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**COUNTRY STRATEGY PAPER**  
**2002-2006**  
**COSTA RICA**

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### **EXECUTIVE SUMMARY**

This Country Strategy Paper forms part of a continuous process of management of European Commission cooperation with Costa Rica. It is a key element in the improved programming process introduced in the reform of the management of external assistance, which is expected to lead to greater coherence between the EU's strategic priorities and to the appropriate policy mix for each partner country. The strategy is based on Costa Rica's own development agenda as well as on the Commission's cooperation principles and the Memorandum of Understanding signed with Costa Rica in March 2001. In addition, it builds on the prior country strategy covering the period from 1998 – 2000. For the period 2002 – 2006, the Commission's cooperation programme with Costa Rica will focus primarily on the three priorities of modernisation and decentralisation of government, economic cooperation and scientific and technological cooperation. An indicative amount of €31.5 million has been allocated to these priority sectors under the Memorandum of Understanding. The final selection of projects and corresponding amounts will be based on the outcome of detailed identification and preparation studies carried out by the Commission. The funding of the indicative work programme is conditional upon the availability of funds in the annual Commission budget. The indicative programme resources will be complemented by projects funded from other thematic budget lines as well as programmes financed under the Central American and Latin American regional programmes. A country fact sheet is included as Annex 1.

### **1. OBJECTIVES AND PRINCIPLES OF COMMUNITY COOPERATION WITH COSTA RICA**

#### **1.1. General Cooperation Objectives**

In accordance with Article 177 of the Treaty establishing the European Community (EC), policy in the sphere of development cooperation shall foster:

- The sustainable economic and social development of the developing countries, and more particularly the most disadvantaged among them;
- The smooth and gradual integration of the developing countries into the world economy; and
- The campaign against poverty in the developing countries

Community policy should also contribute to the general objective of developing and consolidating democracy and the rule of law and encouraging the respect of human rights and fundamental freedoms.

In addition, in their Joint Declaration on the European Community's development policy of 10 November 2000, the Council of the European Union and the European Commission indicated a number of priority areas of action in order to reduce and eventually eliminate poverty. These include: the link between trade and development, support for regional integration and cooperation, support for macro-economic policies and equal access to social services, transport, food security and rural development, and institutional capacity building in particular in the field of good governance and the rule of law.<sup>1</sup>

## **1.2. Regional Cooperation Objectives**

With regard to the specific cooperation objectives and principles for the Latin American and Central American regions, Council Regulation (CEE) No. 443/92 of 25/02/92 concerning Community financial and technical cooperation and economic cooperation with Asian and Latin American countries applies. This regulation places priority on strengthening the cooperation framework, promoting sustainable development and social, economic and democratic stability through institutional dialogue and economic and financial cooperation.

In 1995, in a communication entitled "European Union-Latin America: Current Situation and Prospects for Strengthening the Partnership 1996-2000" (COM(95)495), the Commission underlined the need for differentiated approaches in Latin America adapted to the national and sub-regional realities.

In the context of the guidelines laid down in the March 1999 Commission Communication on a new EU-Latin America partnership (COM(99)105) and the follow-up to the 1999 Rio Summit (COM(2000)670), the Commission restated its aim to reinforce the partnership and proposed stepping up its action in the three priority areas of promotion and protection of human rights, promotion of the information society, and the reduction of social imbalances as well as incorporating the identified priorities into the established bilateral and sub-regional dialogues.

Historically, regional cooperation between the EU and the six republics of the Central American Isthmus has been shaped by a unique mechanism, the San Jose Dialogue, which was launched at an EU-Central American ministerial meeting in Costa Rica in 1984 and is the principal channel for political dialogue between the two regions. This annual dialogue was originally set up to support the peace process and democracy in the region and after a renewal in Florence in 1996 has been expanded to include issues of sustainable and equitable economic and social development, the fight against insecurity and delinquency, the rule of law and social policy. The successes achieved in the ending of civil war and military strife in Central America and the re-establishment of democratic government based on respect for human rights have permitted the dialogue to re-orient itself towards new challenges related to the deepening of economic linkages between the two regions.

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<sup>1</sup> Following the WTO ministerial conference held in Doha in November 2001, the areas of trade and development and institutional capacity building have taken on a renewed priority, noted by the European Commission in SEC(2001)1903 of 20 November 2001.

With respect to economic and development cooperation activities, the current framework is provided by the 1993 Regional Development Cooperation Framework Agreement between the same six Central American countries and the Commission, which came into effect in 1999 following its ratification by all parties. This “third generation” agreement covers a broad range of sectors and foresees the establishment of a Joint Committee to oversee its implementation as well as sub-committees for detailed examination of specific sectors of the Agreement.

Finally EU cooperation with the Central American sub-region would not be complete without mention of the unilateral tariff preferences granted through the Generalised System of Preferences (GSP) including its additional incentive schemes related to environmental and labour standards and in particular the drugs regime. Since 1990, the latter has resulted in duty suspension for agricultural and industrial exports to the EU from both the Andean Community and six Central American countries. The system has been renewed until the end of 2004.

### **1.3. Bilateral Cooperation Objectives**

Within the above-mentioned framework two further specific agreements currently orient EU cooperation with Costa Rica. The Framework Agreement (“Convenio Marco”) signed in June 1999 establishes the mechanisms for the implementation and administration of financial and technical, and economic, cooperation projects, clarifying procedures and assigning to the national authorities a greater role in the financial and contractual management of projects. This Agreement has yet to be ratified by the Costa Rican Legislative Assembly.

The EU-Costa Rica Memorandum of Understanding (MoU) signed in March 2001 foresees an indicative level of assistance under the financial and technical, and economic, cooperation budget-lines of €31.5 million for the period 2000 to 2006, to be assigned to the following priority sectors:

- Modernisation and decentralisation of government (35-40% of the indicative budget)
- Economic cooperation (25-30% of the indicative budget)
- Scientific and technological cooperation (25-30% of the indicative budget)

A maximum of 15% of the indicative total may be allocated to areas outside of these priority sectors subject to agreement by both parties.

## **2. COSTA RICA’S POLICY AGENDA**

Costa Rica’s national development policy is based primarily on its National Plan for Human Development 1998-2002, the main aim of which is to boost the country’s progress and increase the well-being of all Costa Ricans. The Plan was prepared by the Ministry of Planning and Economic Policy and its underlying strategy is based on four fundamental pillars: growth, stability, opportunities and sustainability. The main objectives of the Plan include: reducing poverty; controlling the cost of living; employment creation; generating peaceful citizenry; fighting corruption; improving public services; strengthening agriculture and rural development; upgrading infrastructure; improving the coverage and quality of education; improving health care; protecting children; universalising pensions; promoting gender equality; solving

communal problems in a participatory manner; and protection and rational use of the environment.

The majority of these areas are backed up by specific policy documents and statements that are assessed yearly in the annual reports prepared by the incumbent administration (A comprehensive list of these policies is contained in Annex 2). Some of the most critical objectives, in terms of assuring Costa Rica's longer-term development, are improving public services and upgrading infrastructure, which would entail greater private sector participation. In addition, addressing environmental pollution is of vital importance. In the latter context it is noted that the government has prepared Phase I of the National Plan for Urban Development, which is a first step in addressing critical problems of congestion and environmental degradation in the greater metropolitan area. This area is home to almost 60% of the national urban population and some 90% of the industrial park.

In addition to this, progress in meeting human development goals is assessed annually in a comprehensive "State of the Nation" report on sustainable human development, which has been prepared since 1994 by an independent project headed by a coordinator with a strong technical team and supervised by a board comprising recognised academic institutions, the ombudsman and the UNDP Resident Representative.

The broad-based approach and nature of the national development plan and associated planning tools reflects a high level of analysis of development issues as well as a comprehensive process of consultation among key development partners. The breadth of this process is, however, not matched by a similar performance on the implementation side. Implementation is frequently constrained by both an overly strong state control of fundamental sectors including energy, telecommunications, insurance, sea and airports, railways and water distribution. On top of this additional hurdles include implementation delays associated with frequently applied appeals procedures.

On account of its small domestic market and the relative scarcity of natural resources – other than timber and hydroelectric power, Costa Rica has few natural resource advantages and exports no significant quantities of minerals or oil. Recent governments have adopted an outward-oriented economic growth policy, emphasising the attraction of foreign investment, and the opening of new export markets.

### **3. COSTA RICA COUNTRY ANALYSIS**

#### **3.1. Political Situation**

On the political front, Costa Rica's chief characteristic has been its democratic government and stable domestic environment since 1948. A constitutional republic, Costa Rica's executive is led by a directly elected President with a four-year mandate, and the legislature is composed of a single chamber Legislative Assembly. The fully independent Judiciary includes a separate Electoral Tribunal. The re-election of a President to a second term, whether consecutive or not, is forbidden by the Constitution. Members of the Legislative Assembly may not be re-elected to successive terms, although they may be re-elected provided they stand down for a term.

Over past decades, political life has been dominated by two main parties, the Partido de Liberación Nacional (PLN) and the Partido de la Unidad Socialcristiana (PUSC) which have generally tended to succeed each other in power every four years. While both parties share a broadly similar centrist agenda, their differences tend to reflect different

attitudes to the speed at which reforms should be carried out and the measures to be taken to mitigate the social costs of such changes.

Legislative and presidential elections were held on 3 February 2002 with the PUSC candidate, Abel Pacheco, gaining the most votes, but just short of the 40% required for outright victory. For the first time in Costa Rican history, a run-off election was held between the two leading candidates Abel Pacheco and Rolando Araya (PLN) on 7 April resulting in Abel Pacheco winning 58% of the votes. This run-off election has resulted from the emergence of a strong new third party, Partido de Accion Ciudadana (PAC), led by Otton Solis, which captured some 26% of the popular vote in the 3 February election. Preliminary figures put the abstention rate in the first round at 31%, which rose to 39% in the run-off election. This reflects increasing voter disillusionment with the political process, in particular the poor performance of the current Legislative Assembly in terms of its ability to carry out its business in an expeditious manner.

Perceptions of corruption and the excessive centralisation of power are frequently cited as factors contributing to the public's disillusionment with national politics. Steps have been taken to address the second issue, notably through the recent constitutional amendment which will transfer to municipal authorities responsibility for a much greater range of local issues, accompanied by the transfer of funds from the central budget. A key issue that will determine the success or failure of what is recognised by all political parties as an essential modification in the distribution of power within the country, will be the management capability of the municipal governments, and the transparency with which they will exercise their new responsibilities.

In addition, President Rodriguez has proposed a radical redefinition of the relationship between the executive and the legislature, in order to establish a power relation that would provide for greater mutual accountability and transparency, and greater efficiency in the management of government business. These proposals provide a significant starting point for a discussion that many feel is long overdue

The politicisation of the administration of the country has long been a characteristic of the Costa Rican model of government, with its "spoils system" under which, with each change of government, officials down to even fairly modest levels are replaced by persons bearing allegiance to the new government. Although this practice is less pervasive than some decades ago, and there is now greater professionalisation of a permanent civil service structure, it still has the effect of bringing about significant disruptions in the operation of the system every four years, with loss of continuity and efficiency.

Costa Rica's foreign policy agenda is to a large extent shaped by its own democratic and peaceful history. While Costa Rica maintains largely friendly relations with its regional neighbours, it has been historically reluctant to engage in close political integration until such time as all countries consolidate their democratic system and reduce military expenditures. A more problematic relationship exists with Nicaragua, notably on account of disputes over the navigation rights that Costa Rica enjoys on the Río San Juan that forms a significant part of the border between the two countries. Attempts by Costa Rica to resolve the issue through bilateral negotiations or through international arbitration have failed to produce the desired results and the Costa Rican authorities are considering bringing the issue before the International Court of Justice in The Hague. Nicaragua has threatened, in the event that Costa Rica should proceed in this manner, to impose a 35% customs tariff on all imports from Costa Rica.



With regard to regional integration, Costa Rica is a member of both SIECA and SICA, but does not form part of the Central American Court of Justice or the Central American Parliament (PARLACEN). In 2001, Costa Rica made a series of proposals to revitalise the Central American integration process. These proposals emphasise social development and trade facilitation and also suggest institutional changes including reforming the PARLACEN and limiting the competences of the Central American Court of Justice as well as reactivating the Executive Council of SICA.

Costa Rica is also the seat of a number of important regional institutions, including the Inter-American Human Rights Court and the Inter-American Human Rights Institute. The presence of these institutions serves to reinforce Costa Rica's prestige in the field of human rights, strengthened by its own domestic achievements as well as the recognition of Costa Rica's efforts for regional peace as embodied in the award to President Arias of the Nobel Peace Prize in 1987. At the same time, it also serves to underscore the sensitivity that Costa Rica feels when broached on questions related to human rights, such as child prostitution, the existence of which the government has now recognised and is currently seeking to address.

Costa Rica is a transit country for both drugs being transported northwards from Colombia to the USA, and for weapons from Nicaragua to Colombia. Costa Rica is actively participating in programmes, notably with the US authorities, to stem the flow of drugs through the country, although it is extremely difficult to gauge the extent to which these programmes are achieving the desired results. Domestic drug production is limited to marijuana production especially in mountainous areas in the south of the country.

Connected with the issue of regional drug production activities is that of money laundering. Costa Rica has come under close examination in such fora as the OECD's Financial Action Task Force (FATF/GAFI) on account of the weakness of national legislation with regard to the definition of money-laundering and the supervision of its offshore banking sector. Costa Rica has responded rapidly to the criticisms made in this regard and new legislation has been proposed, which would strengthen controls, including the banks' responsibility to monitor and report suspicious transactions, while also broadening the definition of money-laundering to cover terrorism and organised crime. Close cooperation is also being maintained between Costa Rica and neighbouring Central American and Caribbean countries to monitor the activities of financial institutions.

### **3.2. Economic and Social Situation**

Costa Rica is unique in Central America on account of its historically high indices of social and economic development, themselves the result of progressive policies adopted over the past century and further reinforced and maintained by uninterrupted democratic rule since 1948 and the dissolution of the armed forces.

With a population of 3.8 million and a GDP per capita of some US\$4,000 in 2000, Costa Rica's real GDP growth rate was 1.7%, inflation was 11%, external debt some US\$4.3 billion, the current account deficit some US\$800 million, the balance of trade deficit US\$171 million and the capital and financial account balance US\$676 million.

#### *3.2.1. Economic Situation*

Costa Rica's appearance on the world economic stage in the second half of the 19<sup>th</sup> century was the result of the development of the local coffee industry, which generated sufficient profits and surpluses as to allow rapid economic growth and investment in

government programmes in the social sectors. This marked the beginning of Costa Rica's tradition of investing a significant proportion of the state's revenues in the health and education sectors, which was followed by the adoption of progressive legislation with regard to social welfare and employment.

Following the coffee boom, Costa Rica's growth has been marked by four major developments. The first, which occupied the greater part of the 20<sup>th</sup> century consisted of the rapid growth of the banana industry, which, despite the challenges and declines described below, remains a major source of employment and foreign exchange revenue, with Costa Rica being the world's second largest exporter, behind Ecuador.

The second development took place in the late 1970s and early 1980s when, following a prolonged period of lax economic management, exacerbated by direct and indirect effects of the crises that were taking place in Nicaragua and El Salvador, a sharp macroeconomic management plan had to be implemented to redress the nation's finances. The social costs of this adjustment programme were high, although mitigated to a certain extent by the establishment of donor-supported stabilisation funds.

This was followed by the rise of a new, and now strategically important, sector: tourism. The concept of eco-tourism was to a large extent pioneered in Costa Rica, and the country now attracts around one million visitors a year, mostly from the United States, but with a significant number (25%) coming from EU countries, who in total contribute approximately \$1 billion to the economy annually, the largest single source of foreign exchange revenue. Closely associated with the growth of the tourism industry has been a systematic effort to project an international image of Costa Rica as an environmentally advanced country, endowed with an exceptional biodiversity, in which as much as 25% of the land area is protected in some way or another.

The past two decades also saw the fourth major development: the implementation of increasingly aggressive government policies aimed at attracting foreign direct investment (FDI), capitalising on the country's well-educated workforce, the stability of its institutions and its enduring democracy. In the late 1990s, FDI ran in the region of \$500 million annually, although there are now indications of a significant deceleration in that trend. Most notable in the area of foreign investment has been the establishment in the mid-1990s of a large microchip production facility by Intel, exporting to the US as well as Europe, and now representing, with annual exports of approximately \$1,500 million in 2000, over 25% of total goods exported from the country. In addition, Costa Rica has been successful in attracting a number of multinational corporations to establish regional service centres and support structures.

An important element of Costa Rica's investment attraction policy has been the establishment of free trade zones in which export companies are allowed to operate without payment of tax on their profits and with a favourable regime for the importation of machinery and inputs. At present, some 50% of all exports (including Intel's microchip production) benefits from the advantages provided by the free trade zone arrangements. Since 1994 Costa Rica also has a law promoting competition and effective consumer protection, which is backed up by an active Competition Promotion Commission (COPROCPM).

After pursuing an import substitution model of industrialisation in the 1960s and 1970s coupled with heavy reliance on external debt, the country entered an economic and financial crisis in the early 1980s. This was followed by structural adjustment measures together with a new export orientation founded on attracting foreign direct investment

and a Brady plan commercial bank foreign debt restructuring. The main thrust of economic policy over the past decade has been directed at moving public finances towards balance, in order to bring about lower interest rates and reduce inflation, but success has been limited. Inflation stood at 11% in 2000, interest rates at above 14% and internal debt at 30% of GDP (compared with around 17% in the early 1990s).

The recent downturn in the global economic situation, particularly in the US, combined with the specific sharp slowdowns in three sectors of particular interest to Costa Rica – the computer industry, bananas, and coffee – have clouded Costa Rica's immediate growth prospects. After several years of 5% or higher growth (largely fuelled by Intel's exports of computer chips), 2001 will likely see growth of no more than 2%. This will further exacerbate Costa Rica's fundamental economic debility: the government deficit and public debt. Running at just below 3% of GDP, the deficit is generating constant demands for greater government borrowing, and public debt now stands at over 55% of GDP. External debt amounted to US\$4.3 billion in 2000 with the debt-service ratio calculated at 8.9%. Despite this level of deficit, poor fiscal revenue collection (and a low tax base in general) impedes the generation of resources needed to improve and maintain the country's already weak physical infrastructure. Attempts to remedy this system by recourse to concessions for major public works contracts (airport management and improvement, highway construction, for example) have run into difficulties caused by Costa Rica's notorious bureaucracy and lengthy legal processes. In addition, the strict state monopolies exercised in the telecommunications, energy and insurance sectors prevent the emergence of competition and the provision of improved services at lower costs.

Over recent years, Costa Rica's economy has undergone increased dollarisation. Although the regular micro-devaluations of the national currency, the colon, that are managed by the Central Bank aim to preserve the currency's real value against a basket of currencies that corresponds to the composition of Costa Rica's foreign trade, the most significant reference point is the US dollar, reflecting the fact that some 60% of foreign trade and foreign investment is with the USA. Furthermore, lack of competition in the domestic banking system, combined with inflation of over 10%, have led to high interest rates being charged on debt denominated in colones, causing customers to opt increasingly for debt denominated in dollars. Although no formal plans exist, there is increasing discussion in financial and political circles of the advantages and disadvantages of dollarisation.

The structure of the Costa Rican economy in 2000 is broken down by the manufacturing sector (25% of GDP), agriculture just under 10%, commerce, restaurants and hotels just under 20% and with services and utilities accounting for most of the remainder. However, agriculture remains a major employer with some 20% of the labour force and it is noted that the tourism sector is becoming increasingly important as a revenue earner and employer. An overview of Costa Rica's macroeconomic and social sector indicators is contained in Annex 3.

### 3.2.2. *Trade Policy*

Trade policy has been pursued through a three-pronged approach. At the multilateral level, Costa Rica has been a strong supporter of the WTO since its entry in 1994, seeing in the organisation its best guarantee of a fair rules-based multilateral system within which Costa Rica's exports can grow. Costa Rica also supported the launch of a new round of WTO negotiations and its overall position for the fourth WTO Ministerial in Doha, with the exception of agriculture, was largely in line with the EU's. On

agriculture, as a member of the Cairns Group, Costa Rica seeks the elimination of agricultural subsidies and other measures that it considers as having a distorting effect on the trade in agricultural products. Costa Rica has also been an active participant in the banana dispute between the EU and various Latin American banana-exporting countries. Costa Rica can be expected to play an active part in the new WTO round of negotiations, the Doha Development Agenda.

At the regional level, Costa Rica's trade policy has focussed on attempts to promote greater economic integration with Central America (in contrast to its very reticent position with regard to political integration), as well as on the active pursuit of the finalisation of the Free Trade Area of the Americas agreement and participation in the US Caribbean Basin Initiative. Costa Rica also sees the possibility of trade benefits being generated by the trade facilitation and infrastructure components of the Puebla-Panama Plan proposed by President Fox of Mexico.

On the bilateral front, Costa Rica has been actively engaged in the negotiation of a number of bilateral Free Trade Agreements (FTA), the most recent of which include Mexico, Chile, Canada and the Dominican Republic. Further negotiations are either ongoing or planned with Panama, Jamaica and Trinidad and Tobago. Of these, special mention should be made of the trade agreement signed with Canada, in that not only does it provide an instance of an agreement between a small developing country and a member of the G8, but it also provides for side agreements in the sensitive areas of labour and the environment.

Reflecting Costa Rica's strong outward-looking economic policies is the fact that its index of economic openness (external trade as a percentage of GDP) has risen over the past two decades from around 60% to over 80%, while the total value of foreign trade in 2000 amounted to \$ 12.3 billion, with a trade deficit of \$475 million. In addition to computer parts, (\$1,600 million in 2000), Costa Rica's leading export products in 2000 were garments (\$600 million), bananas (\$540 million), and coffee (\$280 million). The EU has over recent years absorbed some 22% of Costa Rica's exports (principal products now being computer chips, followed by bananas and coffee), while the EU's share of Costa Rica's imports has remained constant at approximately 10% (principally machine goods, pharmaceutical products, vehicles). In 2000, the current account deficit was US\$0.9 billion representing 5.5% of GDP. Despite this high level, it has not represented a major problem to date due to the fact that it has been financed by direct foreign investment to an important extent. However, the increase registered in the deficit over the past few years could pose a problem in the medium to long term should this trend continue. Over the 15-year period from 1985 to 1999, EU-originating investment in Costa Rica amounted to \$355 million, primarily in the form of direct foreign investment, representing 9% of total foreign investment during that period (the US accounted for 64% of foreign investment during that same period).

### 3.2.3. *Social Situation*

As a result of these various phases of economic growth, supported by political stability, Costa Rica has achieved a per capita income of approximately \$4000, far above the regional average and an income distribution that is much less inequitable than other countries in the sub-region. More significant yet, however, is the fact that its human development indices are consistently higher than would be expected given its GDP/capita: Costa Rica is 43rd in the UNDP Human Development ranking, a position exceeded in Latin America only by Chile. This reflects the country's high literacy rate of 85% as well as its health indicators which, in terms of life expectancy especially (77

years), are close to approaching levels of high income countries, and reflect the fact that approximately 32% of public expenditure is channelled to social services. The infant mortality rate for Costa Rica in 2000 was 10.2 per thousand, lower than all other Latin American countries except Cuba.

In this context it is important to note that Costa Rica has, over the past two decades become home to some 350,000 immigrants from Nicaragua, initially as a result of the civil war in that country, and then in 1998 as a result of the devastation of hurricane Mitch. Although a significant number of these immigrants remain outside the scope of the official welfare system, the majority has been integrated into it, implying significant additional costs for the state budget. However, this has also had an effect on Costa Rica's ability to reduce its poverty rate, which has over the past few years remained fixed around 20% of the population. Data indicate that poverty levels among families constituted in part or in total by immigrants are some 20-35% higher than the average. Regionally, it is also apparent that the significant increase in poverty in the Huetar Norte region is linked to immigration from Nicaragua.

Despite the fact that a high level of public expenditure is channelled to social services, there are mounting difficulties in maintaining the levels of access, quality and delivery of services that would lead to significant reductions in poverty. The principal problems for the health sector are related to the lack of adequately trained personnel and the lack of standards and oversight in the provision of collective and individual services. In addition, specific issues such as domestic violence against women and child prostitution are demanding greater government attention.

### **3.3. Sustainability Issues**

The sustainability of Costa Rica's development model is constrained by a number of factors. First, the country remains heavily dependent on a narrow range of options in the global market (computer parts, garments, bananas, and coffee). In line with this, high levels of foreign investment have disguised a growing reliance on internal borrowing. Second, the social development model pursued with success in the past is being challenged by growing delivery problems and external factors such as migration. Finally, consensus policy making is giving way to greater deadlock and institutional rigidities.

### **3.4. Medium-Term Challenges**

Costa Rica's most pressing challenge in the political sphere is to re-establish greater credibility in the domestic political process, whose reputation has become tarnished by the perception among the general public that politicians no longer serve the national interest, only their own self-promotion. There can be no immediate solution to this problem, but it will require interventions on several fronts, including possible constitutional reforms of the type already proposed by President Rodriguez to redraw the boundaries of the responsibilities of different branches of the state, as well as a concerted move towards decentralisation of government. In the latter area, considerable external support will be required, as well as strong political will.

In the economic sphere Government policy must seek to take full advantage of what can be seen as Costa Rica's three competitive advantages: an educated workforce, stable institutions, and broad support for an open outward-looking trade policy. This openness, however, exposes Costa Rica to the full effect of external fluctuations, and this situation is being felt sharply in 2001. Growth and employment prospects are not encouraging, and the debt situation will therefore not likely improve significantly. The government's

ability to provide improved social services – a necessary condition if Costa Rica is to maintain its workforce-related competitive advantage and its political stability – is severely hampered, as these services require ever-greater capital intensive investment. Whether higher levels of growth will lead to increased economic polarisation, and an even greater prevalence of poverty, is one of the challenging questions for the future.

Recent government attempts to allow a greater measure of competition in state monopoly sectors, particularly energy and telecommunications, had to be abandoned in the face of widespread public protests, themselves reflecting concern that any process of privatisation would involve corruption and an increase in fees and charges for consumers. However, without more investment and greater competition in those sectors, there is a danger that Costa Rica may lose its competitive advantage to other Central American countries which have already liberalised key economic sectors thus providing significant investment opportunities for foreign companies.

Moreover, under its WTO obligations, Costa Rica is currently obliged to phase out the subsidies and special fiscal treatment provided to its free trade zones. As seen earlier, these zones account for 50% of Costa Rica's exports, as well as over 35,000 well-remunerated jobs. In December 2001, Costa Rica joined other small developing countries in seeking a formal extension of the period of applicability of the free trade zone regime, as it has not been possible to define an alternative WTO-compatible arrangement that would not severely prejudice the Costa Rican export sector. Under special procedures agreed at the Doha Ministerial Conference, Costa Rica could maintain such export subsidies until 2007.

Further streamlining is also required in the heavy bureaucratic oversight of the approval of major publicly financed investment projects. The long delays and numerous legal challenges that typically accompany the award of contracts are now a significant factor in discouraging foreign investors and in increasing the price of the offers they submit.

Special mention must be made of the environmental sector, an area in which, notwithstanding Costa Rica's significant achievements in recent decades, severe threats remain. The rate of deforestation of primary forest continues to be difficult to control, and although the overall rate of forest cover is beginning to show signs of recovery as a result of commercial reforestation programmes, the loss of biodiversity continues. Although 25% of the country is officially designated as being under some type of control or management, compensation for much of this land has still not been paid to the original owners, sometimes as long as 25 years after expropriation took place. In view of the increasingly vital contribution made by tourism to the national economy, the preservation of Costa Rica's natural heritage takes on added meaning, as the value of a primary forest for purely recreational purposes, and as part of the image that Costa Rica seeks to project overseas, may be considerably greater than originally foreseen.

Costa Rica therefore faces the difficult challenge of modernising its public sector, allowing greater competition in key economic areas, while preserving the broad level of social welfare and equity which has been its hallmark for many decades. The more outward-looking policies of the past two decades have resulted in a noticeable process of marginalisation of rural areas and of the traditional economy, accompanied by greater concentration of economic activity and population in the central valley, with the attendant problems of overcrowding, inadequate spatial planning, pollution, waste management and crime. Although plans are in effect to promote the development of both the Atlantic and Pacific coastal regions, these have so far not succeeded in reversing the excessive concentration of activity in the greater metropolitan area of San Jose.

Finally, on the regional front, Costa Rica is a key stakeholder in the process of Central American regional integration and therefore must seek to act as a driving force in this process.

These challenges should, however, be placed in the context of a country whose authorities have demonstrated their commitment to seek to prepare the country to compete globally and maintain and enhance its social and democratic standing in the region.

#### **4. INTERNATIONAL COOPERATION WITH COSTA RICA**

Since the 1980s when Costa Rica was still a significant recipient of international development assistance (in part due to the ongoing conflicts in other Central American countries), most international cooperation programmes in Costa Rica have been significantly reduced or have ceased, in recognition of the country's relatively high GDP/capita and its high Human Development score. According to the latest government figures, which cover the 1998/99 period, the stock of donor assistance to Costa Rica in existence at that time amounted to \$392 million, including \$150 million of loans from the Central American Economic Integration Bank and \$85 million of loans from the Inter-American Development Bank. As projects typically have a five-year life, this stock would represent a total amount of about \$50 million of assistance annually, including loans from regional development banks. It is probable that, in comparison with the 1998/99 situation, these numbers have dropped further in 2001.

##### **4.1. EC Cooperation with Costa Rica**

###### *4.1.1. Experience*

Over the last 15 years, EC aid to Costa Rica has been in the range of €4 million/year under the main budget-lines, with a drop-off since 1997/8 when no new projects have been approved, pending the preparation of a new strategic framework and the conclusion of a multi-annual Memorandum of Understanding. Given Costa Rica's relatively privileged geographic location and the only rare occurrence of hurricanes (and the absence of a significant earthquake since 1991), neither emergency aid nor food aid have had to be provided. A summary list of EC-funded projects is contained in Annex 4.

Under the financial and technical assistance, and economic cooperation, budget-lines projects in recent years have focussed on the sustainable management of natural resources, environmental protection, and modernisation and reform of the state. Projects have also been funded under the Tropical Forests budget line in the area of natural resource management. It is important to note that Costa Rican universities and scientific institutions have participated in a significant manner under the INCO Scientific Cooperation programme funded by the EC's Research Directorate-General, and that Costa Rica has also had an above average participation in the ALFA programme for inter-University cooperation.

As the seat for the EC's only Delegation in Central America until the opening of a Delegation in Nicaragua in 1996, San Jose was also the centre for many years of a wide-ranging programme of human rights and democracy-building projects throughout Central America, many of which were implemented in collaboration with Costa Rican, or Costa Rica-based, organisations. In addition, Costa Rica participated in numerous regional development cooperation projects in fields such as development of indigenous

communities, fisheries, co-operatives, and adolescent health, which the EC financed in Central America.

Since the mid-1990s most larger-scale EU projects in Costa Rica have been implemented using the Co-direction mechanism, with a national co-director and a European co-director jointly responsible for the financial and technical management of the project, under the final authority of the Commission and the national ministry or entity under which the project was being implemented. This proved to be a relatively effective means of delivering project inputs, especially in terms of allowing the project a sufficient degree of operational autonomy. However, doubts as to the precise legal nature of the co-direction and its contracting powers and the fact that ratification of individual project financing agreements by the Legislative Assembly sometimes took years, led to the decision in 1999 to establish a new and clearer framework mechanism for future projects. The new Framework Agreement will also give the national authorities greater responsibility for the management and oversight of projects, thus allowing a greater sense of national ownership of EC-supported projects. Once ratified by the Legislative Assembly, this Framework Agreement will do away with the current need to ratify individual project agreements.

#### *4.1.2. Lessons Derived*

Although the EC development cooperation programme with Costa Rica has not been formally evaluated as a whole, individual project reviews and monitoring exercises tend to indicate that past EC cooperation projects have been spread over too great a number of sectors, making it difficult to direct sufficient resources in a concentrated manner so as to achieve a significant impact. In part this was the result of a weaker strategic planning framework and the absence of clearly defined priority areas for EC cooperation. In addition, no single entity on the government side exercised a central function to oversee the EC cooperation programme. Under the framework agreement of 1999, however, the figure of National Coordinator has been established within the Ministry of External relations, responsible for receiving and assessing all project proposals that different Costa Rican government entities would wish to submit to the EC for financing. Consequently, a clear government screening mechanism will be established to ensure that only projects corresponding to the country's priorities are submitted.

Another feature of past projects financed by the EC has been the great variation in the size of projects, with a considerable number of projects being below €1 million. As the execution of these projects coincided with several reorganisations of the Commission's own aid and external relations services in Headquarters, the multiplicity of aid management actions required resulted in certain cases in serious delays in the processing of payment requests and contract approvals. A lesson learned has therefore been to concentrate future cooperation activities in a smaller number of larger projects, thus maximising management efficiency. This will be further enhanced once the Commission's programme of decentralising aid management from Headquarters to Delegations is completed in 2002.

It is therefore expected that the steps described above will significantly remove most of the administrative and procedural delays that were experienced in the past.

With regard to assessing the impact of past projects, it has been recognised by the Commission that insufficient resources were devoted in the past to the preparation and identification of new projects. Decentralisation of this task to the Delegations should, in future, help avoid these difficulties, as closer supervision of the process will be possible.



The effect of higher-level government staff changes that occur after each election in Costa Rica and the disruption that this causes in ministries and departments connected with EC-financed projects is a factor that affects programme quality. In addition, the role of civil society and the contribution it makes to policy formulation and project and service delivery could be enhanced through the establishment of closer linkages with government.

#### **4.2. EU Member State Cooperation with Costa Rica**

Reflecting the fact that Costa Rica is not a major recipient of development assistance, only three member-states have significant ongoing bilateral cooperation programmes: Spain, Germany and the Netherlands. Their disbursements in 1998 and 1999 are roughly on a par with those of the European Commission. In addition, France finances a range of activities in Costa Rica, but only as part of its regional Scientific and Cultural Cooperation programme.

Germany supports Costa Rica in the field of financial and technical cooperation. It is intended to concentrate this cooperation in the following focal areas: a) modernisation of the state including decentralisation, and b) protection of natural resources and the environment. This process of concentration will be worked out with the new Government in 2002. The annual value of German support in recent years has amounted to some €5.4 million for both 1998 and 1999 and €1.3 million in 2000. The total value of German cooperation over the period 1990-99 amounts to approximately €123 million.

Spain's bilateral cooperation programme in Costa Rica, managed by AECI, covers activities in the fields of the environment, municipal development, sustainable management of natural resources, agricultural training, public health, police training and equipment, local infrastructure development projects, strengthening of national parks, child labour, and government administration. In addition, Spain provided financial assistance amounting to €7.4 million per annum for 1998 and 1999 and some €3.7 million in 2000. Over the period from 1990-99 Spain has provided some €49 million in cooperation.

The Netherlands Government is in the process of phasing out its direct bilateral cooperation programme in Costa Rica. However, under the terms of the Treaty on Sustainable Development concluded by the Netherlands and Costa Rica, Bhutan and Benin activities are carried out with Dutch financial support through a Costa Rican NGO Fundecooperación in the field of sustainable development and the environment. Over the period 1990-99 the Netherlands have provided a total of €138 million in support of cooperation activities in Costa Rica. A further €4.4 million were granted in 2000.

France's cooperation, in the context of its regional scientific and cultural programme, amounted to some €625,000 in 2000 and some €580,000 in 2001.

#### **4.3. Other Cooperation Programmes**

On the bilateral front, USAID no longer provides direct support to Costa Rica, although projects continue to be funded from trust funds left when USAID closed operations in Costa Rica, and Costa Rica also participates in regional projects managed by USAID Guatemala. Canada, Taiwan and Japan continue to have bilateral programmes in Costa Rica, the latter two providing significant support for infrastructure development projects. Canadian aid is principally derived from a number of established funds: Counterpart value fund (from the proceeds of the sale of Canadian commodities) for gender equality and employment opportunity projects, the Debt Swap Fund (for the implementation of

Agenda 21 and Biodiversity projects) and the Local Initiatives Fund for supporting marginalised urban and rural communities.

On the multilateral front, the IDB remains the main provider of assistance with lending amounting to some \$863 million over the period 1990-99. A major loan (US\$92 million including \$27 million in counterpart contribution) was approved in 2000 for the regularisation of the cadastre and property registry and will be formally linked to the proposed EC municipal decentralisation project. The other main recent project is the Miravalles III Geothermal Power Project approved in 1998. The IDB project pipeline includes a second phase of the Administration of Justice Programme, which will bring an additional \$30 million (including \$9 million of counterpart funding) to this sector.

The World Bank currently has four projects totalling some US\$109 million in loans in Costa Rica covering areas including transportation, basic education, health sector reform and water supply and sewerage. In addition, the International Finance Corporation (IFC) has an active portfolio of some US\$20 million invested in Costa Rican companies in the areas of telecommunications and agroindustry.

The United Nations Development Programme has as its primary focus human development at the local level, public policy formulation, and the environment. An overview of the main international cooperation programmes is contained in the attached donor matrix (Annex 5).

## **5. PROPOSED EC COOPERATION RESPONSE STRATEGY**

### **5.1. Principles and Objectives of Cooperation**

As outlined in Chapter 1 the three basic aims of EC development policy are: sustainable social and economic development; gradual integration developing countries into the world economy; and reduction and eradication of poverty. The Costa Rican national development agenda is founded on the pillars of growth, stability, opportunities and sustainability and encompasses a multi-sectoral approach ranging from the social, macroeconomic and governmental sectors to agriculture, infrastructure and environment.

In view of the limited resources available for the EC's action in Costa Rica, the EC's cooperation should be limited to a narrow focus. The EC cannot pretend to address more than a very few of the challenges that face the country, but by selecting no more than two or three areas, in which the EC itself has an interest to establish closer linkages with Costa Rica, it should be possible to obtain the maximum impact from limited resources.

### **5.2. Priorities for Cooperation**

In the light of the analysis contained in Section 3.4 above, it is underlined that the principal medium-term challenges confronting Costa Rica include to:

- Undertake institutional reform including modernisation and decentralisation of government
- Build on the country's comparative advantages in terms of its educated workforce, economic and political stability and its open and outward looking trade policy and generate renewed growth ensuring that the benefits are shared equitably, and

- Maintain its regional lead as a growth pole based on higher technology and social stability counterbalanced by a coherent environmental management policy.

In this regard the following three priority sectors for cooperation are proposed:

- Modernisation and decentralisation of government
- Economic cooperation
- Scientific and technological cooperation

It is underlined that these three sectors have been identified in the Memorandum of Understanding signed between the Government of Costa Rica and the European Commission in March 2001. This MoU foresees an indicative level of assistance of €31.5 million for the period 2000-2006.

### **5.3. Response Strategy in the Focal Sectors**

#### *5.3.1. Modernisation and Decentralisation of Government*

There is general consensus that, in order to maintain the public's faith in the process of government and in government's ability to provide essential services, there is a need to improve both the quality and timeliness of the provision of basic services. Of critical importance is the issue of those services provided by decentralised authorities, which in Costa Rica have suffered significant funding and personnel constraints in the past.

A number of bilateral programmes are already under implementation within the cooperation programmes of Spain and Germany in Costa Rica and have contributed to preparing the way for local government to play a greater role in service provision. In 2001, a constitutional reform was approved that will lead to the transfer of up to 10% of the central budget to the municipalities in order that they may implement a greatly expanded set of responsibilities. In order to put this reform into effect, it is necessary to assist the Government of Costa Rica in defining the appropriate legal and institutional framework that will enable local government to take on additional responsibilities. In addition, significant capacity building in areas ranging from community development, participatory planning, management skills, gender and environment will be required. It is in these areas that the EC support will be focused in close coordination with those efforts already underway as well as with the involvement of civil society organisations such as the National Confederation of Community Development Associations (CONADECO). It is also envisaged that this support will go beyond the provision of such services and also foster the setting up instruments for community development at the municipal level. These are also areas in which the EC has a relative comparative advantage.

It is foreseen that the area of modernisation and decentralisation of government will absorb 35-40% of the resources available.

#### *5.3.2. Economic Cooperation*

It is generally felt that in the social sectors, or human rights sectors, there is no pressing need for further large-scale support from the EC to the Costa Rican authorities, in view of the significant success that they themselves have recorded in these areas. Nor can, in view of the limited funds available, consideration be given to any type of infrastructure development activity. However, the process of economic and social development in Costa Rica over the past two decades has been marked by strong manufacturing sector

performance that has attracted both foreign investment and internal and external migration. As a consequence, the Central Valley, now holds more than half of the total population of the country and the near totality of its industrial output. Given Costa Rica's relatively high levels of human and technological development and the significant ongoing cooperation efforts in the research sector, the principal focus of cooperation in this area will address the issue of urban planning. Key aspects of the improved planning that the Central Valley requires include the carrying out of sectoral diagnoses, improving coordination between planning authorities, upgrading human resources and contributing to the undertaking of feasibility and design studies. Critical areas of coverage could include pollution control and liquid and solid waste management among others. The strategy to be pursued is to make the planning process more transparent, coherent and effective and thereby open up possibilities for EU technology transfer and private sector participation in infrastructure projects. Particular attention will be given to environmental considerations. The scope for developing synergies with the third focal area, scientific and technological cooperation will also be examined.

It is foreseen that the area of economic cooperation will absorb 25-30% of the resources available.

### *5.3.3. Scientific and Technological Cooperation*

According to the Inter-American Development Bank's latest survey, Costa Rica is one of the most technologically advanced countries in Latin America and the Caribbean. Its high levels of human resource development coupled with political and economic stability have encouraged direct foreign investment from abroad. The significant investment made by Intel in microchip manufacturing plant is a prime example of this trend. In addition, Costa Rican universities are renowned in the Central American subregion and have strong links with both European and North American universities. Costa Rica has been a key beneficiary of the Alfa programme. The strategy to be pursued by the Commission in this sector will focus both on further human resources development and on strengthening the linkages between industry and the scientific community with a view to boosting locally developed higher technology services and enterprises in order to maintain Costa Rica's subregional lead in this area.

It is foreseen that the area of scientific and technological cooperation will absorb 25-30% of the resources available.

### *5.3.4. Non-Focal Areas*

The issue of domestic violence against women is of rising concern in Costa Rica, while that of child prostitution continues to be problematic despite increasingly serious attention from the government. However, in the Costa Rican context, it is apparent that they would not provide convenient sectors for intervention under the EC's main cooperation programmes, as these types of intervention typically require small projects, not easily accommodated under the procedures applied to the financial and technical assistance programmes. Nevertheless, if the need for support in these areas increases and institutions with potential implementation capacity are identified, the Commission could consider the use of non-focal resources and/or decentralised cooperation or NGO co-financing options.

Thus potential actions that may be considered under the non-focal area include those related to poverty alleviation, regional integration and the greater insertion of Costa Rica into the global economy, such as:

- Access of marginal groups to basic services such as health and education, including in particular migrants from Nicaragua
- Fiscal reform promoting greater social equity
- Regulatory framework for trade and investment, export development, competitiveness of small and medium enterprises and training
- Regional projects in the field of integration including customs reform
- Follow-up of the present strategy and the preparation of the next

Specific initiatives will be developed by mutual agreement between the Costa Rican Government and the Commission. Up to 15% of the resources available may be allocated to projects in the non-focal areas.

#### **5.4. EU Policy Coherence**

The most important EC policies that have an impact on the EU's relations with Costa Rica include: trade and development; the Common Agricultural Policy (CAP); sanitary and phytosanitary control policy – consumer protection; internal market; competition policy; research and development policy; environmental policy; justice and home affairs policy and information society policy. In general, the policies underlying this country strategy paper are consistent with the principal policies of the Community. Potential areas of conflict with regard to Costa Rica could arise if the focal areas of cooperation were to include agricultural sector development, which is not the case.

However, it is worthwhile mentioning that the nature of the Common Agricultural Policy is perceived by the Costa Rican authorities to be detrimental to the export development in third country markets such as Costa Rica. In the case of bananas, the preferential access granted by the EU to ACP producers has caused significant grievance in Central American and other Latin American banana-producing countries. It is noted that this preferential access is to be phased out by 2006.

The temporary nature of the concessions granted to Costa Rica under the drugs regime of the Generalised System of Preferences (GSP) is seen by the Costa Rican authorities as an impediment to longer-term direct investment decisions. In addition, the implementation of Community policy in the area of sanitary and phytosanitary controls is perceived by some third countries, or economic sectors (in particular agriculture), as a non-tariff trade barrier.

A more in-depth analysis of policy coherence focussing on the Central American region may be found in Annex 6.

#### **5.5. Complementarity with EU Member State and other Donor Cooperation**

The priority sectors selected for cooperation are areas in which there is an established history of donor support and coordination. In particular, in the field of decentralisation, both the EU Member States (German and Spanish Cooperation) and the IDB have been and are active. In addition, as well as the coordination efforts of the UNDP and the EU Member States, the Costa Rican Directorate-General for International Cooperation has recently taken the lead in coordinating donor support and ensuring complementarity. The role played by the EC Delegation in Costa Rica is also of fundamental importance in ensuring complementarity.

Where feasible projects in the priority focal sectors will be linked with sub-regional and regional programmes financed by the European Commission including programmes such

as AL-INVEST, @LIS, URBAL and ALFA. Costa Rica has been one of the principal beneficiaries of the ALFA I and II programmes in terms of per capita participation and has stressed the importance of such programmes and the linkages with the science and technology focal sector.

The process of project identification through to implementation will be carried out in close coordination with Member States. The Commission, through its Delegation in San Jose, exchanges information with Member States through regular and ad hoc meetings, which ensure the complementarity of EU cooperation programmes and could also lead to the development of joint cooperation programmes.

## **6. INDICATIVE WORK PROGRAMME**

### **6.1. Financial Instruments of Cooperation**

The principal financial instruments that could be used to finance the implementation of the EC-Costa Rica Indicative Work Programme are the different Commission budget lines, which include:

- a) technical and economic cooperation covering long-term operations identified within the country strategy for which an indicative envelope of €31.5 million has been established by the Memorandum of Understanding 2000-2006.
- b) other budget lines set up to finance specific issues including areas such as human rights and democracy, environmental and natural resources conservation, drugs and decentralised cooperation.

The final selection of projects and corresponding amounts will be based on the outcome of detailed identification and preparation studies carried out by the Commission. The funding of the indicative work programme is conditional upon that availability of funds in the annual Commission budget. In addition, funding in the form of loans may be sourced from the European Investment Bank.

### **6.2. Principle of Revision and Evaluation**

The following indicative work programme has been developed on the basis of the preceding analysis as well as in consultation with the national authorities, the EC Delegation in San Jose and EU Member States represented in Costa Rica. It will be subjected to a process of annual review involving the same actors during which special attention will be paid to the indicators and expected outputs of the strategy and on the basis of which eventual modifications may be introduced.

### **6.3. Focal Sector Activities**

#### *6.3.1. Modernisation and Decentralisation of Government*

The overall objective for this focal sector is to modernise and decentralise state institutions in order that the services that they provide are of a better quality and accessible to all strata of society.

The principal intervention will be in the area of municipal development and decentralisation and is aimed at increasing the share of government resources delivered at the municipal level, improving the capacity to manage and deliver selected services, and

stimulating the participation of all citizens in municipal decision-making. Activities will include mapping out the competences of municipal authorities and strengthening their capacities as well as those of other actors. In addition, instruments will be established to foster development initiatives at the community level. Issues such as gender and environmental management will be taken into consideration in these development initiatives. The participation of civil society organisations such as the National Confederation of Community Development Associations (CONADECO) in the preparation and implementation of the project will be assured.

The policy measures to be adopted by the Government will include the implementation of the amendment to Article 170 of the Constitution, which directs an increased share of central government resources be spent at local government level.

The indicators related to the above activities will include data on fiscal management, indices of decentralisation and indicators pertaining to local development such as the share of population benefiting from specific services including pipe-borne water, health and education.

### 6.3.2. *Economic Cooperation*

The overall objective for this focal area is to generate increased economic growth ensuring that the benefits are shared equally through building on the country's comparative advantages in terms of its educated workforce, economic and political stability and its open and outward-looking trade policy.

Interventions under consideration include: urban planning covering issues such as environmental management, waste management and planning of physical infrastructure required to attract investment and increase competitiveness; and the regulatory framework for trade and investment, enterprise development and regional integration. Particular attention will be given to environmental considerations.

The policy measures to be adopted by the Government would include the completion of the remaining phases of the recently initiated national urban development plan plus legislation to improve the investment climate.

The indicators related to the above activities will be primarily of an environmental and social nature such as levels of air and water contamination, respiratory and other health indicators.

### 6.3.3. *Scientific and Technological Cooperation*

The overall objective for this area is to further Costa Rica's regional lead as a growth pole based on technological development and contribute to economic development and competitiveness.

Interventions that may be considered could include supporting greater interaction between enterprises and scientific and technological entities, promoting applied research, international exchanges and training in a number of areas such as information technology, telecommunications, industrial production, medicines, natural resources and cleaner technologies.

The policy measures that may be implemented in this context could include the establishment of international agreements, the guaranteeing of the autonomy of the scientific and business communities and ensuring a positive investment climate.

Relevant indicators could include flows of international investment and numbers of joint ventures, trade data, patents taken out and numbers of graduates of technological institutes.

#### 6.4. Cross-cutting Issues

As mentioned in Chapter 5 above, in areas such as human rights and conflict prevention, Costa Rica has an excellent record. Issues of gender will automatically be considered in the preparation of all initiatives under the above focal sectors. In addition the three crosscutting issues of migration, environmental management and decentralisation are of critical importance to Costa Rica. The latter two are to be addressed both within specific focal sector project initiatives as well as constituting mutually reinforcing threads across all sectors of coverage and also between the EU and Costa Rica.

Finally, regional integration is the main priority for the regional strategy for the Central American sub-region. As such it should be a permanent concern at all levels of the country strategy for Costa Rica, in which all actions should be coherent with the regional strategy.

#### 6.5. Indicative Implementation Schedule

The following table provides an indicative overview of the implementation schedule of the work programme. The amount indicated for the first project is fixed as a result of the approval of the project in the PVD-ALA Committee in December 2001, whereas the remaining figures are indicative. The priority sector for 2002 is economic cooperation focusing on urban planning in the greater metropolitan area of San Jose, whilst the preparation for the science and technology sector intervention will commence in 2004.

Sector/Project	Amount	2002	2003	2004	2005	2006
<b>1. <u>Modernisation and Decentralisation of Government</u></b>						
Decentralisation and Municipal Strengthening Financing Agreement Implementation	€9.6 m					
<b>2. <u>Economic Cooperation</u></b>						
Urban Planning Identification/Preparation Approval Financing Agreement Implementation	€11 m					
<b>3. <u>Scientific and Technological Cooperation</u></b>						
Higher Technology Enterprise Development Preparation Approval Financing Agreement Implementation	€10.9 m					



## **7. ANNEXES**

**Annex 1      Costa Rica Fact Sheet**

**Annex 2      Costa Rica National Development Agenda - Sectoral Policies**

**Annex 3      Costa Rica – Macroeconomic and Social Indicators**

**Annex 4      EC Funded Cooperation – Project Summary**

**Annex 5      Donor Matrix**

**Annex 6      Policy Mix**

**COSTA RICA FACT SHEET**



<b>Official name:</b>	Republic of Costa Rica
<b>Capital:</b>	San Jose
<b>Surface area:</b>	51,100 square km
<b>Population :</b>	3.7 million (est. growth rate 2001 1,65%)
<b>Official language:</b>	Spanish
<b>Currency:</b>	Colon
<b>Nature of the State:</b>	Presidential Democracy with 57-Member single chamber Legislative Assembly elected directly by adult suffrage for a four-year term.
<b>Head of Government (President):</b>	Mr. Miguel Angel Rodriguez
<b>Next presidential and legislative elections:</b>	February 2002
<b>Principal political parties:</b>	
<b><u>Government</u></b>	
Partido Unidad Social Cristiana (PUSC)	
<b><u>Opposition</u></b>	
Partido de Liberacion Nacional (PLN)	
Partido Accion Ciudadana (PAC)	
Movimiento Libertario (ML)	
Partido Fuerza Democratica (PFD)	
Partido Accion Laborista Agricola (PALA)	
Partido Integracion Nacional (PIN)	
Partido Renovacion Costarricense (PRC)	

	<b>1998</b>	<b>1999</b>	<b>2000</b>
<b>Real GDP (% growth)</b>	8.4	8.3	1.7
<b>GDP (US\$ billion)</b>	14.1	15.6	15.8
<b>GDP per capita (\$)</b>			4,000
<b>Inflation rate (%)</b>	11.6	10.0	11.0
<b>Unemployment (%)</b>	5.6	6.0	5.2
<b>Current Account Balance (\$ million)</b>	-481	-521	-650
<b>Overall Trade Balance (\$ million)</b>	-498	-399	660
<b>Total External Debt (\$ million)</b>	4.0	4.2	4.3
<b>Debt Service Ratio (%)</b>	7.40	6.4	8.9

## **Annex 2. Costa Rica - National Development Agenda – Sectoral Policies**

In the context of its National Human Development Plan 1998-2002, the Government of Costa Rica has formulated and revised a number of sectoral and other policies over the past few years. The following list outlines the main policies in existence indicating their respective dates of publication or revision.

<b>Policy</b>	<b>Date</b>
Gender	March 2000
Health	August 2000
Fight against poverty	September 2000
Culture	September 2000
Labour and employment	September 2000
Hydrocarbons	February 2001
Tourism	February 2001
Technical education	May 2001
Monetary, banking, insurance and securities	August 2001
Foreign direct investment	August 2001
Integration and commercial liberalisation and deregulation	August 2001
Education	September 2001
Fiscal	September 2001
Pensions and housing	September 2001
Infrastructure	September 2001
Security	September 2001
Telecommunications	October 2001
Electricity	November 2001

**Annex 3 Table 1**  
**COSTA RICA - Social**  
**Indicators**

	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
<b>Demography</b>					
Total Population	3.409.834	3.509.060	3.611.174	3,856,191	3,943,204
% change, year on year	2,9	2,9	2,9	2,9	2,9
Life expectancy at birth (years)	76,1	76,6	76,8	76,8	77
Infant mortality (per '000)	11,8	14,2	12,6	11,8	10,2
<b>Health</b>					
Expenditure as % of GDP	4,8	4,6	4,8	4,7	5,0
<b>Education</b>					
Literacy rate as % of adult population		95,1			
Expenditure as % of GDP	4,4	4,4	4,5	4,1	4,7
<b>Human Development rating</b>	<b>31</b>	<b>33</b>	<b>34</b>	<b>45</b>	<b>48</b>

UNDP, *Estado de la Nación, Reporte 4, 1998, Reporte 1999, and Reporte 2000*; World Bank, World Development Indicators;

**Annex 3 Table 2**  
**COSTA RICA - Economic Indicators**

	1996	1997	1998	1999	2000
<b>GDP (US\$ m)</b>					
At current prices	11.823	12.822	14.090	15.637	15.784
% change, year on year	0,1	8,4	9,9	11,0	0,9
<b>Prices and earnings</b>					
Consumer price index (1995=100)	117,5	133,1	148,6	163,5	181,5
Real minimum wage (1984=100)	106,02	109,97	133,8	116,3	115,6
<b>Debt</b>					
External debt (US\$ m)	3802	3491	3476	3954	4182
Internal Public Sector Debt (c m)	647.114	851.467	945.804	1.392.456	1.499.876
External Debt Servicing (as % total gov. expenditure)	3,3	2,4	2,3	3,3	3,5
Internal Debt Servicing (as % total gov. expenditure)	25,3	3,8	19,4	22,1	20,2
<b>Foreign Exchange Reserves</b>					
Number of months of imports	2,78	3,05	2,05	2,76	2,48
<b>Central government finances</b> (c m at current prices unless otherwise indicated)					
Total revenue	302.497	363.540	444.484	547.434	599.102
of which:					
Income tax	45.756	55.924	77.001	118.859	122.032
Customs taxes	137.796	168.214	211.240	229.288	267.266
Expenditure	397.968	445.309	533.920	646.425	739.274
of which:					
Interest payments	112.124	113.211	116.026	164.226	175.653
on internal debt	100.698	103.022	103.577	142.867	149.549
on external debt	11.426	10.189	12.449	21.359	26.104
<b>Balance</b>	<b>-95.471</b>	<b>-81.769</b>	<b>-89.436</b>	<b>-98.991</b>	<b>-140.172</b>
<b>Ratios (% of GDP)</b>					
Total revenue	12,3	12,2	12,3	12,3	12,3
Income tax	1,9	1,9	2,1	2,7	2,5
Expenditure	16,2	14,9	14,7	14,5	15,2
Interest on domestic debt	4,1	3,5	2,9	3,2	3,1
<b>Balance</b>	<b>-3,9</b>	<b>-2,7</b>	<b>-2,5</b>	<b>-2,2</b>	<b>-2,9</b>

Sources: Banco Central de Costa Rica; Economist Intelligence Unit, *Estado de la Nacion 2000*, IMF, International Financial Statistics; UNDP, World Bank, Global Development Finance

**Annex 3 Table 3**  
**COSTA RICA - Trade**

	1996	1997	1998	1999	2000
<b>Main trading partners (US\$ m)</b>					
<b>Exports to:</b>					
US	1794	2074	2551	3452	3057
EU	846	863	1175	1432	1181
Central America	408	449	516	575	624
Asia	122	148	386	453	306
South America	94	126	137	104	102
<b>Total incl others</b>	<b>3681</b>	<b>4190</b>	<b>5479</b>	<b>6719</b>	<b>5879</b>
<b>Imports from:</b>					
US	2275	2553	3464	3581	3388
South America	508	532	450	551	688
EU	413	474	594	570	658
Asia	364	515	731	666	596
Central America	251	301	313	310	315
<b>Total incl others</b>	<b>4327</b>	<b>4970</b>	<b>6239</b>	<b>6347</b>	<b>6373</b>
<b>Exports (US\$ m; fob)</b>					
<b>Traditional</b>	<b>1.103,1</b>	<b>1.049,2</b>	<b>1.142,7</b>	<b>969,4</b>	<b>893,9</b>
Bananas	631,1	577,3	667,5	623,5	549,2
Coffee	385,4	402,3	409,4	288,7	284,2
Beef	42,2	28,3	24,0	27,2	31,9
Sugar	44,4	41,3	41,8	30	28,6
<b>Non-Traditional</b>	<b>2.655,3</b>	<b>3.156,3</b>	<b>4.382,9</b>	<b>5.671,5</b>	<b>4.973,1</b>
Farm & fisheries	526,3	716,8	757,8	573,5	530,2
Manufacturing	1.107,2	1.121,0	1.244,4	1.134,7	1.124,0
<i>Maquila</i> value added	378,8	427,2	444,5	396,1	396,1
Zona franca value added	643	891,3	1.936,2	3.567,2	2.922,6
<b>Total</b>	<b>3.758,4</b>	<b>4.205,5</b>	<b>5.525,6</b>	<b>6.640,9</b>	<b>5.867,0</b>
<b>Imports (US\$ m; cif)</b>					
<b>Raw materials</b>	<b>2282,4</b>	<b>2665,9</b>	<b>3320,7</b>	<b>3563,2</b>	<b>3472,9</b>
For industry & mining	2211	2509,3	3163,8	3411,5	3331,2
<i>Maquila</i>	318,6	407,5	348,1	328,3	342,1
<i>Zonas francas</i> (incl Intel)	443,7	628,2	1281	1638,1	1554,5
Others	1448,7	1473,6	1534,7	1445,1	1434,6
For agriculture	71,4	156,7	156,9	151,7	141,7
<b>Consumer goods</b>	<b>982,9</b>	<b>1078,4</b>	<b>1283,3</b>	<b>1142,6</b>	<b>1179,5</b>
Non-durable	666,6	666,8	743,3	770,7	807,7
Durable	316,3	411,6	540	371,9	371,8
<b>Capital goods</b>	<b>708,7</b>	<b>878,6</b>	<b>1199,8</b>	<b>1148,8</b>	<b>1072,9</b>
For industry & mining	557,2	675,6	937,9	900,7	848,5
For agriculture	30,4	46,7	56,5	52,6	45,7
For transport	121	156,3	205,4	195,5	178,7
Construction materials	108,6	122,8	172,6	174,1	173,4
Fuel & lubricants	238,7	222	260,8	320,2	472,1
Others	5,5	1,9	1,1	1,7	2,1
<b>Total</b>	<b>4326,8</b>	<b>4969,7</b>	<b>6238,4</b>	<b>6350,6</b>	<b>6372,9</b>

**Costa Rica- EU Trade (US\$  
m)**

Exports	845,5	862,6	1174,8	1431,5	1181,1
Imports	404,6	473,6	594,2	569,8	658,4
<b>Trade balance</b>	<b>440,9</b>	<b>389</b>	<b>580,6</b>	<b>861,7</b>	<b>522,7</b>

**Main products** (% total EU  
exports)

Computer parts	43,3
Bananas	18,5
Coffee	11,9
Pineapple	4,2

Source: Banco Central de Costa Rica, COMEX

**Annex 4. Costa Rica –EC Funded Co-operation – Project Summary**

<b>Project</b>	<b>Date</b>	<b>Amount €</b>
Decentralisation and Municipal Development	2001	9,600,000
Support to Fundación CIPIE	2000	384,000
Rehabilitation following Hurricane Cesar	2000	2,247,000
Strengthening of Communal Banks	1999	500,000
Strengthening Productive Enterprise in the Southern zone	1998	850,000
Human Rights and Democracy Programme	1994-1997	2,576,000
Young Drug Addicts Prevention Programme	1996	284,000
HIV/AIDS Prevention Programme	1996	545,000
Forest Conservation and Sustainable Development in the North Atlantic Zone	1996	4,400,000
Agricultural School in the Tropical Humid Region	1996	940,000
Training for Sustainable Livestock Farming	1995	675,000
Support to Refugees and displaced persons in the Atlantic Region	1995	1,000,000
Care and Treatment for young abuse victims	1995	240,000
Integrated Rural Development in Indigenous Regions	1995	146,000
HIV/AIDS Prevention	1994	376,000
Agrarian Reform Osa Golfito	1993	5,500,000
Conservation in the Tortuguero Plains	1993	1,600,000
Reforestation	1993	400,000
Integrated Watershed management	1992	651,000
Integrated Drug Prevention and Treatment Region	1992	284,000



**Annex 5. Costa Rica Country Strategy Paper - Donor Matrix**

<b>SECTOR</b>	<b>IDB</b>	<b>IBRD</b>	<b>EC</b>	<b>Spain</b>	<b>Germany</b>	<b>Netherlands</b>	<b>UK</b>	<b>Belgium</b>
Infrastructure	Geothermal Power 1998	-Water Supply and Sewerage (\$26m) 1993 -Transport (\$60m) 1990			-Transport -Rural Drinking Water and Sanitation			
Economy		Ecomarkets (\$32.6m) 2000	-Small Enterprises Development - Studies Fund		-Small enterprise			
Health		-Health sector Reform (\$22m) 1994						
Education				-School Infrastructure	-Educational and Training			-Training of Unions
Environment Natural resources and forestry	-Cadastre and property registry (\$92m) 2000		-Forest Conservation (\$9m)	-Environment and Natural Resources -Water management (\$2m) 1999	-Clean air San Jose	-Sustainable Development	-Biodiversity micro-projects	
Poverty Gender							-Women in Development micro-projects	
Governance	-Justice (\$30m) 2001		-Human Rights and Democracy (€ 2.5m) 1994-97 -Decentralisation and municipal Development (€ 9.7m) 2002	-Decentralisation (\$ 0.7m) 1995 -Police training (\$ 0.4m) 1999	-Decentralisation -Community Development -Political training			-Civil Society
Agriculture			-Agrarian Reform and Integrated Rural Development		-Disease Control -Ecological Agriculture			-Food Security and Agricultural Production

## **Annex 6 : Policy Mix**

### **1. Trade Policy:**

Article 133 of the EU Treaty constitutes the legal basis for the EU's trade policy. It states that the objective of the Union's commercial policy is «to contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and the lowering of customs barriers». It covers all the main aspects of trade in agricultural and non-agricultural goods and services as well as key related issues of intellectual property, investment and competition.

The main instruments of the Union's trade policy towards Central America include :

- Strengthening and expansion of bilateral trade relations with Central American countries on the basis of transparent and non-discriminatory rules
- Supporting regional trade and economic integration processes in the Central American sub-region
- Supporting Central America in its fight against drugs through autonomously granting duty free market access to the EU for all industrial products (excluding arms and ammunition) and a range of agricultural products under the special arrangements to combat drug production and trafficking (drug regime) of the Generalised System of Preferences (GSP).
- To support the integration of Central American countries into the world economy by assisting them to implement existing WTO commitments as well as new commitments that will result from the Doha Development Agenda.

The strategy set in this document, in particular with regard to the economic co-operation section, is fully in line with the achievement of these objectives. However, for the drug regime of the GSP, there is some concern among Central American countries that the short period of renewal of the GSP regulation may act as a disincentive to longer-term investment in the region.

As far as the GSP is concerned, Costa Rica benefits from duty free access for virtually all products the export of which it is interested in, under the drug regime. This regime, which has been in place since 1990, has been regularly renewed ever since, through recurring regulations covering an average of 3 years. Its present legal basis is Council Regulation 2501/2001, which will expire at the end of 2004, when the next 10 year cycle for the implementation of the GSP will start. The combination of 10 year cycles and multi-annual regulations provide traders and investors with the predictability required for making informed decisions.

### **2. Common Agriculture Policy (CAP)**

The 1957 Treaty of Rome contained provision for a Common Agricultural Policy (CAP). This policy sought to increase the productivity of European agriculture, ensure reasonable living standards for farmers, stabilise farm produce markets and guarantee a stable food supply at fair prices for consumers. Many changes to the CAP were made, modifying price policy, restricting market intervention, regulating output and introducing a system to control spending on agriculture. Measures were added to stimulate development in rural areas. By 1992, an important overhaul of the CAP took place which involved: reduction of support prices, adjustment of market management

to restore market balance, and more assistance was provided for social and environmental measures. Concerning its external dimension, those changes focussed on the next enlargement of the Union, the global economy and the need to implement WTO commitments.

Few agricultural commodities covered by the CAP enter into competition with Central American products. A notable exception is bananas and since the EU is an important destination for Central American products, Central American banana producers have voiced significant grievance concerning the impact Community policy in this field has had on their market access. In addition, the CAP has also influenced meat and sugar markets.

### 3. Sanitary and Phytosanitary Control Policy – Consumer Protection

In its external dimension, the Community policy in this sector aims to assure a high level of protection of health, safety and economic interests of the consumers, as well as the protection of public health in the EU. For exporters of agricultural goods of third countries, to achieve these high EU standards is sometimes difficult and the result is that their products may not be able to enter the EU. The objective of improving exporting countries' capacity to meet EU sanitary and phytosanitary standards should be an important focus for trade related technical assistance and capacity building.

### 4. Internal Market

The principal aim of this policy is to strengthen the process of economic integration for a liberalisation of the markets, as well as the development of a legislative framework compatible with that of the EC in order to:

- assure a suitable level of protection of industrial and intellectual property,
- prevent money laundering,
- protect personal data
- guarantee minimum standards for public calls for tender, avoiding any kinds of restrictive measure of the markets.

Regulatory convergence leads to mutual benefits, supporting trade and investment and favouring investment abroad of EU companies. This policy is compatible with the present strategy both in the bilateral and the regional context.

### 5. Competition Policy

The interest in applying competition policy in the EU's relations with third countries, mainly in the negotiation of trade agreements, is based on the establishment of a stable and clear legal framework for relations among economic operators that may prevent commercial conflicts.

At the same time, the discriminatory treatment between companies of both parties is avoided with respect to direct investments or access to the services market. Likewise, the EU takes part in multilateral co-operation in this sector in the framework of the World Trade Organisation (WTO). The WTO working group on "trade and competition" examines the possibility of strengthening the convergence of policies for which a multilateral horizontal action might be explored by the EC.

This policy is compatible with the present strategy since interventions promoting its aims and policies are included, in particular in the regional context.

## 6. Research and Development Policy

In the EC, international co-operation in this area is covered by the Fifth Framework Programme (FP5) through two principal axes:

- An international co-operation dimension for each research programme, included in the FP5, that contributes to the solution of common or general problems.
- a specific international programme third countries and regions, including Central America.

The training and mobility programmes for researchers included in the EC Framework Programme are also compatible with the aims of the present strategy.

## 7. Environmental Policy

The priorities of the environmental policy for Central America are defined at two levels:

- Objectives and principles included in the 6<sup>th</sup> Community Environment Action Programme (6EAP, 2002-2011): climate change, depletion of natural resources and the loss of bio-diversity, participation in the discussions and negotiations on forest related issues<sup>1</sup>.
- To encourage Central America to implement its international commitments under the different multilateral environmental agreements, notably:
  - the Biodiversity Convention, Cartagena Protocol of Biosafety,
  - Climate Change Convention,
  - the Kyoto Protocol,
  - Stockholm Convention of Persistent Organic Pollutants
  - the Rotterdam Convention on the Prior Informed Consent Procedure for certain hazardous chemicals and pesticides in international trade.

These objectives are compatible with the present strategy in particular in view of the fact that environment as one of the main crosscutting issues for sustainable development has been mainstreamed into the co-operation strategy.

## 8. Conflict Prevention

In its communication on conflict prevention (April 2001), the Commission announced its intention to focus its co-operation programmes more clearly on addressing root causes of conflict in an integrated manner. In this context, the Commission will seek to incorporate specific conflict prevention (or resolution) measures into its various sectoral programmes.

## 9. Justice and Home Affairs:

The instruments put into place by the EC in its relations with Central America in the fight against drugs are coherent with the objectives of the present strategy.

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<sup>1</sup> In line with the EC communication on “Forests and Development: the EC approach” (COM1999 (554)).

The current policy concerning immigration could have a impact on the development of some Central American countries that depend heavily on remittances from emigrants. Costa Rica does not fall into this category.

#### 10. Information Society

The main objectives pursued by co-operation with Latin America in the Information Society field are the following:

1. Promoting the development of an inclusive Information Society in those countries and fighting the digital divide within and between countries and regions and, as such, contributing to the economic and social development of Latin American countries;
2. Fostering the integration of Latin American countries in the global Information Society;
3. Promoting European industrial interests in Latin America by creating a favourable environment for the EU Information Society stakeholders in the region, notably by promoting efficient regulatory and policy frameworks, as well as open and global standards in the region;
4. Reinforcing technological co-operation in the field of Information Society, in particular through the European Union Framework Programme for RTD;

Those objectives are compatible with both the national and regional strategies.