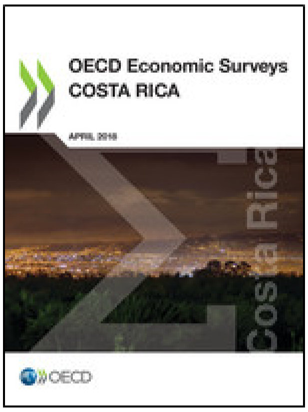
Costa Rica: Sharing the benefits of growth more widely

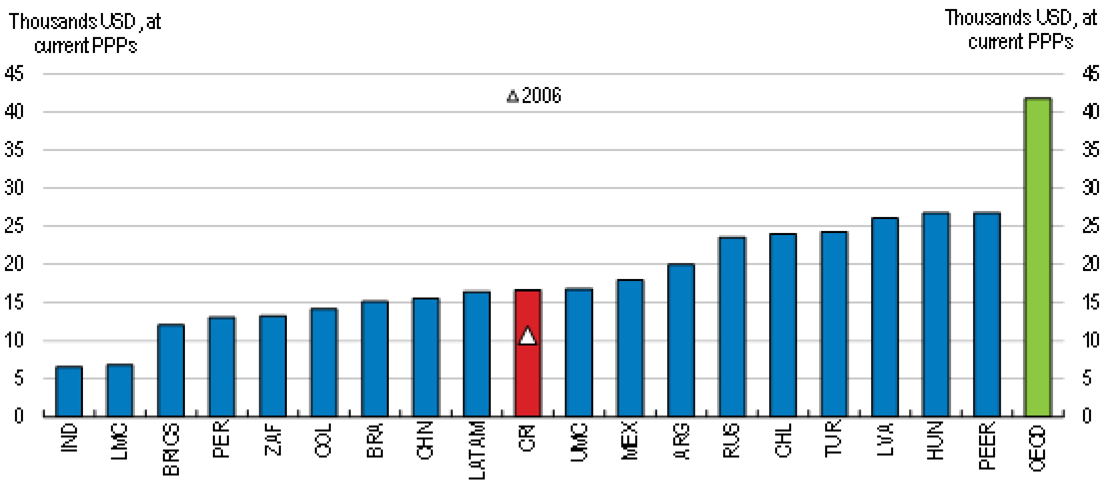


By Sonia Araujo and Lisa Meehan, Costa Rica Desk, OECD Economics Department

Costa Rica’s economy is strong and continues to converge towards OECD living standards (Figure 1). Although productivity has picked up recently, a wide gap relative to the OECD remains. Employment rates are low and unemployment remains above pre-crisis levels, hitting predominantly youth and the low skilled. And against the general trend in Latin America, informality and inequality are not declining (Figure 2). The OECD 2018 Economic Survey of Costa Rica finds that anti-competitive regulations and high labour market segmentation hinder the full realisation of opportunities to make growth more inclusive. Setting in motion a ‘virtuous cycle’ of inclusive growth will require reforms across several policy areas that present win-win opportunities in terms of equity and productivity improvements.

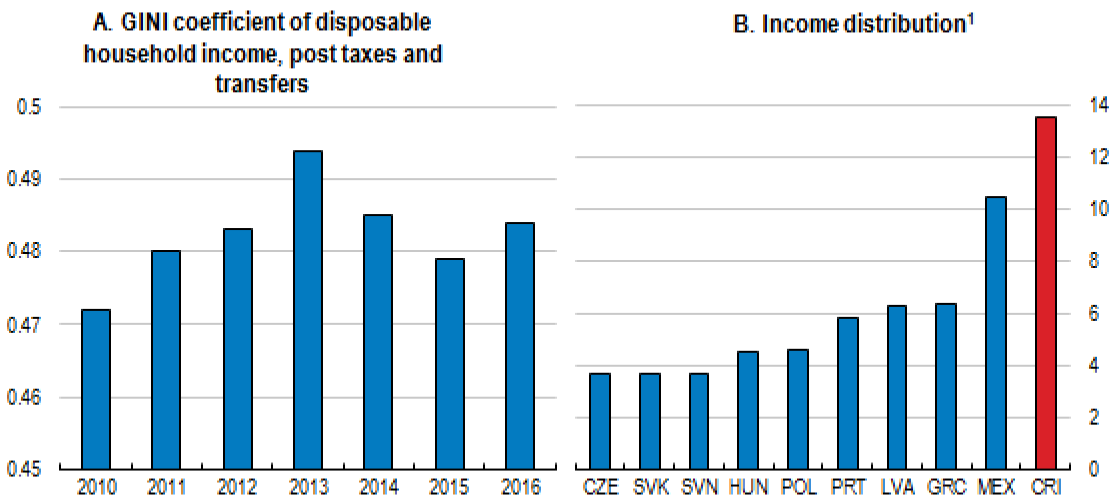
Figure 1. Costa Rica has converged towards higher income levels

GDP per capita, 2016 or latest available year



Note: PEER refers to the 10 non-Latin American OECD countries with the lowest GDP per capita: Czech Republic, Estonia, Greece, Hungary, Latvia, Poland, Portugal, Slovak Republic, Slovenia and Turkey. LMC and UMC refers to the lower-middle-income and upper-middle-income economies as classified by the World Bank. LATAM refers to Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico and Peru. BRICS refers to Brazil, Russian Federation, India, China and South Africa.
Source: World Bank Development Indicators.

Figure 2. Inequality is high and increasing



1. Income distribution is computed as S80/S20. This ratio represents the share of all income received by the top quintile divided by the share of the first, or the ratio of the average income of the top quintile to that of the first.
Note: Income distribution data refer to 2015 except for Hungary (2014), Mexico (2014) and Costa Rica (2016)
Source: OECD, Income Distribution Database (IDD)

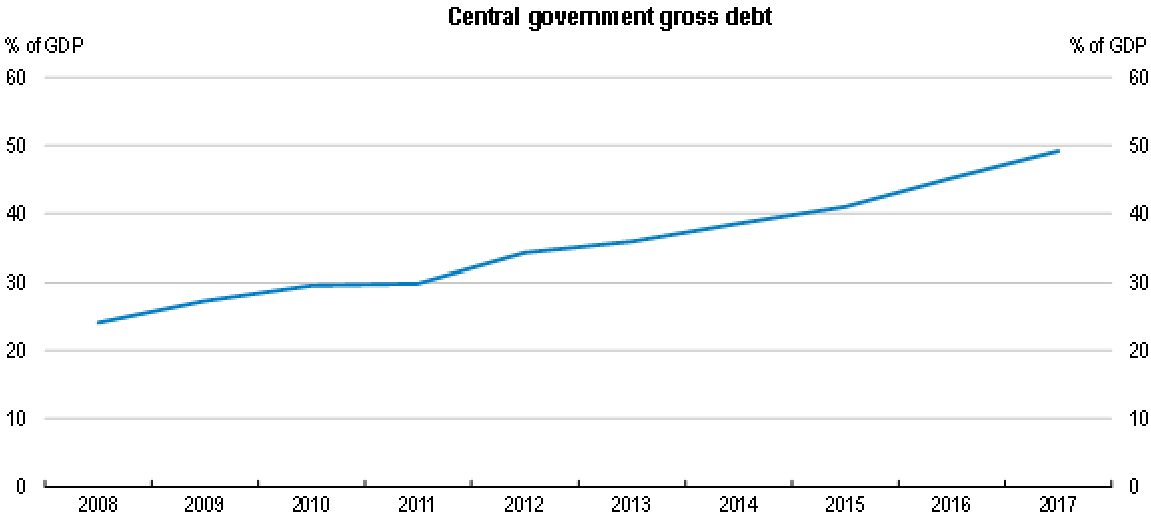
First, there are high barriers to entrepreneurship, anti-trust exemptions and state control in many sectors. Improving state-owned enterprises' governance according to OECD standards, establishing one-stop shops for business registration and licensing, streamlining insolvency procedures, removing anti-trust exemptions and enhancing trade facilitation would bring large growth benefits.

Second, Costa Rica should implement a comprehensive strategy to fight informality, including greater enforcement of compliance and by continuing to reduce the complex minimum wage structure, which increases firms' costs and discourages job formalisation. Costa Rica should continue to simplify its complex web of 23 sectoral, occupation, education attainment and skill minimum wages.

Third, education should remain a policy priority as a strategy to move to higher income levels and respond to the ongoing structural change towards higher value-added activities. But Costa Rica obtains too little from its substantial investment in education. At almost 8% of GDP, education spending is higher than in all OECD countries. However, PISA results reveal that one third of students lack core competencies and outcomes are strongly influenced by socio-economic background. Resources need to be channelled to secondary education, where there are growing demographic pressures and a need to increase access, and early childhood education and care, in order for all children to fully realise their potential. More focused, targeted support should also be given to students at risk early on. Overall, the government should move from the current focus on resources and funding to outcomes, and establish clear and verifiable performance based targets against which to measure the success of its education policies.

But the major threat to growth and living standards in the medium term continues to be fiscal sustainability. The budget deficit has exceeded 5% of GDP for the past five years. Recent efforts to increase tax collection have not reduced the budget deficit due to the extensive use of earmarking, public sector fragmentation into autonomous agencies and spending mandates. As a result, central government debt has soared, from less than 25% of GDP in 2008 to 49% in 2017 (Figure 3). A comprehensive fiscal reform package is urgently needed to stabilise the debt-to-GDP ratio. There is ample room to raise additional revenue by broadening the tax base and continuing to fight tax evasion and avoidance. However, raising tax revenue will not help to contain the deficit unless strong earmarking and mandated spending are restricted. Reforming public-sector compensation, strengthening the budgetary framework with a new, operational fiscal rule and improving debt management would help to balance the budget.

Figure 3. Public debt is growing rapidly



Note: Includes only central government debt for Costa Rica.
Source: Ministerio de Hacienda de Costa Rica.

References:

OCDE (2018), OECD Economic Surveys: Costa Rica 2018, OECD Publishing,