Facing global challenges

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In 2008, the complex international economic situation presented some serious challenges

Costa Rica's economy is small and open; middle income, but high in human development. Per capita GDP is around US$6,000 (US$10,000 in terms of Purchasing Power Parity), and imports and exports of goods and services constitute around 100 per cent of GDP. The country has a diversified and dynamic export sector, supported by strong inflows of direct foreign investment (more than six per cent of GDP). Literacy rates are around 95 per cent of the population, and life expectancy is above 78 years of age.

Between 2006 and 2007, the Costa Rican economy grew by an average annual rate of eight per cent, with inflation of around 10 per cent. Direct foreign investment more than covered the balance of payments current account deficit. Public finances also improved substantially over this period, with a surplus in 2007. The public deficit fell to 54.7 per cent of GDP in 2005, and to 46.6 per cent in 2007. Foreign currency reserves at the end of 2007 stood at US$4 billion, more than twice the monetary base.

In 2008, the complex international economic situation presented some serious challenges. Despite a broader range of goods and services exports, the country remains heavily dependent on US markets. The country is a net exporter of agricultural products, but a net importer of basic cereals, which have been affected by high price rises. Although most energy production is based on renewable sources, there is still dependence on imported hydrocarbons.

Changes in the international arena affect Costa Rica in three ways. Firstly, in terms of its productive capacity: the slow down in overseas demand has affected output, which is expected to grow by just 3.3 per cent in 2008. In the second place, it has been affected by the worsening trade deficit: a slow down in exports and higher import costs will see the balance of payments account rise to eight per cent of GDP in 2008. Thirdly, domestic prices will be hit: the rising price of oil and foodstuffs, combined with economic growth that outstripped productive capacity will see inflation rise to 14 percent in 2008.

Fortunately, the country is well placed to face these external challenges. There is a spending surplus, which would allow for anti-cyclical measures should they be necessary. The foreign debt in July of 2008 was just 10.5 per cent of GDP, and taking into account the Central Bank's monetary reserves, the public sector is a net creditor of the rest of the world. The exchange rate regime is gradually becoming more flexible, allowing a move towards a nominal exchange rate and less dependency on the US dollar. Foreign direct investment will continue to support diversification of exports, technology transfer and employment opportunities.

In the short term, economic adjustments have shown themselves through more conservative fiscal policies, an increase in the nominal exchange rate, and a more restrictive monetary policy, reflected in a slowdown in the growth of liquidity, and a trend toward higher interest rates. Lending, which had driven part of the increase in demand in recent months, is slowing down, and the country has maintained a policy of transferring external price rises to domestic prices.

At the same time as pursuing these policies, the country has also taken measures to protect the economy from of external shocks on employment and prices. There is a clear strategy to strengthen the integration of Costa Rica into the world economy. Last year a referendum approved the Free Trade Treaty with the US, Central America, and the Dominican Republic, which is due to come into effect on October 1 this year, following approval of adjoining legislation. Along with Central America, an association treaty with the European Union is also being negotiated. The country has also applied to join APEC, and has established diplomatic relations with China, thereby creating better opportunities to penetrate this key market.

Public spending is being directed with the aim of boosting investment, both in terms of human capital, as well as infrastructure. In the latter, by developing public-private-partnerships to build airports, ports, and roads. The Central Bank is moving toward setting up measures to control inflation, as well as greater administrative flexibility in setting exchange rates. In terms of employment, aside from increasing training to meet the needs of foreign companies coming into the country, a salary policy has been pursued to compensate for the impact of prices rises on the country's lower income groups.

The future of the Costa Rican economy, despite the unfavourable international conditions, is positive. International financial ratings agencies such as Standard & Poor's and Moody's have recently improved their ratings for Costa Rica. The positive outlook is also reflected in the continuing inflow of foreign direct investment and the intelligent integration in the global economy, backed by a strengthening of human resources, along with the search for greater internal and external stability. F