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Costa Rica's Wrong Turn

By JUAN CARLOS HIDALGO

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WASHINGTON — On Sunday, Costa Ricans will go to the polls in what many consider the most important presidential election in a generation.

At stake is the future of an economic model that over the last 25 years has produced robust economic growth but has failed to significantly reduce the poverty rate. Unfortunately, a bad reading of the economic policies implemented by a succession of conservative and social-democratic administrations over the last three decades could lead voters to follow the siren song of populism.

The groundwork for a populist shift has already been laid. Rampant corruption, social stagnation and growing inequality have provided fertile soil in other Latin American nations for the rise of populist candidates — and Costa Rica is no exception.

The lead-up to the election has been marked by widespread national dissatisfaction, and according to surveys, corruption is voters' main concern. After eight years in power, the National Liberation Party has become synonymous with cronyism and embezzlement.

This is the reason that a Socialist congressman, José María Villalta, is one of the leading candidates. His platform calls for policies similar to those disastrously implemented in Venezuela, like land distribution, punitive taxes on big corporations, price controls and the nationalization of key industries.

His claim that the country's economic liberalization of the last 30 years has failed the masses resonates among a large segment of the electorate. But Mr. Villalta's policy prescriptions are based on a wrong diagnosis of Costa Rica's economic model.

After an acute crisis from 1980 to 1982 swelled the poverty rate to 54 percent, Costa Rica put in place reforms to move the economy toward an export-oriented model. The country set exchange rates to provide more certainty to exporters and established free-trade zones and entered into free-trade agreements with the United States, the European Union and China, among others. It also privatized inefficient state-owned enterprises and opened certain industries to competition.

These reforms brought significant growth. Since 1987, Costa Rica has been growing an average of 4.7 percent a year, one of the fastest rates in Latin America.

But since 1994, poverty has remained stagnant and income inequality is on the rise. In fact, Costa Rica is one of only three Latin American countries where inequality has risen since 2000.

And this has happened despite the fact that Costa Rica has one of Latin America's highest social expenditures: The government has 44 anti-poverty programs, plus large entitlement programs like social security and state-provided health insurance.

So why has Costa Rica been unable to lower its poverty rate despite healthy growth rates? Because its economic model is still in significant ways based on a mercantilist system that is biased toward certain favored sectors of the economy (exports, tourism) at the expense of the poor.

Take, for example, monetary policy. Over the last 30 years the Costa Rican central bank has actively intervened in the foreign exchange market to boost the export-related sectors of the economy, even though doing so has driven inflation as high as 14 percent in 2005, the highest rate in the last 10 years.

Trade policy is another problem. While Costa Rica opened up to imports in the early 1990s by cutting tariffs on many consumer goods, it maintains high tariffs on a number of key farm goods like milk, rice and chicken, which drives up prices.

And yet these are precisely the products most consumed by the poor. A 2002 study by Costa Rica's Incae Business School found that agricultural protectionism constituted a 17.5 percent income burden on the poorest 20 percent of the population. In 2013, the cost of a basic basket of food products required to meet an average person's minimum caloric intake represented 82 percent of the average per capita income of the poorest Costa Ricans.

To make matters worse, while the Costa Rican government offers tax and regulatory incentives to multinational companies, it suffocates local businesses with high taxes and crippling regulations. The country ranks 102 (out of 189 economies) in the World Bank's Doing Business Report. The total tax rate amounts to 55.3 percent of an average local business's profit. As a result, many people can't cope with the high costs of doing business and turn to the parallel economy: The latest data show that one in three Costa Ricans work in the informal sector.

Many Costa Ricans mistakenly believe that economic liberalization is to blame for the country's social woes. In reality, the current economic model is designed to benefit powerful sectors of the economy at the expense of the overall population, particularly the poor. What Costa Rica needs are genuine market reforms that eliminate the government's power to pick winners and losers. Let's hope the voters can see past the empty promises of populism next week.

Juan Carlos Hidalgo is a policy analyst on Latin America at the Cato Institute's Center for Global Liberty and Prosperity.