The challenge of "starting two motors"

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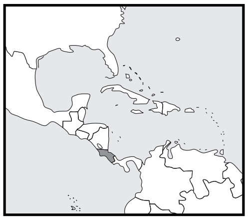


Follow-up on international commitments taken on by the Costa Rican government and the development of social auditing practices would promote government accountability and strengthen democracy and good governance in our country. Conversely, the lack of fulfilment of such commitments erodes citizen confidence in their leaders and in the legitimacy of their performance.[1]

At the United Nations Millennium Summit, Costa Rican leaders ratified many of the commitments taken on in the nineties, which are presently included in the Millennium Declaration. They reaffirmed the right of all people to a decent and good quality life and committed themselves to creating an enabling economic environment for social development and in particular, to overcoming poverty. The relevance of fulfilling this commitment is underscored by the trend towards national inequality and poverty. In fact, the social gap has increased: the richest 20% of the population presently concentrate 13.5 times more income than the poorest 20%.[2] Furthermore, since 1994, poverty has remained constant at 20%, while the absolute number of poor people has increased.[3]

The limitations of social policies

It is evident that the eradication of poverty and promotion of social equity requires economic resources. No social policy, however successful, can solve the problems of poverty and social inequality on its own. It has to be skilfully linked to productive models and economic policies that make possible the redistribution of opportunities and generation of corresponding resources. The eradication of poverty and rehabilitation and consolidation of social development indicators achieved in past decades necessarily require an examination of the economic model, in terms of generation of quality employment and promotion of production for the internal market.

In comparative terms, Costa Rica does not have pressing problems of funding and resources that prevent it from giving content to social policies. However, the lack of political will to assign the necessary resources to such programmes constantly threatens their effectiveness.

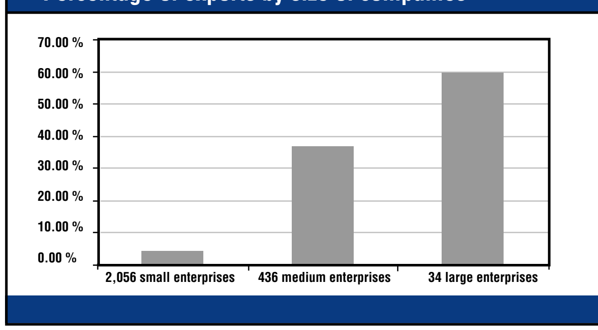
A country should not depend on foreign co-operation to eliminate poverty, but should choose a productive model that promotes equity and is socially and environmentally sustainable. From a citizen standpoint based on this conviction, Costa Rica lacks co-ordination between social policies and economic policies. The productive model has major problems that must be resolved so that more resources can be mobilised for development with better results.

Equity in the distribution of wealth and opportunities and a decrease in poverty require, in addition to social policies, economic and productive policies that complement them. The achievement of social welfare is not the exclusive responsibility of social policies. Alleviating poverty also requires the design and implementation of an alternative development system that includes a better distribution of income, quality employment, and a tax regime that promotes solidarity, is equitable and is adapted to the needs of the country. In such a system, social policy measures would be more effective insofar as they would be conceived as integral with economic and political measures and respond to a coherent orientation of solutions to the country's problems.

The present economic and productive model, linked exclusively to exports and benefiting a very small group of export companies, does not correspond to the national productive structure and excludes most of the country's productive units.[4] Meanwhile, most of the country's productive capacity is concentrated in medium, small and micro enterprises that produce for the internal market (see graph below).[5]

CHART 1

Percentage of exports by size of companies



In fact, only 5% of the county's companies are directly devoted to production for export. Most of the productive units (approximately 90%, mainly micro-enterprises)[6] produce for the internal market. Since this is not a priority in the present productive model, these companies do not benefit from government support, as the export sector does.

1 A major part of the statistical information used in the preparation of this report was provided by the Observatorio del Desarrollo, of the University of Costa Rica.

2 Estado de la Nación y Encuesta de Hogares. *La Nación*, 15 November 2001.

3 Informe del Estado de la Nación, 2001. Proyecto Estado de la Nación, Séptimo Informe. San José, Costa Rica.

4 Unless stated otherwise, data was provided by the Costa Rican Chamber of Exporters.

5 The data regarding the number of enterprises by size are based on Castillo Artavia, Geovanny and Luis Fernando Chávez Cómez. 2001. *Pymes: una oportunidad de desarrollo para Costa Rica.* FUNDES. San José, Costa Rica.

TABLE 1

Exporting companies

COMPANIES	NUMBER	EXPORTERS
Large	1,346	34
Medium and small	14,891	2,492
Micro-enterprises	58,594	0

Because they are not a priority in the economic model, these companieshave limited access to loans, borrow at very high interest rates and have serious marketing problems. They lack training and, in general, there is no public mechanism that responds to their needs.

Consistent with the emphasis on the export model, internal consumption of goods and services is not a priority. A sustained decrease in consumption by the Costa Rican population since 1985 reflects this. Thus, while private consumption represented 46.7% of the global demand in 1985, in 1999 it was only 33.2%. This, added to the reduction in tariffs and consequent increase in imports, has had a negative effect on those 90% of companies producing to satisfy consumer needs on the internal market.

The export model, opening of markets and reduction of tariffs have created a situation in which fewer than 5% of national companies produce directly for export. To this should be added that 63% of the exports are generated by companies within the Duty Free Zone (DFZ) system, which enables them to enjoy a series of tax exemptions. Thus the sector that produces most of the wealth contributes least to a redistribution of wealth and opportunities. These companies employ only 2.5% of the economically active population, while the micro and small enterprises, basically producing for the internal market, in 1998 generated 42% of national employment.[7]

Summing up, the export promotion model and the drop in internal consumption do not correspond to the most important characteristics and possibilities of the national productive structure. The most dynamic companies are geared towards export, but generate a scant percentage of employment and are mainly located in the DFZ, and therefore do not contribute to national tax revenues. Conversely, most companies – those that generate the most local employment– are outside the productive model. All these elements create insecurity of employment and growth of the informal sector, threaten equity, limit redistribution of income and opportunity and hinder the struggle against poverty.

Since the most dynamic sectors of the economy are exempt from taxes, the tax system cannot redistribute income and opportunity and these sectors do not contribute to national development. The national tax burden represents 12.5% of the GDP and is threatened by the sustained process of tariff reductions. This is a small burden compared with other countries, but it is insufficient to cover the current functions of the Costa Rican government. Furthermore, 75% of tax revenue comes from indirect taxes, which directly affect low-income families because they consume a greater proportion of their income.

Meanwhile, most of the companies that benefit from the export promotion model and that most export, are located in the DFZ (209 of the 470 companies generating 96% of the exports). DFZs contribute little to redistributed wealth since companies operating in them are not bound by taxes. Thus, for example, the 100% income tax exemption means that GDP growth generated in the DFZ is not transformed into an increase in available national savings and much less into the strengthening of public social and productive policies.

Within the framework of the present model of export promotion, social, labour and environmental investments constitute a cost, a dead weight, rather than adding value to production. However, it is precisely social investment that reflects the democratic will, not only the political will, but also the social and economic will. In this respect, the struggle against poverty requires a productive model in which social investment really adds value to production.

It should also be added that social policy, in particular anti-poverty policy, also faces a set of serious problems. These problems are not necessarily problems of funding, but of effective allocation. Resources allocated to the struggle against poverty should be assigned more effectively, with better design and monitoring of programmes and reduction in political cronyism.

"Starting two motors"

Progress towards equity and in the struggle against poverty in Costa Rica requires a comprehensive productive model. This poses a challenge for the whole of Costa Rican society and requires participation of the whole productive structure and not only a small part of it. Taxation of all economic agents, and the transformation of social, labour and environmental investment into added value for production, are also urgent tasks.

This implies linking medium, small and micro-enterprises to export production, but additionally and basically, promoting production for the domestic market. It involves support for idea that the production system will benefit from greater domestic consumption and a more equitable distribution of income. Only in this way will economic and social policy be compatible. We have called this challenge "starting two motors," the economic motors of export promotion and promotion of production for the domestic market.

Following this path would enable the country to mobilise a set of domestic resources for development. These would be "healthy" resources, since they would result from the development model and not from international co-operation or from social policies that are incompatible with economic policies. Parallel to these efforts, social policies need to be strengthened, both through additional financing and through improved design, monitoring and assessment of results.

In short, the question of mobilising domestic resources for development brings the country face to face with the enormous challenge of building alternatives to the productive model implemented for the past 20 years. ■

The generation of resources to fund social development and the creation of efficient mechanisms for their distribution are commitments made at the Copenhagen Summit:

> *"We commit ourselves to creating an economic, political, social, cultural and legal environment that will enable people to achieve social development."*
>
> *"We will create an enabling economic environment aimed at promoting more equitable access for all to income, resources and social services."*

The second Copenhagen commitment, regarding the eradication of poverty, has not been achieved in the last five years.

> *"We commit ourselves to the goal of eradicating poverty in the world, through decisive national actions and international co-operation as an ethical, political and economic imperative of mankind."*

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6 Micro-enterprises make up 78.3% of total enterprises in the country.

7 National Programme for support to micro and small enterprises. ILO Interdisciplinary Technical Group, 2000. "The informal sector of the economy: characteristics of micro and small enterprises in Costa Rica." San José, Costa Rica.