people. The XVIII State of the Nation Report also observes a strong and sustained increase in households headed by an elderly person who lives alone.

Traditionally the incidence of poverty is higher in households with older persons than in those who do not have elderly people. An average of 87.5% of adults own a home in Costa Rica, and within this group, the quality of the buildings where elderly people live tend to be lower than the rest of the population.

Homicide rates declined despite prevailing feeling of insecurity

Costa Rica's homicide rate is the lowest in Central America and registered an important decrease from 11.2 cases per 100,000 people in 2010 to 8.8 in 2012. The country also experienced a fall in property crimes (such as theft and robbery), and continues to differ itself from the historically high rates of crime and violence that prevail in the region. However, not all crimes have declined at the same rates. The most common offenses in Costa Rican households such as assaults, and burglary, are also the incidents least likely to fall and one of the reasons of the prevailing feeling of insecurity among the population.

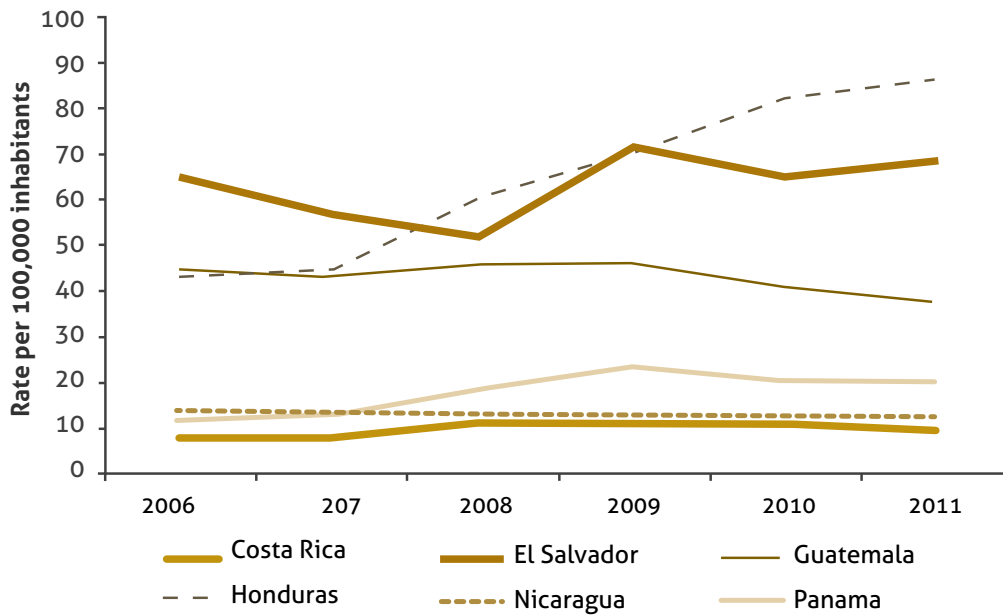
A 2011 World Bank study alerts about Central America's spiraling wave of crime and violence which has triggered huge economic and human losses. Crime rates in Honduras, El Salvador, and Guatemala are among the top five in Latin America and a ten percent reduction of murder rates in these violent countries could boost annual economic growth by as much as a full one percent. The World Bank report agrees with the State of the Nation Program's own Central American Report in that with the exception of Costa Rica, all Central American business owners place

crime among the top five obstacles to business growth and productivity.

Crime and violence in the region is a result of unprecedented levels of drug trafficking and a decades-long culture of violence, as well as easy access to firearms and weak judicial institutions. Indeed, drug trafficking ranks as the top cause for the rising crime rates and violence levels in the region. The lengthy civil wars (1970s-1980s) resulted in a massive

proliferation of weapons - most of them illegal, and often used in violent crimes; the great majority of homicide victims are young men between the ages of 15 and 34. Central America registers as well persistently high rates of domestic violence, which are expressed in the number of female murders and in parental homicide against children. In this context, Costa Rica continues to be a positive outlier.

Graph 4. Central America: Homicide rate per 100,000 inhabitants (2000-2011)



Source: Prepared with data from the Statistics Compendium State of the Region.

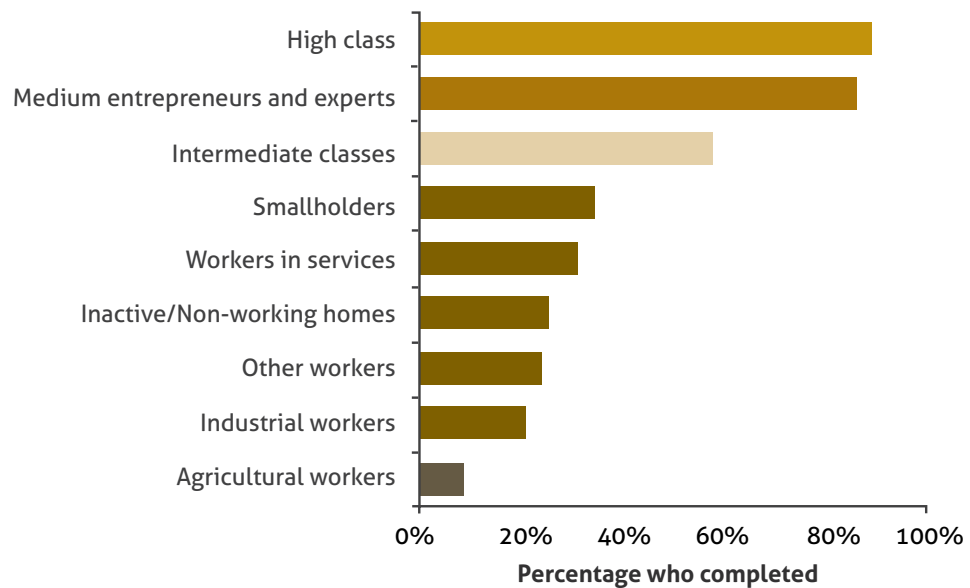
Costa Rica still struggles to achieve universal secondary education

Average schooling of the population aged 18 to 64 was 8.9 years, and rose less than two years in the last two decades. Thus, overall, average educational level is still below the Constitutional goal (Basic Education –9 years– for all). When examining the indicator of educational achievement in the population aged 25 to 39, it appears that recently only 42.1% had completed high school. However, there are important social and territorial differences. In the Greater Metropolitan Area five or more people out of ten have high school

diplomas, while in places such as the coastal areas of the Caribbean and the border counties of the Northern and Southern areas, only one in ten people get into college.

The distribution according to social classes shows great differences: businesspeople and professionals account for the highest percentages of high school graduates: 89.6% and 86.9%, respectively. Among intermediate social classes (clerks, technicians) achievement is lower (57.7%), followed by small business owners and workers in the services sector. At the lower end lie the agricultural workers among who only 8.8% have managed to finish high school.

Graph 5. Costa Rica: Percentage of population age 25-39 with at least upper secondary education, according to household's social class (2011)



Source: XVIII State of the Nation Report, based on Enaho data of 2011, from INEC.

In comparative perspective, Costa Rica ranks far behind other high Human Development achievers. In 28 out of 33 OECD countries, 60% or more of all adults (25-64 year-olds) have completed high school, though

levels vary between countries. For instance, in Brazil, Mexico, Portugal and Turkey, less than half of all adults have achieved upper secondary education. Costa Rica is one among this lagging group.

Table 3. OECD and Costa Rica: Population with at least upper secondary education (2009)

(percentage by group)

OECD	Age group				
	25-64	25-34	35-44	45-54	55-64
Australia	71	83	73	67	58
Austria	82	88	85	80	72
Canada	88	92	91	87	80
Chile	69	86	75	66	43
Costa Rica	36	41	35	36	29
Denmark	76	86	81	71	68
Finland	82	90	88	84	67
France	70	84	77	64	55
Germany	85	86	87	86	83
Greece	61	75	69	57	40
Ireland	72	86	77	65	48
Israel	82	87	84	78	74
Italy	54	70	58	50	37
Korea	80	98	94	71	43
Mexico	35	42	37	32	21
Netherlands	73	82	78	71	63
Norway	81	84	83	77	79
Poland	88	93	92	88	77
Portugal	30	48	31	22	14
Spain	52	64	58	46	30
Switzerland	87	90	88	86	83
United Kingdom	74	82	76	72	64
United States	89	88	88	89	89
OECD average	73	81	77	71	61

Source: OECD (www.oecd.org/edu/eag2011).

Poverty levels stagnate and income inequality rises

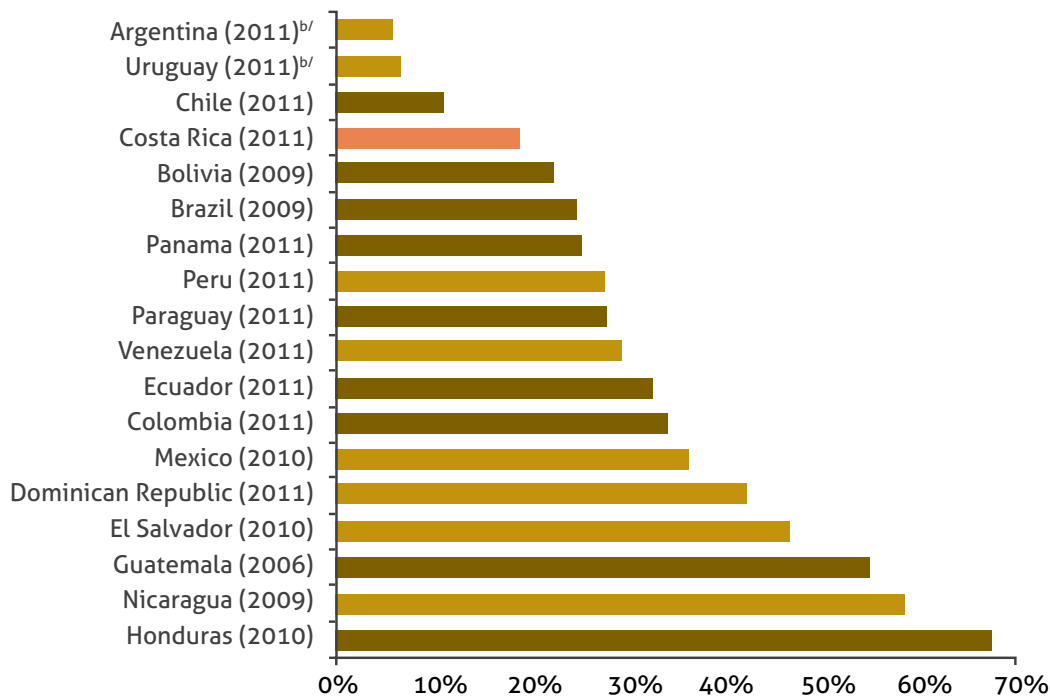
Since 1994, poverty has been affecting roughly 1 out of 5 Costa Rican households. No sustained progress has been made in spite of an average annual economic growth close to 4% during this period. This outcome stands in sharp contrast to the brisk progress experienced in previous decades, when poverty levels fell from close to 50% around 1960 to 30% in 1980.

However, Costa Rica's poverty level is comparatively low in the Latin American context. In perspective, one in three Latin Americans (180 million people in the region) still lives below the poverty line. In spite of scant progress in abating current levels of poverty, the country continues to stand out as an example of a middle-income country with comparatively high levels of human development.

The profile of the poor population also shows little change in the last twenty years, a situation signaling the lack of effectiveness by a wide range of public policies and programs aimed at improving schooling and the quality of jobs. Poverty is mainly concentrated in people under 18 years of age, jobless, with incomplete primary education or low education levels in general, smallholders, and agricultural workers. It also has an increasingly urban face and persistently occurs in female-headed households. In between 1990 and 2012 the gap in the average schooling of the poor and the non-poor has widened.

Costa Rica's measurement of poverty: The National Institute of Census and Statistics is the official entity in charge of the methodology used to estimate the "poverty line" of Costa Rica's population. This is an indicator that sets the minimum dollar amount required for a person to meet basic needs such as purchasing basic staples and other services. It requires estimating the cost of a basic food basket plus an estimate of the cost of non-food basic needs, differentiated by urban and rural areas of the country. The value of the poverty line is compared to the per capita household income, a comparison which enables the following classification of people and households with known income: **Non-poor households** are those with a per capita income that allows them to cover their basic food and non-food stuff, thus their per capita income is above the poverty line. **Poor households** are those households with a per capita income equal to or below the poverty line. **Extremely poor households** are those households with a per capita income equal to or less than the per capita cost of the basic food basket.

Graph 6. Latin America: People living in poverty and indigence (around 2011)^{a/}



a/ In brown the ten most unequal countries of Latin America.

b/ Urban area.

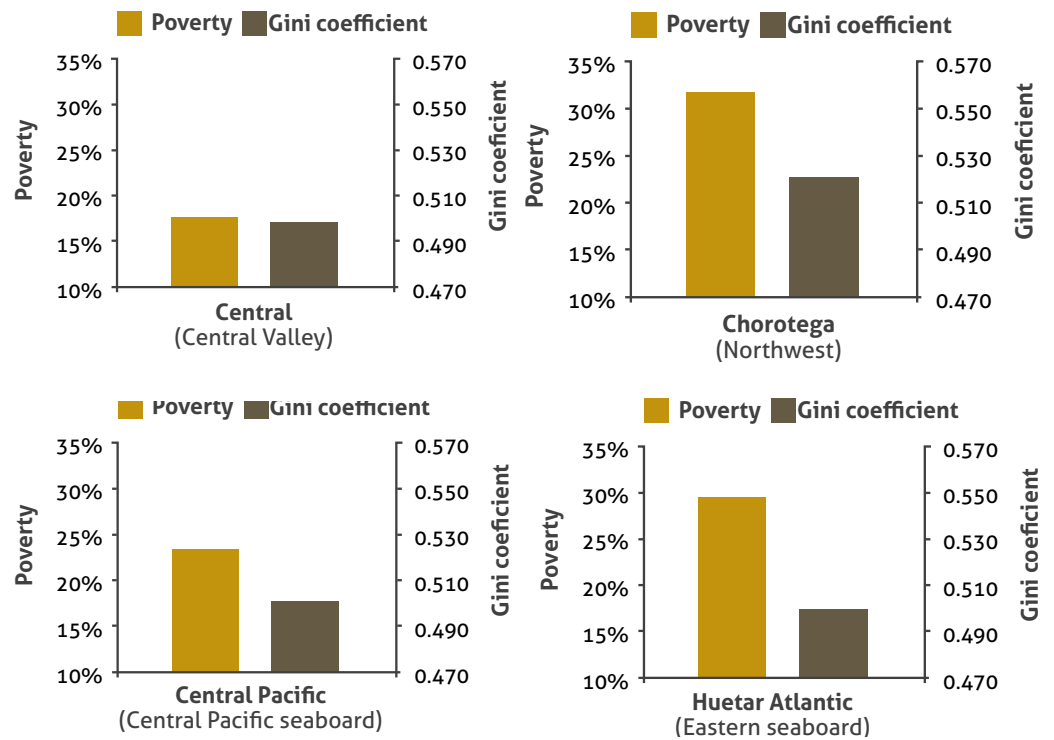
Source: Economic Commission for Latin America and the Caribbean (ECLAC).

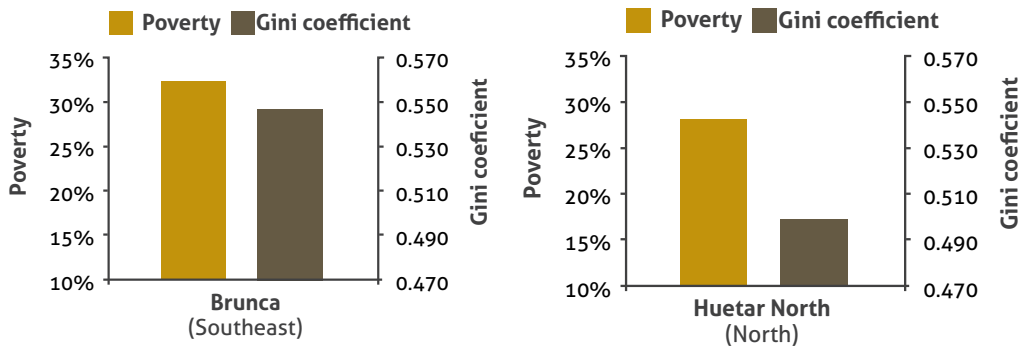
In spite of Costa Rican historical low levels of income inequality in Latin America, in recent years inequality has risen. Although data from the 1990's is not strictly comparable to the latest figures, all estimates show a growing gap between the haves and have-nots. In spite of renewed economic growth during the 2010-2012 period, the measure of inequality, the Gini coefficient, increased from 0.508 to 0.518, respectively. The main indigenous population of Costa Rica located in the southeastern side of the country lives in the most unequal area of the country.

Higher poverty and inequality levels are found outside the Central Valley where the Greater Metropolitan Area is located. The Brunca region -bordered by Panama to the east and the Pacific Ocean to the south and west- stands out for showing the highest poverty and inequality levels in the country, followed by the Chorotega region, in the northwest side of the country - bordered by Nicaragua to the north and the Pacific Ocean to the west.

About the Gini-coefficient of inequality: The most commonly used measure of inequality. The coefficient varies between 0, which reflects complete equality and 1, which indicates complete inequality (one person has all the income or consumption, all others have none). Graphically, the Gini coefficient can be easily represented by the area between the Lorenz curve and the line of equality. Numbers around 0.5 or more indicate high income inequality.

Graph 7. Costa Rica: Gini^{2/} coefficient and poverty levels by regions





Note: The organization and counting of people is based on their net income per capita adjustment. Values range between 0 and 1, where 0 corresponds to perfect equality and 1 to perfect inequality.

Source: XVIII State of the Nation Report, with data from EHPM, Enaho, and INEC.

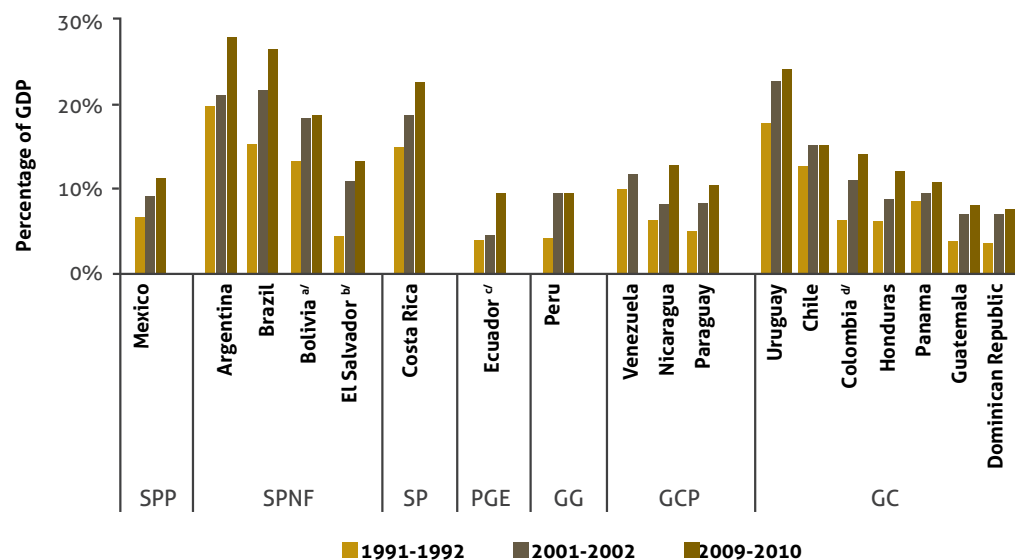
A recent comparative analysis performed by the State of the Nation Program, titled: International Experiences in Reducing Poverty and Inequality, analyzed trends in poverty reduction and income distribution among countries worldwide. Costa Rica has been moving away from a list of those exhibiting the best levels of income distribution (below 0.40) as well as high ranks in sustainable human development, such as Norway, Sweden, Northern Ireland, Germany, Belgium, Austria, Japan, South Korea, Czech Republic, Hungary, Canada and Uruguay. Nonetheless, countries like Austria, Canada, and Sweden have been experiencing widening gaps in income distribution levels.

Fiscal deficit triggers cuts in social spending

Costa Rica stands out among Latin American and Caribbean countries in that social spending persistently exceeds 15% of GDP, along with Uruguay, Brazil, and Argentina. Even if in recent years most countries in the region made efforts to increase the relevance of public social spending as a macroeconomic priority, Costa Rica remains among the top regional investors in social issues. It is worth noting that in 2009 and 2010 only Ecuador, Guatemala, Peru, the Dominican Republic and Trinidad and Tobago recorded social expenditures with values below 10% of their respective GDP.

About spending-to-GDP ratios: In an economic downturn, it can rise for two reasons: 1) Because public spending goes up to address the greater need for social support, such as unemployment or housing benefits; and/or 2) GDP declines more rapidly than public spending.

Graph 8. Latin America: Evolution of Public Social Spending as percentage of GDP (1991-1992 to 2009-2010)



SPP: Public Sector Budget;
SPNF: Non-financial Public Sector;
SP: Total Public Sector;
PGE: General State Budget;
GG: General Government;
GCP: Central Government Budget;
GC: Central Government

a/ The 1991-1992 data is for 1995-1996.

b/ Series with methodological changes since 2004, so it is not strictly comparable with earlier data.

c/ Doesn't include social security spending.

d / From 2000 data are not comparable with previous years.

Source: Economic Commission for Latin America and The Caribbean.

When compared to a more developed set of countries, such as those belonging to the OECD (see box below), Costa Rica fares positively. Its economy has been growing above OECD average and the level of social spending (GDP ratio) is also above OECD average. However, it should be remembered that OECD countries boast of much more advanced economies and vastly higher social spending per capita.

Table 4. OECD and Costa Rica: Levels and recent trends in public social spending^{a/} (2007-2012)

		Level of public social spending		
		Below average (below 5.7%)	Around average (between 5.7% and 14.2%)	Above average (above 14.2%)
Change in real GDP	Above average (above 3.6%)		Canada, Mexico, Poland, Sweden	Australia, Chile, Israel, Korea, Norway, Switzerland, Costa Rica
	Around average (-4.9% thru 3.6%)	Germany	Austria, Belgium, Denmark, Finland, France, Luxembourg, Netherlands, Slovak Republic	New Zealand, United States
	Below average (below -4.9%)	Greece, Hungary, Iceland, Italy, Portugal	Czech Republic, Estonia, Ireland, Spain, Slovenia, United Kingdom	

a/ Countries are grouped "above", "average" and "below" in line with the changes to real social spending and real GDP between the average for 2007 and 2008 and the average for 2011 and 2012.

Source: Organization for Economic Co-operation and Development (OECD) and Programa Estado de la Nación.

About the OECD countries: Dating back to 1960 when 18 European countries plus the United States and Canada joined forces to create an organization dedicated to global development, today the OECD is composed of 34 member countries from across the globe, from North and South America to Europe and the Asia-Pacific region. They include many of the world's most advanced countries but also emerging countries. The current membership is composed of: Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

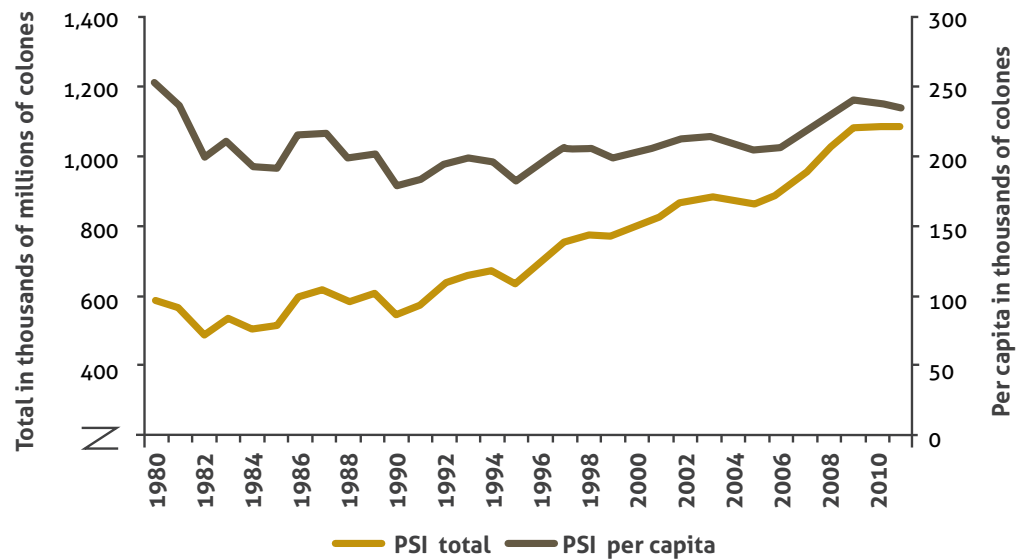
Nonetheless, Costa Rica's public social investment has struggled during the past three years due to the country's fiscal problem previously analyzed. Universal programs such as public education and selective programs such as poverty reduction went through cutbacks or, in the best case, barely managed to maintain overall real term expenditures.

per capita terms. Universal programs were the most affected by real term expenditure cuts. However, in 2012 better allocation of resources slowed the negative effect of cuts since benefits to the population most in need did not shrink, at least for the moment. This is a positive sign, but hard to replicate in the future if fiscal deficits continue at current levels.

Social investment per capita showed a mild contraction of -1.6% in 2011, pausing the sustained expansion registered between 2006-2009 when expenditures increased by 18% in

GRAPH 9. Costa Rica: Evolution of real public social investment (PSI), total and per capita (1980-2011)

(in colones of year 2000)



Source: XVIII State of the Nation Report, based on Trejos, 2012 and information from STAP, BCCR, CGR, INEC and CCP-UCR.

A progressive social security system faces unprecedented hardships

Costa Rica has one of the most developed social welfare regimes in Latin America, providing quality health care and pensions to the majority of the country's population. Its cornerstone is the Costa Rican Social Security System (CCSS). Established in 1941, the mission of the CCSS or "Caja" -as colloquially referred to in Spanish-, is to provide health services in an integrated manner to all individuals, families and the community (with targeted programs aimed at the poor and vulnerable) and to provide financial, social and pension-related protection to Costa Rica's population. The Caja's structure is based on a set of three basic principles: universal coverage, equal access, and solidarity in its financing. The Caja manages two funds: the Health Insurance and the Pensions Funds.

While social security coverage is very low in two thirds of Latin American countries, Costa Rica stands out in the region as the country with the most coverage for health insurance: 92% of the total population. The Caja also covers the migrant population in terms of basic services, especially in the case of emergency services and primary care, but also in terms of hospitalization for childbirth or serious accidents.

The global financial crisis left its most serious mark in Costa Rica by delivering a hard blow to the Costa Rican Security System (CCSS). In the past, the Caja has experienced some financial hardships, but never quite like in 2010-2011. The recent institutional crisis led to many

protests, strikes and serious questions about how one of Costa Rica's most cherished public institutions should be managed. The recent crisis is a risk factor that could be detrimental to the health gains that have merited Costa Rica in the last decades, if no appropriate corrective action is taken.

Historically, social security expenditures have grown at lower rates than revenues. However, in the last five years this trend reversed: while health insurance revenue grew at an annual average rate of 8.1% (in real terms), expenditures were up at 10.1%. The coexistence of a highly procyclical revenue model with a cost structure decoupled from economic cycles may lead to financial imbalances in times of economic crisis.

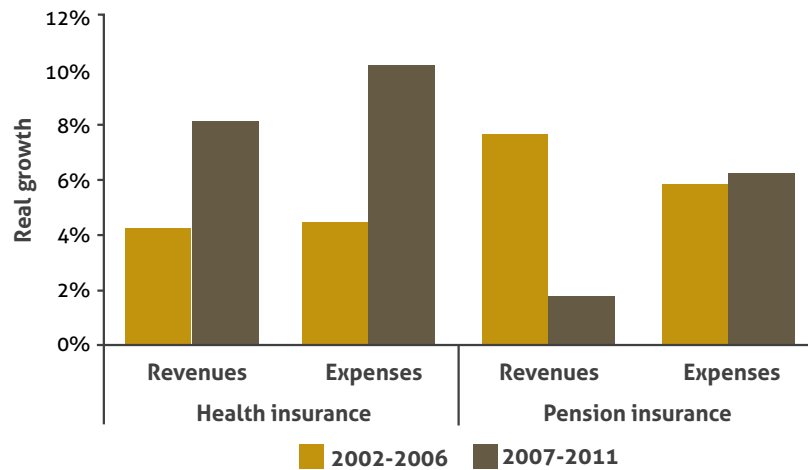
The CCSS administration faces the dilemma of implementing unpopular actions to rebalance its finances. These actions have the potential to generate conflicts with various power groups. Postponing the implementation of corrective but "controversial" measures to a time when there is a more favorable political environment may help preventing protests. Nonetheless, the Caja needs to address the factors undermining its financial sustainability to further prevent a gradual weakening of the entity.

Throughout 2012, the Board of the CCSS promoted a series of strategic actions designed to improve the finances of the institution, such as the adoption of 45 austerity measures which cover almost half of the recommendations of the Expert Commission appointed in 2011 to

study the entity's financial situation. However, these actions are not sufficient to ensure the sustainability of the social security system. There are more fundamental drivers threatening the ability of the Caja to deliver the high quality services for the population. Some factors relate the conditions through which the population has access to the portfolio of health insurance and pensions services. Other factors pressing institutional finances stem from the changing demographic structure of Costa Rican society, which is leading

to a fundamental transformation of the country's health and pensions demands. Some are organizational in nature, related to the institutional reforms, management of human resources and more effective planning. However, the presence of a variety of political forces with substantial bargaining powers could hinder the implementation of these measures. Many of the required changes affect commercial and professional interests of a wide range of actors.

Graph 11. Costa Rica: Real annual growth of the CCSS budget by type of insurance (2002-2011)
(five year averages)



Source: CCSS Budget reports to the National Comptroller.

Insufficient enforcement of workers' rights

Compared to most Latin American countries, Costa Rica's labor market development is fairly developed. The formal sector -which comprises all jobs that comply with a country's regulatory framework such as reported payroll items, income taxes, employee taxes- covers roughly 55% of the workforce. In most countries of the region, the formal sector encompasses a third or less of the workforce. However, in the past two decades Costa Rica has been unable to vigorously expand its formal sector. In consequence, roughly 1 out of 3 workers are employed in the non regulated informal sector, lacking proper labor rights and guarantees.

Nonetheless, the XVIII State of the Nation Report revealed widespread illegal treatment of workers in the formal sector with regards to lawfully mandated bonuses, sick pay, vacation, and overtime payments. At least one in five salaried employees aged between 15 and 64 saw their rights breached by employers. In general, workers in regions such as the Chorotega and Brunca, are the most vulnerable to these situations. In the southern Brunca region only one in three workers receives overtime pay. Employees in construction and domestic work, as well as people under 20 years of age or over 55, tend to be more affected by violations of the labor law.

Table 5. Costa Rica: Salaried workers ages 15 to 64 who enjoy legally mandated paid labor rights (2011)

Region	Compulsory annual bonus	Sick pay	Paid vacation	Occupational hazard	Extra hours
Central	83.4	73.9	76.4	69.9	56.4
Chorotega	69.3	59.0	62.6	55.8	45.5
Central Pacific	74.2	65.7	67.2	66.2	47.0
Brunca	64.2	56.2	58.3	54.8	35.3
Huetar Atlantic	78.9	74.1	74.2	72.2	51.8
Huetar North	72.7	61.7	65.0	62.0	49.5
Country total	80.4	71.3	73.6	68.1	53.6

Source: XVIII State of the Nation Report, with 2011 Enaho and INEC data.

Political Outlook

Key Findings

- The current Chinchilla Miranda administration has been entangled in high-profile domestic and international conflicts, such as the CCSS crisis, the border dispute with Nicaragua and a number of corruption cases, among others, which has led to increasing negative public opinion assessments.
- In 2011, for the first time in 42 years, Congress was not chaired by the political party of the government in office -an unprecedented scenario for the National Liberation Party of President Laura Chinchilla Miranda. The brief experience of an opposition-controlled Congress ended in 2012.
- Social mobilization and citizen protests -with no overall major trigger- rose to levels not seen since 1995 and 2000. 2011 registered the third highest point of the last seventeen years in organized protests – that is, when two or more people demonstrate and/or issue a petition from a public or private entity. Preliminary data for 2012 shows that protest levels remained at the 2011 high levels.
- An increasing citizen malaise reflects a deep unease among citizens, who feel their demands are unheard and unanswered by their political parties, institutions, or traditional organizations of civil society.
- The Judiciary's key performance indicators improved. However, high profile events damaged the Judiciary's public standing and may undermine in the future the legitimacy of its institutions.

Political Performance in 2012

For the past two years, the three branches of government (Executive, Legislative and Judicial) experienced severe and simultaneous political problems. Although causes differ, as well as the intensity of these problems, their convergence contributed to generate a sense of gridlock, uncertainty and negative citizen reviews.

A particular concern is the weakening of citizen support towards democracy and the surge of organized protests. Under current conditions, the general feeling is that the political system has been increasingly unable to attend social demands and it remains unclear how some public management and political representation problems will be addressed. Despite this prevailing malaise, the foundations of the country's political regime and institutional system remain robust.

Political Outlook

Lowest public support for democracy since 1978

According to the 2012 Americas Barometer survey results, Costa Ricans' support for democracy and its institutions has steadily deteriorated. Average support for the country's political system recorded its lowest level since 1978.

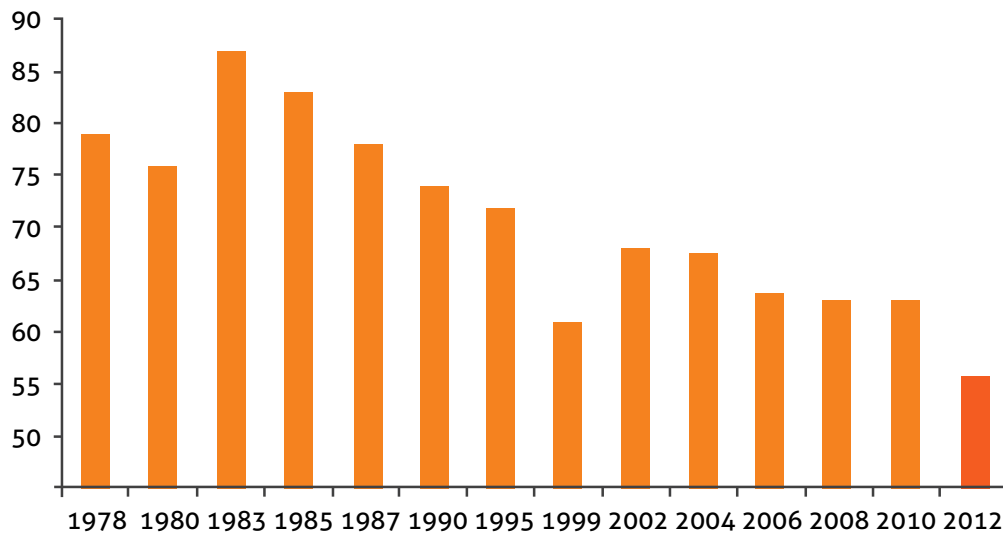
This data reflects a long-term trend showing a decline in support for democracy and coincides with a number of factors, such as: 1) The deterioration of the bipartisan political system, 2) Volatility in voter preferences,

3) Corruption scandals, and, 4) Lower levels of electoral participation. The components of the Citizen Support Index which suffered the biggest drops were: Pride felt towards the political system, Support for the political system, and the perception that the courts guarantee a fair trial.

The comparatively low level of system support has also coincided with a significant increase in organized citizen protests which, according to data, is not driven by any particular unifying element of discontent. More and more actors are turning to social mobilization to "shout out" and bring in their demands to the government.

About the Americas Barometer: It is the only survey of democratic public opinion and behavior that covers the Americas (North, Central, South and the Caribbean). It is the cornerstone of the Latin American Public Opinion Project (LAPOP), hosted by Vanderbilt University. The Barometer is an effort to measure democratic values and behaviors in the Americas using national probability samples of voting-age adults.

Graph 12. Costa Rica: Average Support for the Political System (1978-2012)



Note 1: Taking into account the Americas Barometer survey, the average index of support for the political system is estimated by averaging the responses to the following questions (using a scale of 1-7):

To what extent do you think the courts in your country guarantee a fair trial?

To what extent do you feel respect towards the political institutions of your country?

To what extent do you think that citizens' basic rights are well protected by the political system of your country?

To what extent do you feel proud of living under the political system of your country?

How do you think citizens should support the political system of their country?

Note 2: Studies from 1978, 1980, 1983, 1985, 1990, 1995 and 2002 are based on sample interviews throughout the Greater Metropolitan Area of San José. In other cases, the analysis is based on a national sample used.

Source: XVIII State of the Nation Report, with Lapop data.

Current cabinet suffers highest instability of the past four administrations

High cabinet instability reigned throughout the first two years of President Chinchilla Miranda's administration (2010-2014), weakening the Executive's ability to conduct governmental affairs. In some cases, resignations came after allegations of corruption and political mismanagement, which in turn affected public trust in the government. Among the incidents that triggered resignations were the fiscal reform quagmire in 2012, the border dispute with Nicaragua, the loss of control by the incumbent party of the Parliament's Legislative Directory, the Social Security System (CCSS) Crisis, and irregularities in the construction of a new road along the border with Nicaragua.

Fifteen out of the 21 ministers left their posts during the first twenty-four months in office. As a result, the current administration registers the greatest level of instability of the last four administrations. While cabinet changes are considered normal in any government, volatility contributed to the loss of confidence in the work of the Executive as a whole.

New progressive legislation lacks resources for enforcement

Congress has repeatedly been enacting laws that recognize and expand the portfolio of rights

enjoyed by the population and assign new responsibilities to the State, but do not provide funding sources for their implementation. One third of the laws passed in 2011-2012 include expansive rights provisions. However, 68% of this legislation lacks financial support, which in turn becomes an obstacle for compliance and execution. This is what the State of the Nation Report calls a "democratic promise without economic support", an leads to further citizen criticism and public discontent due to the inability of state institutions to adequately meet the new legally enacted mandates.

At the same time, Congress has lengthened the timeframe it needs to pass new legislation. In the 2011-2012 it took an average of 28.2 months to approve a piece of legislation, up more than 6 months a few years ago. This means that nowadays the legislative process has become more complex, which may be due, among other factors, to the multiparty scenario currently prevailing in Congress, in which any kind of agreement requires more effort and time to come through.

On a positive note, the new electoral code of Costa Rica (enacted in 2009) requires mandatory gender parity in party lists for congress (50% male and 50% female, with a system of alternation). This requirement will ensure at least 45% of the seats in Congress for women, an uptick from the current situation where 23 seats are held by them (40% of the total seats).

A robust judiciary entangled in the judicialization of politics

Overall, Costa Rica's justice system's main indicators have been showing positive trends over the past few years: improvements in productivity (number of solved cases per judge) and reductions in the net inflow of cases entering the system annually. Furthermore, the judicial modernization process also shows favorable results. Flagrant courts are a good example. Through these instances, the processing of cases in which the accused has been caught red-handed has made criminal justice more expedite.

However, the Judiciary faces complex political challenges. Conflicts with the Executive and Congress, as well as high profile cases of influence peddling by high ranking officials, and overt conflicts between members of the Supreme Court are creating risks for the legitimacy and public trust in this State branch.

New resources to fight corruption amidst critical challenges

Transparency in public affairs is largely recognized as a precondition for fighting corruption. In the last decade, Costa Rican governments ratified International treaties, approved laws and created new watchdogs against corruption. Citizen awareness and

activism has risen, and the media has helped to uncover corruption cases of high ranking public officials.

Still, the institutions that control and monitor public resources (such as courts, Office of the Public Prosecutor, the Office of the Attorney General, the Office of the Ombudsman, the Office of the Comptroller General, among others), continue to deal with inadequate human and financial resources to attend ever increasing and complex workload which demands costly legal research, even international travel and highly specialized expertise. There is still a long way ahead towards strengthening the capacities of the institutions to ensure the legality, transparency, and accountability of public resources and their use. However, Costa Rica's accountability institutions are by far one of the most robust in Latin America and, certainly, the most developed in Central America.

Table 6. Central America: Per capita budget of Public Audit Institutions (2007-2011)
(dollars)

Country	2007	2008	2009	2010	2011
Costa Rica	5.3	5.6	6.7	7.5	7.9
El Salvador	4.4	4.5	5.1	5.5	5.6
Guatemala	1.5	1.9	1.9	1.8	1.9
Honduras	0.9	1.0	1.2	1.2	1.2
Nicaragua	1.3	1.2	1.1	1.0	1.1
Panama	12.6	13.4	14.3	17.3	21.3

Source: IV State of the Region, 2011, updated with data from the budgets of each country.

In Costa Rica, the increasing complexity of cases requires institutions to diversify the professional profile of its staff and engage in interdisciplinary work. Such is the case with the Office of the Comptroller General -which performs not only financial and legal but also technical control- and would be benefitted with professionals from various fields, such as specialists in environmental issues (due to the high demand in that subject-matter), as well as economists and social workers to assess the effectiveness of social policy spending.

Poor management and low human development in most municipalities

Based on data from the United Nations Development Program (UNDP) and the Office of the Comptroller General of Costa Rica, the State of the Nation Report developed a typology of municipalities: 1) Best municipalities (counties above average in both human development indicators and quality of local governance), 2) Vulnerable municipalities (combines high human development with poor management), 3) Municipalities with potential to improve

(low human development but high quality of local governance), and, 4) Lagging municipalities (matching the worst conditions on human development and poor management).

Only 23 of the 81 counties (28%) can be placed in the best group. Consequently, most counties show a combination of low levels of human development and/or municipal management. The most vulnerable group encompasses 25 municipalities (31%).

Costa Rica's foreign policy: political setbacks despite dynamic trade agenda

Costa Rica's foreign policy has a dual leadership. On the one hand, the responsibility of diplomatic and political components of international relations lies with the Ministry of Foreign Affairs, and, on the other hand, the trade component is led by the Ministry of Foreign Trade, in coordination with other institutions such as the Export Promotion Agency of Costa Rica (PROCOMER in Spanish) and the Costa Rican Coalition for Development Initiatives, among others.

On balance the Foreign Ministry's performance in the 2010-2012 period was mired by management and policy problems. In the past three years there have been two issues which occupied much of

the attention and the work of this Ministry: 1) The border dispute with Nicaragua, which resulted in a complaint to the International Court of Justice at The Hague, Netherlands –still unresolved–; and 2) Allegations of irregularities in appointments in the Foreign Service. Actions taken were more reactive than propositional, and no evidence of clear priorities and guidelines were set in this area. However, in 2013 Costa Rica's foreign policy scored an international victory when the United Nations Assembly approved the Arms Trade Treaty, an initiative promoted by Costa Rica since the late 1990s.

In the case of the Ministry of Foreign Trade the balance is quite positive. It was able to complete the negotiations of new Free Trade Agreements (FTAs) with the European Union and Singapore, initiate negotiations with China, promote new international business alliances, such as a feasibility study for a FTA with Korea. In general, actions taken in recent years went beyond Costa Rica's three main trading partners: Central America, the United States and Europe. The Ministry's focus also lies in approaching the Asia-Pacific region and deepening trade ties with other nations in South America and the Caribbean.

Environmental Outlook

Key Findings

- In 2011, Costa Rica's ecological balance was negative. As a result, the country is environmentally indebted: every person used 8% more than the land available to meet their own demand for natural resources.
- Carbon emissions are the main cause of the country's ecological debt, accounting for 27% of the overall ecological footprint. It is estimated that a 27% reduction in greenhouse gas emissions would enable balancing the footprint.

Ecological Footprint: Area of ecologically productive land (crops, pastures, forests and aquatic ecosystems) necessary to supply the resources a human population consumes, and to assimilate associated waste.

- More than 90 percent of Costa Rica's electricity comes from clean sources, in contrast with other Central American countries where most of the electricity production comes from oil. Currently about 9.5% of Costa Rica's electricity is produced using fossil fuels, the highest percentage in fifteen years when it was around 3-5%.
- Average consumption of water per inhabitant of Costa Rica is of 1,490 cubic meters of water per year, 8% more than the world's average and significantly above the levels required for full replenishment of water sources.
- Only 0.79% of sewage from the Greater Metropolitan Area is treated in appropriate facilities. The rest is discharged directly into rivers flowing through the country's capital, San José.
- High concentrations of pharmaceuticals and personal care products were found in marine and superficial waters, especially the antibiotic doxycycline.
- In thirty years, the noise emitted by the country's vehicle fleet has increased. In selected areas of San José, noise can be five times as much than the appropriate levels to allow normal conversation.
- Only 12 of the 81 municipalities in the country have county land use plans; 18 more have partial urban plans.

- In spite of weak regulatory framework, the 1982 Greater Metropolitan Area's Urban Plan, mitigated some of the worst excesses of urban sprawling.

Environmental Performance in 2012

Costa Rica is internationally renowned by its environmental policies and accomplishments. It was an early developer of a system of national parks and protected areas, an innovator in establishing policies to promote forestry such as environmental service payments, and international activities for setting new treaties related to climate change and curbing greenhouse gases. All these accomplishments render a quite robust platform for further action in the quest of achieving sustainable development.

However, in recent years, the State of the Nation Reports have been warning about worrying trends in the country's overall environmental management. Although Costa Rica's efforts in environmental conservation and forest coverage are commendable, the country has a long way to go in other key areas, such as implementing a sustainable land management agenda and reducing the impact of human activities on the quality and availability of natural resources. Unsustainable patterns by the population in the use of natural resources are increasing the country's ecological debt.

As of 2012, a robust recovery of forest coverage can be reported as well as an increase in marine protected areas. However, no progress has been made in the protection of key ecosystems coastal areas, wetlands and water bodies. In addition, the growing demand of natural resources yields an increasingly negative ecological footprint. Every year, the country's energy matrix, fueled by rising oil demand of the transportation sector (59% of total energy demand), becomes more dependent on fossil fuels. Costa Rica registered the highest record in the use of oil for power generation in fifteen years, despite being one of the countries of the world with highest use of clean energies.

The country needs to engage in both a regional planning and a national dialogue to bring environmental issues beyond conservation policies back in as priorities for Costa Rica's human development.

Environmental Outlook

Remarkable recovery in forest coverage

Even if Costa Rica is part of Central America, a region in which the rate of forest loss in the last decade has been higher than the Latin American and global averages, the country can report a remarkable achievement. Since the 1990s the country underwent a remarkable recovery of its wooded areas. As of 2010, 52.3% of the national territory is under forest coverage, due to reforestation of cattle pastures and the expansion of new forested areas induced by public policy, more than

doubling the coverage the country had thirty years ago.

Costa Rica is a leading innovator in policies aimed at encouraging reforestation. Since the late 1990s, targeted environmental programs such as the Forest Credit Certificate and Payment for Environmental Services came into effect and helped maintain forest-covered areas and restore degraded areas. Along with other public and private initiatives, the PES has delivered over 258 million dollars to land owners and since its onset, it has enabled reforestation and

Map 1. Costa Rica: Forest coverage (2010)



Source: XVIII State of the Nation Report based on FONAFIFO, 2012.

protection of 867,100 hectares (17% of national continental territory). Regarding the use of forest resources, for several years Costa Ricans use wood from plantations, reducing the pressure on forests. Nevertheless, illegal logging practices still remain.

Robust conservation system still lagging in maritime areas

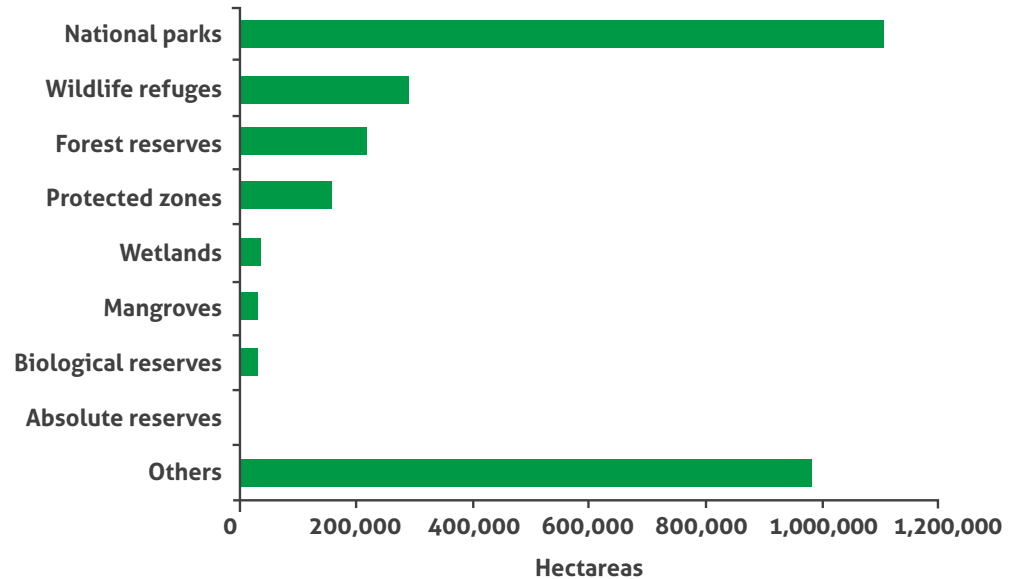
Costa Rica's total protected areas amount to approximately 28,559 sq km (11,027 sq miles), of which 47% are terrestrial and 53% marine habitats, neritic and oceanic. The country has taken steps forward by creating the "Marine Seamounts Management Area", a result of which, for the first time ever, the marine protected area was larger than the mainland's system of national parks and protected areas. However, the country continues to show weaknesses in the protection of wetlands.

Abiding by the international commitment to protect the twelve existing Ramsar sites in the country (a total of 5,697 sq km - 2,200 sq miles) is far from completion. Numerous complaints to the Environmental Administrative Court involved wetlands, mostly related to pollution concerns.

As for the marine area, the "Health Index of the Oceans" by Conservation International, which evaluates progress toward healthy oceans, ranked Costa Rica at an intermediate level, an average of 61 out of 100 (best score). Of the ten goals examined, only four scored above 70. The goals worst rated were food supply, tourism and recreation.

Ramsar sites: The Convention on Wetlands of International Importance, called the Ramsar Convention, is an intergovernmental treaty that provides the framework for national action and international cooperation in the conservation and wise use of wetlands and their resources. The Ramsar Convention is the only global environmental treaty that deals with a particular ecosystem. The treaty was adopted in the Iranian city of Ramsar in 1971 and the Convention's member countries cover all geographic regions of the planet.

Graph 13. Costa Rica: Protected areas by management category (2011)
(in hectares)



Source: XVIII State of the Nation Report based on Corrales, 2012 with data from Sinac-Minaet.

Costa Ricans’ increasing demand for natural resources compromises sustainability

The population’s demand for goods and natural resources exceeds the territory’s capacity to match it, which means that current consumption patterns are unsustainable. According to the latest international measurements of the Global Footprint Network, the environmental overuse of Costa Rica—the percentage by which the ecological footprint exceeded the country’s biocapacity—is 41.4%. Although this figure shows the unsustainable patterns of resource

use, when comparing Costa Rica on this indicator, the country’s ranking is lower than the average Latin American and global levels of overuse with 52.9% and 51.3% respectively. Costa Rica has drastically lower rates than countries with accelerated consumption levels like the United States - that reached 106.7% of overuse.

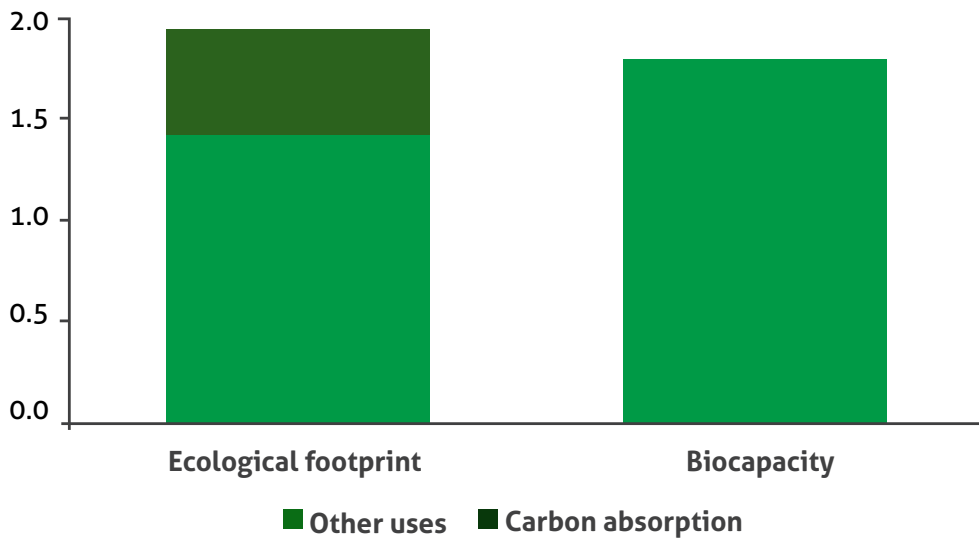
Costa Rica’s ecological debt is due to the intensive use of fossil sources of energy (oil), agricultural land and water. Estimates show that a 27% cut in carbon emissions would ensure that Costa Rica could achieve a balanced ecological footprint for the

first time in this century. Nonetheless, achieving such a goal is not easy because nearly three quarters of the energy demand is dependent on oil.

Indeed, transportation is the largest consumer of energy in the country (59% of final consumption demand), stemming from a fast growing fleet of 1,213,616 vehicles (as of 2011). Of the total registered units, approximately only 200 are hybrids. The country still lacks policies aimed at improving public transportation in

terms of organization, efficiency and environmental impact. One sign of progress is the expansion of the urban railroad service, which during 2011 opened new routes and mobilized 2.1 million passengers. However, this figure is marginal in contrast to bus transportation: train travel is less than 1% of total annual bus transfers that take place in the Greater Metropolitan Area.

Graph 14. Ecological footprint and biocapacity, regarding carbon absorption and other uses (2011)
(global hectares per person)



Source: XVIII State of the Nation Report, based on Fernández, 2012, with data from INEC, Sepesa, DSE, ONF and FAO.

Lack of urban planning fuels land-use conflicts

Land-use planning is a critical issue for environmental protection, sustainable use of natural resources and disaster risk management, among others. However, this issue has never been a policy priority for Costa Rica's government authorities. The initiatives undertaken in the last three decades have failed or been misused, and there is neither the political will nor the necessary institutional regulations to take concrete actions on this subject-matter.

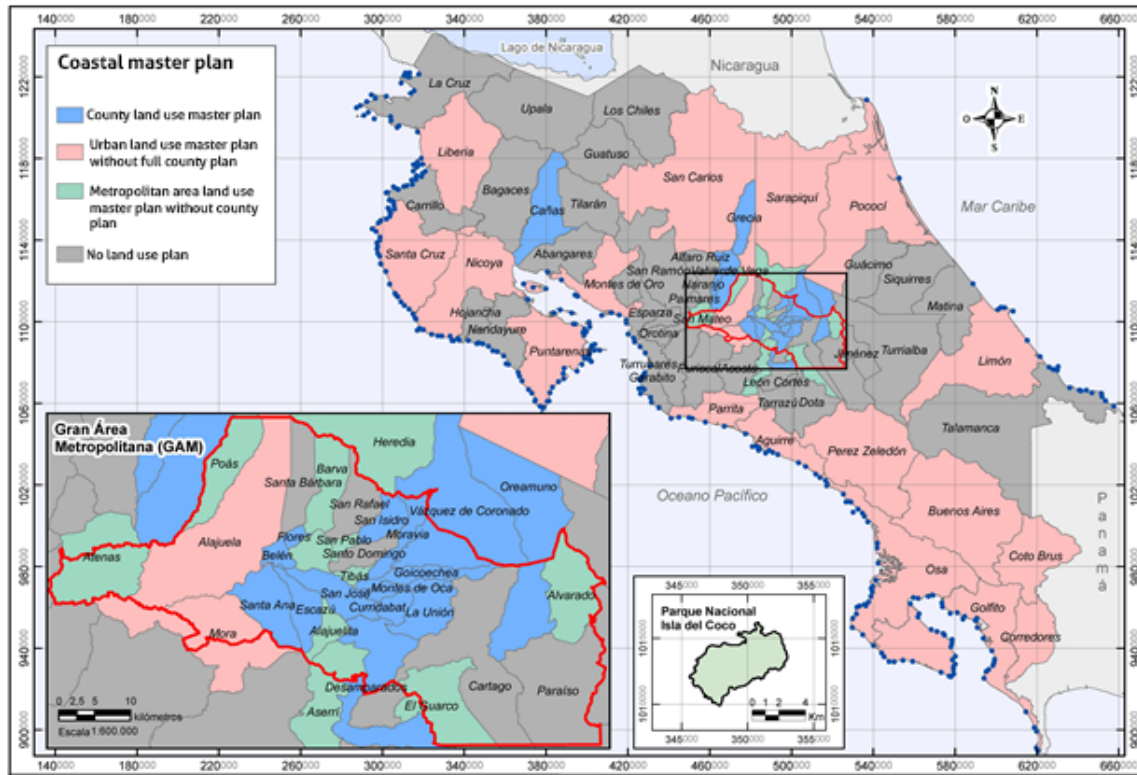
Out of Costa Rica's 81 municipalities, only 18 have a land use master plan (Map 2). Most of the country lacks these plans. The exception is the Greater Metropolitan Area (GMA) – roughly 4% of the national territory – which is home to 31 counties, to more than half of Costa Rica's population and the country's economic activity. Herein, a weak GMA Plan dated from 1982 established an urban planning strategy delimiting construction areas on the one hand, and protected and agricultural use areas on the other hand. However, the Plan did not provide public authorities with appropriate regulatory capabilities to ensure sustainability and order urban development, even though it prevented key protected areas from urban encroachment. Among a bitter dispute between public and private institutions, the task of updating or improving the GMA Plan remains and other new proposals are under study and discussion.

Universal water supply coexists with lack of proper sanitation and waste

In Latin America, Costa Rica stands out for its quasi-universal water supply to the population but has major weaknesses in its wastewater treatment and monitoring of water bodies to prevent pollution. In-house water supply covers approximately 98% of the population, and certified potable water supply up to 90.1%. However, water demand is nowadays exerting significant pressure on water sources. A recent study found that 31.2% of the population uses more water than the threshold required to ensure proper replenishment of water sources.

Besides sewage, new pollutants threaten coastal waters, superficial and underground water bodies such as pesticide residues, organic compounds, detergents, heavy metals and other substances. High levels of pharmaceuticals and personal care products have been found in rivers, mangroves, estuarine waters and sewage effluents at various points around the country, as well as pesticides in several rivers on the Caribbean coast. Furthermore, there has been slow progress related to wastewater management as only 20.5% of Costa Ricans have sanitary sewage service, and over 75% use septic tanks.

Map 2. Municipalities with land use master plans. 2011



Source: XVIII State of the Nation Report, based on ProDUS-UCR, 2012.

High levels of noise pollution in capital city

Noise pollution is an issue of great importance to the quality of life of Costa Ricans and a cause for repeated complaints to the Ombudsman and the Ministry of Health. The main source of emissions and noise comes from the transportation sector, which has great impact on the urban

environment. However, it has been seldom measured nor it has become, until now, a priority for health and urban policies.

The growth of the motorized vehicle fleet is a main cause of noise pollution in the Greater Metropolitan Area. The country lacks regulations to ensure that imported cars meet international standards of sonic emissions.

Other sources of noise that are also common causes for complaint are entertainment centers and churches. The highest amount of noise pollution complaints comes from urban areas.

Noise pollution: The term refers to the noise emissions affecting the health or the activities of people. Its magnitude is determined by measuring noise levels at specific sites and then comparing results with values and standards of national and international regulations.

A disaster risk prone country

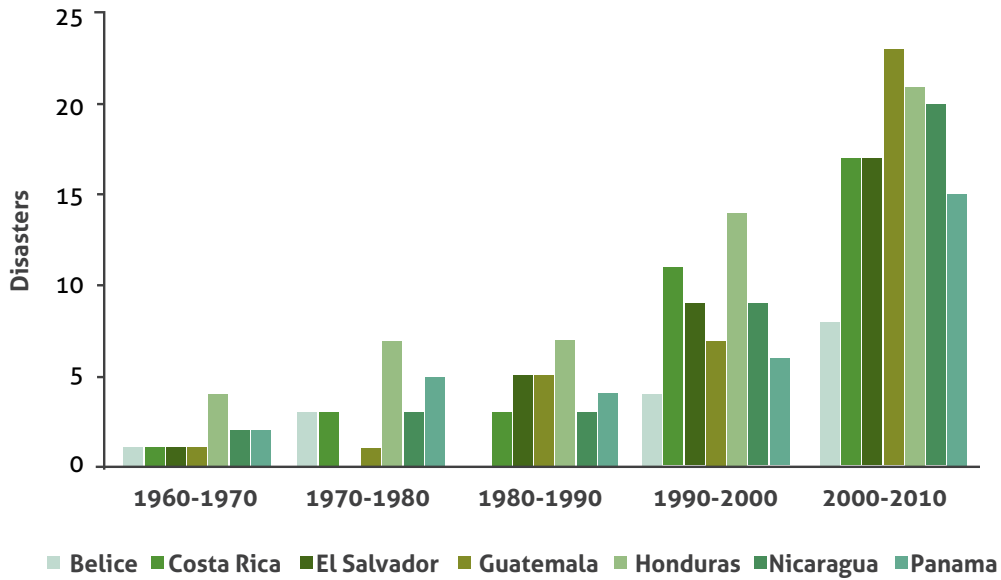
As part of Central America, Costa Rica belongs to a disaster risk prone region. It is exposed to a wide variety of natural hazards such as floods, hurricanes, earthquakes, and landslides. The Climate Risk Index (calculated for 176 countries between 1990 and 2008, based on extreme weather events) located neighboring Honduras and Nicaragua among the countries most at risk (third and fifth places, respectively).

However, in the past two years no big scale natural or manmade event prompted a national emergency decree in Costa Rica. In spite of this lull, territories and populations were once again victims of small scale disasters. Approximately 96% were

hydro-meteorological phenomena (62% floodings and 27% landslides). A longer-term analysis reveals that for the past twelve years, disaster risk showed an increasing trend: hazardous events increased by 179% as compared to previous decades. Total deaths from landslides grew five times, and the number of houses affected by floods and rains increased by 242%.

Historically, as seen, Costa Rica lags far behind in land use planning and risk management, much in line with the rest of Central America. However, after Hurricane Mitch's catastrophic impacts in 1998 (a turning point in the understanding of the human and economic costs of vulnerability to natural events), the country has coordinated with other Central American authorities in adopting integrated risk management reduction policies. Still, major and persistent challenges are yet to be dealt with such urban sprawling in vulnerable areas, adaptation to climate change, reconstruction of damaged and aging infrastructure, adoption of improved building codes and standards, and coordinated approaches to disaster risk reduction. Nonetheless, in the past decade the country has improved its capabilities for disaster management and prevention.

Graph 15. Central America: number of meteorological and hydro-meteorological disasters^{a/}, per decade (1940-2010)



a / Includes droughts, extreme temperatures, floods, landslides and storms, and events that meet one or more of the following criteria: i) ten or more deaths, ii) one hundred or more affected, iii) declaration of a state of emergency, iv) call for international assistance. Data for 2000-2010 are preliminary projections extrapolated.

Source: Lavell and Lavell, 2011, EM-DAT data.

About The State of the Nation Report

Since 1995, the State of the Nation Program prepares the annual State of the Nation Report. The Program is a center for research and training on sustainable human development sponsored by the National Council of Rectors (CONARE in Spanish) and the Ombudsman's Office.

Established in 1994, the State of the Nation Program and Reports came to fill the country's need to have documents with reliable and systematic information that could provide a clear understanding of Costa Rica based on four pillars of investigation and analysis: Social, Economic, Environmental and Political. In each of its annual deliveries –most recently its XVIII edition– the State of the Nation Report takes the pulse of the country and presents and analyzes the challenges, successes and shortcomings in sustainable human development.

The State of the Nation Report is based on the concept of sustainable human development as originally proposed by the United Nations Development Program (UNDP). In turn, UNDP was influenced by Indian philosopher, economist and Nobel Laureate Amartya Sen. Under this approach, development is defined as a process of **enlarging people's choices and enhancing human capabilities** (the range of things people can be and do) **and freedoms**, enabling them

to: live a long and healthy life, have access to knowledge and a decent standard of living, and participate in the life of their community and decisions affecting their lives. This is an alternative and contrasting vision to the currents that prevailed in recent decades, which reduced development to economic growth.

Costa Rica's State of the Nation Report is one of the world's oldest national initiatives for monitoring a country's human development performance, and certainly, the most persistent. No other country in the world has been able to prepare eighteen annual reports that systematically evaluate the performance of the society from various development angles. Such discipline and structure has led to a robust platform of research –more than 700 documents on economic, demographic, social, political, cultural and environmental subject-matters have been produced since 1994, accessible online at: www.estadonacion.or.cr.

The report is independent and has enjoyed complete editorial freedom since its inception. More than a document, the State of the Nation Report is a system that monitors the country's development, supported by academic research processes as well as dialogues between a diverse group of actors from the public and private spheres, academia, and civil society

-with different views and agendas- yet collaborating in ushering a deeper understanding of Costa Rica's main developmental challenge.

Currently, the State of the Nation Program has a robust and diverse research agenda far beyond its flagship Report: the State of the Education Report, whose fourth edition will be presented by mid-2013, and the State of the Region Report –covering Central America–, whose fifth edition is scheduled for 2015. In 2012 work began on the first State of Science, Innovation and Technology Report, with support from the Inter-American Development Bank (IDB), and the first State of Justice Report in Costa

Rica, through an agreement with the Judiciary branch. Other research has been conducted for entities like Transparency International, among others.

This XVIII State of the Nation Report (2011) engaged multidisciplinary research networks from public universities, research centers and other public and private entities, as well as collaboration from a large and diverse group of people from all walks of Costa Rican society, who attended meetings and consultation workshops, provided information, reviewed documents, prepared papers and engaged in content coordination—enhancing the goals of this initiative.

Glossary

Basic Food Basket: Set of selected foods and their caloric intake frequency that will satisfy the calorie needs of an average individual.

Biocapacity: Biologically productive area by type of use (forestry, crops, fishing, grazing, infrastructure) within a territory with the ability to meet the consumption needs of its inhabitants.

Bipartisanship: Political party system in which two parties garner the support of the vast majority of the electorate. Despite the involvement of other parties, one of the two prevailing forces becomes the official government party, while the second is the main opposition party.

Climate change: Changing climate attributed directly or indirectly to human activity, that alters the composition of the global atmosphere and has effects on the natural climate variability observed over comparable time periods.

Collective action: When two or more people join together and issue a petition from a public or private entity.

Consumer Price Index (CPI): Indicator showing the variation in the prices of items included in the basket of goods and services considered representative of consumption patterns of families.

Demographics: Characteristics of the population in terms of size, territorial distribution and age structure, sex, and the changes that occur in these areas over time. The most important relevant indicators are fertility, mortality and migration.

Demographic transition: Transition from high birth and death rates to low birth and death rates as a country develops from a pre-industrial to an industrialized economic system.

Ecological footprint: Area of ecologically productive land (crops, pastures, forests and aquatic ecosystems) needed to supply the resources a human population consumes, and to assimilate associated waste.

EHPM (Encuesta de Hogares de Propósitos Múltiples in Spanish): Multipurpose Household Survey (during 1987-2009), conducted annually by the National Institute of Statistics and Census (INEC in Spanish).

ENAH (Encuesta Nacional de Hogares in Spanish): Household Survey (began in 2010), conducted annually by the National Institute of Statistics and Census (INEC in Spanish).

Environmental overuse: The proportion by which the ecological footprint exceeds biocapacity.

Exports: Goods and services produced in Costa Rica and sold abroad. The price is paid in dollars.

Fertility: Number of live births per thousand in women aged 15-49 years, in a given year.

Foreign direct investment (FDI): Capital from abroad or foreign capital, which is placed in the long term in the country, invested towards building projects: agricultural, industrial and services sectors, among others.

Formal and informal jobs: In formal jobs people have an employment contract, stipulating workday, payment and access to health insurance and other social guarantees. Informal jobs lack all these mentioned conditions. Therefore, it is said that informal work is precarious.

Free Trade Zone, Free Trade Export Zones: Legally bound area host to private firms linked to exports that enjoy tax benefits and non-payment of fees for the import of goods or other taxes.

Greater Metropolitan Area (GAM in Spanish): The area of the Central Valley of Costa Rica host to San José, the country's capital, and main cities.

Gross domestic product (GDP): The sum of all goods and services produced in the country in a year.

Horizontal control: Control exerted by some state institutions over other public entities, as is the case of the auditing made by the Office of the Comptroller General or the Ombudsman, to ensure that any state institution complies with lawfully mandated obligations..

Infant mortality: Deaths occurred during the first year of life.

Inflation: Widespread and sustained increase in the price level of goods and services.

Intermediate and high-tech goods: Goods that are produced through sophisticated processes and which demand highly skilled personnel.

Multiparty: Political party system in which several parties have ample opportunities to win elections. In these systems Congress is divided among parties with a significant political clout, as opposed to bipartisanship (the dominance of two political parties), or one-party (the dominance of a single political party).

Natural hazards: Naturally occurring physical phenomena caused either by rapid or slow onset events which can be geophysical (earthquakes, landslides, tsunamis and volcanic activity), hydrological (avalanches and floods), climatological (extreme temperatures, drought and wildfires), meteorological (cyclones and storms/wave surges) or biological (disease epidemics and insect/animal plagues).

New economy: Economic model based on telecommunications and business services, free trade export zones, call centers, finance and tourism, manufacturing and agro-exports, among others "and absorb a labor force with high" skilled workers and high qualification profiles.

Old economy: Activities which were pivotal to Costa Rica's economy prior to the 1980s based on traditional agriculture (rice, beans, corn), agroexports (coffee, banana, sugar cane, meat) and light industry.

Open unemployment, unemployment rate: The working age population that has sought employment, but cannot find it. The unemployment rate is the percentage of such persons with respect to the total workforce of the country.

Openness: Imports and exports as compared to the size of a country's economy as measured by the Gross Domestic Product (GDP).

PROCOMER: Export Promotion Agency of Costa Rica.

Public social spending, public social investment, public social expenditure: The provision by public (and private) institutions of benefits to, and financial contributions targeted at, households and individuals in order to provide support during circumstances which adversely affect their welfare, provided that the provision of the benefits and financial contributions constitutes neither a direct payment for a particular good or service nor an individual contract or transfer. Such benefits can be cash transfers, or can be the direct ("in-kind") provision of goods and services.

Referendum: Direct consultation with the public on issues of national interest. It is performed through a polling process.

Restrictive programs: Social programs which demand the fulfillment of certain conditions (such as higher education).

Selective programs: Social programs aimed at lower income and vulnerable groups, suffering situations of exclusion or discrimination.

Social classes: Sets of people with certain characteristics that make them share a position in the economic life of a country, which gives them access to certain income, power or authority. This position is determined by the ways in which individuals and families are involved in the socio-organization (or economic integration).

Social targeted programs: Programs focusing their attention on the most vulnerable social groups and the poor.

Technological or man-made hazards: (Complex emergencies/conflicts, famine, displaced populations, industrial accidents and transport accidents) are events that are caused by humans and occur in or close to human settlements. This can include environmental degradation, pollution and accidents.

Universal programs: Social programs aimed at the whole population (such as compulsory public education).

Vulnerability to poverty: It reflects how close the household income is to the poverty line.

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Estado de la Nación

EN DESARROLLO HUMANO SOSTENIBLE

