

ENCUENTROS

Hard-Pressed to Invest: The Political Economy of Public Sector Reform in Costa Rica*LaDawn Haglund*¹

Over the last twenty-five years, a paradigm shift in economic thinking has occurred in Latin America. State-led development, once prevalent throughout the region, gave way to an emphasis on markets as the engine of growth and prosperity.² Neo-liberal reforms promoting trade liberalization, fiscal austerity, privatization, and openings to international investment were the reigning orthodoxy.³ Such reforms have been a source of conflict and protest throughout the region, and have given rise to contradictions between previous state-led development strategies and new liberalization paradigms. Trade instruments, in particular, severely restrict state intervention by labeling it, by definition, as distorting (Wade,

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2 This research was supported by the National Science Foundation under NSF Grant # 0221283. Any opinions, findings, conclusions, or recommendations expressed in this paper are those of the author and do not necessarily reflect the views of the National Science Foundation.

3 "Neo-liberalism" in this paper refers to a set of policy prescriptions in which markets are the preferred mechanism for economic management. Widely disseminated in the developing world under the rubric of "the Washington Consensus," neo-liberalism comprises the measures mentioned above, as well as reduced government expenditures and deregulation. These ideas are credited to Williamson (1990), though Williamson himself rejects the term "neo-liberal," as well as some of the excesses carried out by advocates of liberalization.

2003). This rollback of the state has placed Costa Rica's autonomous public institutions directly at the center of controversy over neo-liberal reform. During the latter half of the 20th century, these institutions served a crucial and effective developmental function, especially in public goods sectors. Yet despite this seeming success, neo-liberal reformers have challenged state institutions in Costa Rica as vigorously as in places where the benefits of state intervention were less clear. The imposition of strict fiscal discipline, the introduction of market mechanisms in public goods sectors, and the implementation of the Central American Free Trade Agreement (CAFTA), all threatened to weaken the key institutions of the Costa Rican model of development. At the same time, these institutions have proven remarkably resistant to change, in part due to concerted resistance to neo-liberalism from multiple sectors of Costa Rican society.

1. Theoretical Framework

How are we to understand the push for neo-liberal reform in contexts where public goods are provided relatively well? From a neo-liberal perspective, state-led development represents a failed paradigm. State-owned enterprises do not possess the efficiency, resources, or autonomy required to promote growth, macroeconomic stability, or development. These explanations have at their root an important insight regarding the dangers of political interference that can lead to rent-seeking and productive inefficiencies (Krueger, 1974). This deep concern with state failure is coupled with the assumption that market failures are less costly and intransigent. Establishing a liberal economic order is thus proposed and implemented as a solution to the inadequacies of state-led development. In the words of Margaret Thatcher, "TINA: there is no alternative." If true, the main concern becomes identifying and overcoming impediments to reform. Scholars from the "politics of economic adjustment" perspective deepened this debate by addressing the question of how collective action problems arise and are overcome (Nelson, 1990; Haggard and Kaufman, 1992). They argued that because potential winners are diffuse and only benefit at indeterminate points in the future, while potential losers are specific, organized actors whose interests will be quickly and clearly harmed, neo-liberal reform would be limited where autonomy from interest groups was not secured. The success of reform projects was thus dependent upon a strong, autonomous team of technocrats that could direct the economy without political interference from interest groups.

But how well does this analysis explain actual reform processes in the developing world? If diffuse beneficiaries are disorganized and powerful rent-seeking losers organized, for example, why have reforms such as privatization been so inexorable and far-reaching? The aforementioned theories do not adequately address this question because they fail to attend to the interests behind the construction of a liberal economic order, which organize for and are served by that order. Policies such as privatization are widespread in Latin America because in many cases, those who support liberalizing reform are themselves part of powerful distributional coalitions who stand to gain through collusive ties and rent-seeking behaviors (Schamis, 1999). These actors have an interest in taking concrete steps to ensure that alternatives to liberal reforms are suppressed. In Costa Rica, the interests of elites dovetailed with reformist prescriptions of international financial institutions (IFIs), and this serendipity was exploited by some in a concerted attack on state-owned enterprises. These strategies must be examined with the same scrutiny as the actions of resisters if we are to understand reform processes, a task that I take on in this paper.

Conversely, resistance is not well explained by interest group theories. If market-oriented reform is superior to state-led development, why are so many people fervently opposed to it? Is it the case that special interests groups drowned out the voices of hapless, unorganized potential beneficiaries? In Costa Rica, many diverse sectors of civil society rallied against liberalization policies, not simply public sector unions and civil servants. If coordination failures are so rampant, how did these varied groups come together in forceful collective acts of resistance? The data reveal more than groups clashing over selfish interests: they reveal serious grievances regarding visions of the role of the state and inclusion in decisions about the model of development that will be pursued. In public goods sectors, these decisions transcend interest group boundaries and efficiency considerations to tread on constitutional, legal, and cultural norms and regulations. The very meaning of concepts like social rights and the public good are contested, as are the institutional spaces within which such decisions are made.

If reform cannot be explained by appeals to their inevitability and superiority, and resistance cannot be explained by entrenched interest groups alone, then the conclusion that policy decisions are best handled by impartial technocrats is also questionable. Heterodox economists and other critics of neo-liberal policy reform point out that reducing “political interference” in practice has not resulted in a removal of political

interests from economic policy making, but a redefining of whose interests can be served legitimately by the state (Chang, 2003). The boundaries of the state are redefined to include actions that aid strong market actors while limiting those that protect weaker actors. International pressures for reform, technocratic decision-making (*e.g.*, via independent central banks), and restrictive accounting techniques have closed policy spaces in ways that limit state capacity to act; “consumers” expressing preferences via purchasing decisions have been emphasized over “citizens” as actors in the political process; and voices—even at times those of nationally-elected assemblies—have been silenced. What is at stake is a clash in understandings not only of state and market, but of citizenship and democracy.

The case of Costa Rica is particularly relevant to these debates, in part due to the strength of its democratic institutions. The creation of trust, capacity, and accountability via institutions has been a cornerstone of this democracy since the 1950s. Far from saving Costa Rica from an unsuccessful model of state-led development, I argue that neo-liberalism is undermining the institutional efficacy of this still-promising approach. Neo-liberal policies have harmed the capacity of the state to carry out important functions, fostered disillusionment by restricting the parameters of debate, and effectively ruled out a functional and relevant potential alternative to the neo-liberal paradigm. With the implementation of CAFTA and its implications for public monopolies, private dispute arbitration, and institutionalization of a neo-liberal agenda, the institutions of Costa Rican social democracy face even greater challenges. For those in search of alternatives to a largely failed neo-liberal model, the dismantling of the Costa Rican example should be disconcerting.

In order to evaluate the claim that neo-liberalism itself is posing a threat to Costa Rica’s institutional model, I examine the concrete struggles over the privatization of electricity and telecommunications in this country, based on interviews with key informants and archival research. The story begins with a description of Costa Rica as a site for neo-liberal reform, and an outline of arguments about the fiscal crisis of the 1980s and 1990s, with a specific focus on the state-owned electricity and telecommunications enterprise. I present evidence regarding the concerted attack on this institution waged by local elites and bolstered by neo-liberal ideology, the concrete results of policies that were implemented as a consequence, the veracity of claims of “crisis,” and alternative explanations for the reform process. I also examine the dynamics of resistance, highlighting the importance of struggles over meaning and process. I conclude by

drawing connections between this specific case and the broader neo-liberal political and economic project that slowly is reconstructing the institutional basis of state-market-society relations in ways that effectively suppress viable and promising alternatives.

2. Costa Rica: social democracy meets neo-liberalism

Costa Rica has a long democratic history and its institutions a strongly social democratic character that is unique in Latin America. The establishment of free and obligatory education was fundamental to the early consolidation of its democracy and continues to stimulate intellectual discourse among relatively large segments of the population. After the end of the civil war of 1948, the government abolished the military, thereby making funds that other countries in the region spent on weapons and internal conflicts available for other uses. Successive governments, regardless of ideological inclination, authorized investments in areas essential for development, such as health, education, physical infrastructure, and more recently environmental protection. The Constitution, ratified in 1949, formed the legal basis of a uniquely Costa Rican state, which strongly embraced elements of intervention and social democratic consciousness, requiring those who govern actively to seek the means to create equitable national policies. State institutions were established to fulfill national development goals, create political and economic stability, and foster greater liberty, broadly conceived, in which political freedoms are strengthened by social rights.

Costa Rica, like other liberal states during the late 19th and early 20th century, had once relied heavily on market mechanisms in utility sectors. Yet because, “(...) investors were not interested (in investing), given the lack of profitability and the inability to recoup their inputs” (Rodríguez Argüello, 2000), low rates of coverage and deficient service prevailed. Nationalization under a social democratic paradigm was finally chosen as the only route to ensuring adequate coverage of the population. Costa Rica is remarkable among the countries of Latin America for the high level of infrastructural and resource development that followed. “Autonomous institutions” in electricity, telecommunications, and water actively and effectively promoted the extension of services to the majority of the population, which in turn contributed to a marked improvement in the quality of life for the average citizen. This “solidary model” reflects an implicit social pact that promotes a relatively egalitarian dis-

tribution of not only income, but also goods and services.⁴ Close to 98% of Costa Ricans enjoy access to electricity, 95% to “improved” water sources, and 93% to sewage treatment (see Table 1). State institutions have strategically and actively intervened to promote solidary national development, and thus have developed capacities for planning, implementation, and public administration that are rare in other parts of Latin America. And in Costa Rica, unlike many Latin American countries, institutions in utility sectors remain in the hands of the state.

4 This model should not be confused with "solidarismo," which is more concerned with inclusion of labor in political processes.

Table 1
Comparing certain Costa Rican social indicators with those from elsewhere in Central America

Country Name	Electrical Coverage IDB Data* (% of total pop-1999)	Household Electricity Prices (US\$ per kwh-1999)	Improved water source (% of pop w/access-2000-total/urban/rural)	Sanitation (% of pop with access-2000 total/urban/rural)	Telephone Coverage (per 1000-2001-mobile/landlines)	Telephone avg cost: local call (US\$ per 3 minutes-1999)	Personal computers (per 1,000 people-2000)
Costa Rica†	0.93	0.050	95/99/92	93/89/97	52/250	0.02	149.14
El Salvador	0.65	0.082	77/91/64	82/89/76	118/100	0.06	19.12
Guatemala	0.67	0.073	92/98/88	81/83/79	61/57	0.08	11.42
Honduras	0.45	0.064	88/95/81	75/93/55	24/46	0.06	10.79
Nicaragua	0.50	0.139	77/91/59	85/95/72	18/31	0.08	8.87
Panama	0.70	0.121	90/99/79	92/99/83	145/151	0.06	36.98
Panama	0.70	0.121	90/99/79	92/99/83	145/151	0.06	36.98

* The IDB data was gathered shortly after Hurricane *Mitch* disabled electrical networks in Central America, and thus underestimates current coverage, especially in Nicaragua & Honduras. Also, coverage in Costa Rica was significantly higher in 2001, at 97%. Other than these caveats, the data are more or less proportionally accurate.

† Shaded boxes represent outcomes that the Costa Rican Electricity and Telecommunications Institute (ICE) is mainly responsible for achieving.

2.1 The neo-liberal attack on the activist state⁵

Washington Consensus policies made their entry onto the Costa Rican stage in the early 1980s during the Monge Álvarez Administration via a series of IMF structural adjustment programs. These agreements viewed state budget imbalances as problematic, and the privatization of autonomous state institutions, especially the highly profitable Costa Rican Electricity and Telecommunications Institute (ICE), was advocated as the way to avert fiscal crisis. Though ICE's efficiency indicators are exceptional, prices are low, consumer satisfaction is relatively high, and the company is deemed a powerful motor of national development, it began to be reframed by certain actors as a burden on the state and a potential source of windfall income from its sale. Central to these efforts were the politically influential Calderón and Figueres families, which boast four presidents between them over the last few decades. Elites and their "team" of heavyweight advisors included former Finance Minister and Central Bank President Francisco de Paula Gutiérrez, who formed the "Tomorrow is Too Late" panel (discussed below); Dr. Eduardo Lizano Fait, President of the Governmental Commission on the Internal Debt and head of "Tomorrow is too Late" panel; Dr. Óscar Arias Sánchez, former (and recently re-elected) President and Nobel Peace Prize winner; José Figueres Ferrer, former President and member of one of Costa Rica's most powerful families; Carlos Vargas Pagán, former President of the Legislative Assembly; and Rodrigo Oreamuno, former Vice President. It also includes members of the National Association of Economic Advancement (ANFE) and the Costa Rican Coalition for Development Initiatives (CINDE),⁶ and is well represented in the editorial pages of *La Nación*.⁷

Elites and their intellectual counterparts were particularly active in promoting neo-liberal policies while criticizing state-run enterprises in

5 Though not all actors discussed below can be strictly categorized as "neo-liberal," this paper argues that the processes, discourses, and policies employed in the attack on Costa Rican institutions had a distinctive neo-liberal flavor.

6 CINDE's stated role is to promote foreign investment in the Costa Rican economy.

7 Information culled from several interviews conducted by the author, and from Segura Ballar, 1999. See (Wilson, 1994), for an interesting discussion of elites in the Costa Rican context.

areas that were potentially lucrative for the private sector. Even as political parties alternated in executive and legislative positions, many individual members of this group remained within ministries, on advisory boards, and in other influential positions from the 1980s onward. In 1996, Costa Rican elites formed a committee of “experts” that convened to discuss fiscal policy and the future of Costa Rican institutions (*Comisión*, 1996). The committee’s conclusions, released under the ominous title, “Tomorrow is Too Late” recommended the immediate sale of Costa Rica’s power generation facilities, and were endorsed by a majority of a panel of former presidents set up by the president at the time, José María Figueres. The only dissenter was former President Rodrigo Carazo - the (in)famous leader who, in the early 1980s, refused conditions demanded by the IMF, thereby forfeiting millions of dollars in loans.⁸ Though the committee and the panel were ostensibly established in response to a looming fiscal deficit, there was a great deal of suspicion outside this group that those involved were exaggerating the crisis, and stood to gain a great deal personally by the privatization of ICE. There was a scandal, for example, when a local newspaper reported that President Figueres’ family held stock in a private company, Energía Global, which had benefited from earlier openings in the electricity generation market.⁹ Ignoring charges of rent-seeking, the team of advisors pressed on, arguing repeatedly for the potential benefits of privatization, and later (when privatization had become a politically unviable term) of “modernization”.¹⁰

In March of 2000, the “Energy Combo” bill (hereafter “Combo”),¹¹ designed in part to modernize ICE by opening it to private sector competition, was submitted to the Legislative Assembly. Opponents of private sector participation in the electricity sector expressed concern that the Combo would lead to higher costs, inequality of access, environmental

8 Carazo was also the first President of the Council for the Defense of Institutionalism (CDI), a non-profit organization that formed to counter neo-liberal attacks on Costa Rican Institutions.

9 "The Ex-President Denies Influence Peddling; José María Figueres Olsen Would Have Benefited His Family Businesses." *La República*, January 26, 2000. Other members of the pro-privatization coalition alleged to have ties to electricity generation were Óscar Arias Sánchez and Carlos Vargas Pagán.

10 See below for a discussion of more recent scandals involving elite gains from openings to private sector contracts by public firms.

11 The full name of the bill was "Law for the Betterment of Public Electricity and Telecommunications Services, and of State Participation," and was called a "combination" bill because it addressed two sectors at once.

destruction, and loss of revenue for the state – as well as eventual privatization – and were fully anticipating lengthy discussions, in which they would be included, regarding the future of this important institution. On March 17th, thousands of citizens attended the Legislative Assembly session to listen to the debates. But instead of hearing a discussion of the pros and cons of the bill, they heard only support from both major parties; the bill was passed in one session without opponents having recourse to their usual channels of dialogue and lobbying.¹² The following day, several groups that had been organizing against the Combo returned to the Assembly to find the doors locked. Radio Internacional Feminista described the ensuing events thus: “(...) *outraged to be shut out of the debate once again, the protesters decided to climb the walls to get in. The police then came and used force to get them out. The debates were halted and the deputies went on ‘vacation’.* Further frustrated, protesters took to the streets again (and) were met by the police who attacked them (with police batons and tear gas) (...) On Thursday, March 23rd, 26 students were released from jail (...) more than 100,000 people marched in the streets of San José, and at least 30 rural communities throughout the country mobilized and created barricades in support of the protest”.¹³

Public sector employees, students, taxi drivers, teachers’ unions, farm-worker associations, and civil society organizations called a general strike that lasted until April 5th, when President Rodríguez rescinded the bill.

This dramatic account of events is consistent with more moderate reports that stressed the severity of the political crisis. In a country where political cooperation and calm deliberation are customary, these events were alarming. Costa Rica’s political culture has rarely deteriorated to the levels of polarization and social conflict characteristic of many other Latin American countries, but in response to the Combo, the ubiquitous calm erupted into conflict. According to President Abel Pacheco (2002-2006), “(...) *the message was clear: the people do not want privatization*”; just mentioning it was political suicide. This fact was reflected in opinion polls at the time, which showed a mere 15.3% of Costa Ricans expressing sup-

12 Albino Vargas, Secretary General, National Association of Public and Private Employees (ANEP), interview with the author, 20 Jan 2003.

13 <http://www.fire.or.cr/protest.htm>. Two of my interviewees were among those against whom the police used force. They reported surprise and apprehension at the use of tear gas and police batons, a practice that previously had been rare in this relatively peaceful country.

port for opening ICE to competition, 66.9% supporting non-market based internal reforms, and 24.7% saying it should be left as is (UNIMER, 2000). Faced with this broad-based opposition, reformers responded not by ceasing their efforts to open ICE to the private sector, but by changing the terms of the discourse.

2.2 Crisis orientation: the alternate neo-liberal strategy

John Williamson, father of the Washington Consensus, argues that it can be propitious in situations of resistance to, “(...) think of deliberately provoking a crisis to remove the political logjam to reform,” or at least to conjure up a, “(...) pseudo-crisis that could serve the same positive function” (Williamson, 1994: 20). In fact, even perceived crises can be instrumental to reform (Grindle and Thomas, 1991). Crisis situations engage higher level policy makers, open policy spaces to more far-reaching changes, and create pressure to take action immediately. The stakes are higher for decision makers, but so is their autonomy. This “crisis-creation” strategy was used by Costa Rican elites, simultaneously with less subtle attempts at direct market openings, to provoke institutional change in utility sectors. Backed by the ideologies and practices of international financial institutions (IFIs), Costa Rican elites seized the opportunity presented by a crisis orientation in order to implement policies that could break the “logjam” of popular opinion.¹⁴

One key aspect of this campaign was the creation of the “Budget Authority Commission,” a technocratic body that sets rules for salaries, hiring, debt, and budgets for all public institutions. The idea behind this body was to promote fiscal responsibility in the government, but the manner in which this sensible goal was carried out became the subject of heated controversy. When balancing the budget, the state must take into account three areas: the central government, the Central Bank, and autonomous state institutions. When incomes of the autonomous institutions are greater than their spending, the surplus can be transferred to the central government to cover the general budget; but if the incomes of

14 This crisis orientation has more recently been replaced by an equally panic-stricken discourse about the “stagnation” that the country is purportedly experiencing, and which CAFTA, it is claimed by these same elites, will remedy. See Vargas Solís (2005).

these institutions drop below their expenditures, the central government would be expected to cover the extra cost. Under the new system, political authorities were authorized to dictate specific rules for generating surpluses within state institutions, and for transferring those surpluses to the central government. They used an IMF formula for handling debt as a guide, compelling autonomous institutions not only to turn over profits but also to generate a surplus by cutting expenditures to balance the federal budget, regardless of internal investment needs.¹⁵

The result of this surplus expropriation was that state firms were not allowed to spend earnings as needed on infrastructure investments. As an ICE engineer put it: “(...) ICE, is thrown into the same “public sector” bag, and if there are limits on public spending and the central government cannot balance its own budget, ICE’s spending and investment is limited. This creates a lot of inefficiency” (Engineer, CENPE (ICE), interview with the author, 12 Dec 02).

Instead of productive investments in capacity, state firms were forced to purchase non-productive government bonds from the Central Bank at interest rates up to fifteen points below those of state banks. Because of their high profitability, ICE and other state institutions provided millions of dollars to the state through their purchase of bonds. This, in part, helped to “resolve” the external debt crisis of the 1980s by substituting a crisis of internal indebtedness. Paradoxically, this same internal debt, a large proportion of which is owed to ICE and other autonomous institutions, was used as a reason for preventing ICE from obtaining external loans: “(...) The problem (with ICE obtaining its own external financing) is that ICE is very big, and its decisions regarding external financing are part of the public sector debt of Costa Rica. (...) Costa Rica has a high level of debt that limits its ability to do other things” (Representative of the Central Bank of Costa Rica, interview with the author, 27 Jan 03).

In short, the ever-indebted government compelled ICE to generate surpluses and buy government bonds at sub-market rates, and then prevented it from seeking loans to invest in its own infrastructure because the government owed too much to ICE and other autonomous institutions.

15 Regulatory officials support the concept of generating surpluses, not in order to balance budgets, but rather so that autonomous institutions can re-invest in infrastructure. Otherwise they have to obtain external loans, “(...) which would turn out to be a lot more expensive for consumers” (Rodríguez Argüello, 2000: 221), quote from Leonel Fonseca. “Los superávit y el SNE.” *La República*, 6 Jun 1993.).

At the heart of this policy stance is a fundamentally restrictive view of fiscal policy. Rather than focusing on how to bring income and expenditures of the government and Central Bank into equilibrium, differing social demands are pitted against one another with a tone of resignation: “(...) *The Costa Rican state is a unitary entity, with rich and poor elements within it. If we want more education and we don't have a way to finance it, and we want ICE to invest more, eventually the state bears a cost. The decision here is what to do. More education or more to ICE (...) We could leave ICE to do what it wants and cut the central government in half. This implies cutting education, social assistance, etc.* (Carlos Vargas Pagán, Assessor of the Pacheco Administration, interview with the author, 29 Jan 03).

Ignoring the income side of the fiscal account leaves social programs to battle each other for ever-scarce resources. A 2001 report by the Economic Commission on Latin America and the Caribbean expressed concern regarding this stark zero-sum interpretation of fiscal policy: “(...) notwithstanding the benefits of improving the efficiency of social policy, a higher political weight should be given to the consequences of reducing the financing of the social effort of government action” (ECLAC, 2001: 9). As we shall see, many Costa Ricans shared this concern.

3. Debts, deficits, and deficient investment: evaluating the evidence

The main arguments presented above for expropriating surpluses and limiting spending of autonomous institutions rest on a key assumption: that deficits are bad for the economy. But there is nothing in macroeconomic theory that says how high a deficit is unsustainable.¹⁶ It is not the size of the deficit that matters; it is the use to which funds are put, with investment being preferable to consumption. If the rate of return on investments exceeds the cost of borrowing, as it does with ICE, then it is sustainable. Moreover, behind the fixation on deficits in neo-liberal thinking is a double standard that belies technocratic explanations of “sound policy”: the practice seems to be “(...) Keynesianism for devel-

16 Nayyar, Deepak, economist and Vice Chancellor of the University of Delhi, lecture presented at the Cambridge Advanced Programme on Rethinking Development Economics, Cambridge, U.K. July, 2004.

oped countries, monetarism for developing countries”.¹⁷ An example of this bias was provided by U.S. Treasury Secretary John Snow, who praised Mexico for deciding to limit its deficit to 0.5 per cent of GDP, while insisting that a much higher U.S. deficit was justified, in order to, “(...) finance our priorities”.¹⁸ Less-developed economies are not strong enough, the argument goes, to support deficits; these countries should limit social spending that might shift interest rates and crowd-out private investment.

Critics of this view argue that, “(...) leaving aside the logical problems with the crowding out argument – tackled long ago when Keynes debated the so-called Treasury view – there is very little evidence that deficits affect the rate of interest” (Câmara Neto and Vernengo, 2004). Deficit spending may actually lead not to, “crowding out,” but to, “crowding in,” a situation in which state expenditure on infrastructure and services improves the profitability of private investment and thus leads to higher capital formation (Heilbroner and Bernstein, 1989; Taylor, 1993). Proponents of harsh deficit restrictions not only ignore the history of development in many now-developed countries including the U.S. (Chang, 2002), but also fail to recognize that the U.S. model of finance and macroeconomic management is just one of many possible systems (Zysman, 1985; Hall, 1986; Stallings, 1995). They also discount the experiences of countries like Costa Rica that have used deficit spending effectively to build infrastructure and create strong, equitable social support systems.

Closely tied to the issue of deficits is debt. Costa Rica’s internal debt makes up a large proportion of its total debt, and without question puts a strain on public finance. But it is not enough to look at the internal debt alone. As mentioned above, the growth in internal debt in part occurred concurrently with a reduction in external debt. According to the Central Bank of Costa Rica, total debt actually decreased after 1990. A single-minded focus on the internal debt, “(...) generates the impression of a greater fiscal problem than that which exists in reality” (Rodríguez-Clare, 1998). Moreover, identifying the internal debt as a problem has not led to enlightened fiscal policy based on the causes; instead, the cure seems worse than the disease. The real problem beneath government indebted-

17 Ocampo, José Antonio, economist and UN Under-Secretary General for Economic and Social Affairs, lecture presented at the Cambridge Advanced Programme on Rethinking Development Economics, Cambridge, U.K. July, 2004.

18 *Financial Times*, June 12, 2003.

ness is an insufficient taxation system (see below); privatization would provide a one-time boon, but would not address this underlying structural problem (Schipke, 2001). Worse, it would deprive the state of income from very profitable state-owned enterprises, thus exacerbating the fiscal situation. Yet Costa Rican elites continued to promote privatizing or restricting investment in precisely those lucrative institutions from which the government received millions in surplus profits, in order to pay off internal debt.

Just how serious are concerns over deficits and debts? Using the most basic economic indicator, GDP growth, there appears to be no strong negative relationship between public sector deficits and macro-economic performance. In fact, as mentioned above, deficits that finance productive investments often promote growth. Extreme budget shortfalls and long-term debt can be worrisome; but in the case of Costa Rica there appears to be no cause for the alarming predictions of proponents of neo-liberalism (see Table 2).

Table 2
Correlations between balanced budgets, government debt,
and growth: 1990-2001

	Latin America		Costa Rica	
	Overall buget balance (% of GDP)	Central gov- ernment debt, total (% of GDP)	Overall budget bal- ance (% of GDP)	Central gov- ernment debt, total (% of GDP)*
GDP per capita growth (annual %)	.586	-.599	.434	.282
Significance.	.028	.088	.159	.588

*Costa Rica data on central government debt only available for 1996-2001.

Turning to the argument that Costa Rica does not have enough money to invest in electricity and telecommunications infrastructure, it is true that investments in these sectors have not kept pace with growth, or with their historical trajectory. Since the 1970s, the total demand for these services has grown tremendously. In order to realize the necessary expansion to meet these demands, ICE utilized financing from development banks, such as the International Bank of Reconstruction and Development, the Central American Bank for Economic Integration, and the Inter-American Development Bank (IDB), as well as from the National Bank of Costa Rica. Yet, a look at recent data reveals stagnation in investment in new capacity. From 1990 to 1994, the annual rate of growth of real investment in ICE was 21.88%, but between 1995 and 1997, this rate turned negative (Cordero, 2000). Tellingly, the gap between needed and actual investment in the latter period corresponded closely to the net surplus transferred from ICE to the central government. Some privatization advocates argue that the declining investment is due to the burden that state-owned enterprises lay upon already strained government budgets. But ASDEICE President Fabio Chaves argues that this is “totally false,” citing the benefits that arise from ICE’s operation as a state-owned enterprise: “(...) *ICE, being a self-sufficient and lucrative business that charges just enough over cost to be able to reinvest in new projects, should have no problem apart from the state (...) In fact, it contributes as well. ICE investments create dynamism in the rest of the economy, and this year in taxes, ICE collected 61 billion colones (~\$155 million), which were given to the state to use these for other things*” (Association of ICE Employees, interview with the author, 30 Jan 03).

The empirical record suggests that the crisis of investment instead rests upon a confluence of factors some incidental, others intentional, some based in interests, – some in ideology – that have come together to effect the de-funding or under-funding of public services in such a way that they appear to be inefficient, and are thus more vulnerable to privatization. Four of these factors will be discussed in greater detail: changes in the international environment, political interference in autonomous institutions, problematic accounting strategies, and a regressive taxation system.

3.1 International changes

The oil crisis of the 1970s and the massive flow of petrodollars into Latin America thereafter set the stage for one of the greatest turning points for economic policy throughout the region. States that had borrowed exten-

sively to finance economic development via freely available credit suddenly found themselves with massive and crippling debt in the 1980s. One of the main culprits behind the magnitude of the crisis was not state expenditures *per se*, but service on the accumulated debt. When controlling for interest payments, the huge fiscal imbalances in the region statistically diminished or disappeared (Duménil and Lévy, 2001). Massive interest rate hikes by the U.S. during the 70s and 80s were in large part responsible for this outcome, transforming a debt-based strategy for development, not necessarily harmful in itself, into a catastrophe. The “hemorrhaging” of resources out of Costa Rica was thus in part due to changes in interest rates that were quite independent of its model of development. These changes had a direct, adverse impact on sectoral development in electricity, with high rates of interest negatively affecting the sector’s financial, and thus productive, capacity. The debt crisis also opened the policy space to neoliberal structural adjustment programs, with their emphasis on fiscal austerity and transfer of surpluses from public institutions to balance the budget.

There were also changes in lending practices of IFIs such as the IDB and the World Bank. Development loans for potentially commercial projects in energy, transportation, water and sanitation, and telecommunications – once a key source for funding for public infrastructural investment in Costa Rica – began to dry up at the end of the Cold War. Lending increasingly focused on funding initiatives to support private finance, and large projects that were once executed by governments were carried out more and more frequently by private firms. The IDB claimed that it was governments and not lenders encouraging private sources to fill the investment void in public utility sectors. The IDB only “anticipated” this shift by creating the Private Sector Department, the objective of which is, “(...) to finance private sector participation in infrastructure investments through long-term direct lending, syndicated lending, and guarantees in the LAC Region” (García, Rodríguez, and Rossi, 2000). But as one ICE executive explained, the mandate clearly issued from the bank to the state, and not vice-versa: “(...) *ICE has historically had a partner in the IDB. Decades earlier it was the World Bank, but later it was the IDB. The IDB changed its course in terms of the conception of economic models, of the country, and of investment. They said, “(...) we are not going to continue supporting the electricity sector, and even less telecommunications, if investment is public”. (...) They talk a lot about the “Washington Consensus”, a model in which the state is reduced to focus only on education, health and housing, while the private sectors does everything that is possible for it to do. It is almost religious (...)* (Confidential interview with the author, Dec 02).

The story is not new. In fact, a recent study on electricity reform in Argentina, Bulgaria, Ghana, India, Indonesia, and South Africa indicated that in all cases, reforms were driven by the need for immediate capital due to the retraction of credit for the public power sector from the international financial community (Dubash, 2002). International banks have increasingly shifted their emphasis from promoting state-led development to a vision of privatization and market-led development. What is puzzling is the application of this logic to the Costa Rican situation. Its institutions have proven to be responsible borrowers with excellent loan amortization records, as well as efficient providers of public services. More importantly, “solidary spending” has been used in creative ways to improve the quality public goods, as well as the overall health of the economy, the putative goal of development lending.

As mentioned above, the IMF is also implicated in challenges to this model of development, with its recipe for appropriating surpluses from autonomous institutions based not on their current availability, but rather on an abstract formula that fails to take into account the broader development paradigm and deprives institutions of funds otherwise earmarked for investment (Stiglitz, 2002).

Again, the ICE executive’s experience is telling “(...) *A week ago, we had a mission from the IMF here, which comes every year. Apparently ICE is like a whale in a fishbowl: very important, so they visit us a lot. Just outside the meeting they said to me, “look, what you are doing is good, business-wise; you are doing things right, you are growing, you are investing in very lucrative endeavors, and this allows you to do things that are not lucrative, like installing public phones and rural electricity. But from the macroeconomic point of view, you are causing the government problems (...).” So I think the problem is one of perception, or the model. In the end, it has been made more or less difficult to obtain financing*”.

IFIs tend to praise social indicators in Costa Rica while insisting that the country has not done enough to promote fiscal austerity or divest from the very enterprises that are partly responsible for high ratings in social development. The IMF continues to recommend stronger control over public enterprises and adoption of a “more ambitious” privatization program.¹⁹ Meanwhile, the IDB conditioned its 2004 loan on the sole consideration that Costa Rica reduce its fiscal deficit.²⁰ Recognition of the

19 “The IMF asks for a ‘reorientation’ of economic policy and more reforms.” *La Nación*. Mar. 7, 2003.

20 “Regional managers of the IDB analyze credit of \$350 million”. *La Nación*, Feb. 2, 2004.

positive institutional arrangements that fuel Costa Rica's outstanding social indicators is rare, perhaps because these arrangements contradict key assumptions regarding the pervasiveness of state failure as extolled by the international financial community.

A final external factor that has weakened the Costa Rican approach to public services is geo-political. Since the end of the Cold War, countries all over the world have tended to follow policies analogous to the main economic power in their region, and this has had major consequences for development (Stallings, 1995). U.S. influence over economic policy in Latin America was due partly to the decline of Soviet and European support and increased U.S. foreign direct investment, as well as to the greater transmission of ideas and "best practices" via an epistemic community of academics, think tanks, and U.S. multinationals, as well as via negotiations with regional financial institutions (Biersteker, 1995). It was also due to direct pressure from the United States: "(...) *Costa Rican banks won't lend a cent to any state enterprises, because the U.S. Agency for International Development (USAID) would react by cutting off aid to Costa Rica.*"²¹ (Oduber Quirós, Daniel, former Costa Rican President).

As we will see with the case of OPIC (below), interventions have gone as far as to challenge legal rulings by institutions of the Costa Rican state. Its location in the Americas has meant more pressure for Costa Rica to conform to the U.S. (rather than Asian or European) model of development. With the advent of the Central American Free Trade Agreement, even stronger pressures prevail to comply with U.S. demands to open its efficacious autonomous institutions to competition with the private sector. This raises an interesting counterfactual: what would have happened if Costa Rica were located in a region that did not place such a premium on privatization? Perhaps government investments in electricity and other developmental areas would not be deemed so problematic.

In sum, what seem to be inevitable factors of a new globalized environment are actually policy choices by powerful international actors that limit policy space for countries such as Costa Rica. Liberalization of trade and finance, far from protecting these countries from external shocks, actually makes them more vulnerable to the vagaries of global markets, and to pressures to conform to otherwise alien strategies of economic organization.

21 Interviewed by Reding, 1986. Though USAID has drastically reduced its aid to Costa Rica in recent years, it continues to influence development policy decisions.

3.2 Politicization

Of course, external forces cannot be held entirely responsible for the application of a historically incongruous model to the Costa Rican economy: some government actors, as mentioned above, also advocated these trends. In fact, the economic “team” was behind the implementation of IMF-inspired policies for balancing the fiscal account and the enforcement of IMF-imposed debt caps, even though the country had no loan agreement with the IMF at the time of implementation.²² They also negotiated CAFTA, which leaves public institutions like ICE open to private competition. Why would these actors want to challenge the institutional basis of an efficacious public entity? The electricity sector in Costa Rica has long been the site of struggle between those who see it as a favorable terrain on which to develop private businesses and those who see it as a strategic sector for state-led development and a pillar in the particularly Costa Rican model of social citizenship. During its more than fifty-year history, ICE has been a revenue-generating public monopoly that also funds other social projects. According to former President Carazo, it is “(...) *a terrific business, one that provides great profits for the Costa Rican community*” (Interview with the author, 21 Jan 03). Yet despite – or perhaps because of – this great success, efforts to open ICE’s activities to private participation are long-standing.

In 1990, the electricity generation market was opened to the private sector in response to an acute need brought on by a drought-related energy shortage. This potentially beneficial usage of the private sector, however, turned out to be quite costly. Rather than prices being set locally via market mechanisms, private companies were allowed to peg rates for generation to the US consumer price index, which resulted in rates up to three times higher than the costs of energy from ICE’s own plants. The contracts obligated ICE to purchase all the energy produced by the suppliers, even when ICE’s own cheaper production was sufficient. Instead of fostering competition, this law institutionalized a regime of privilege in which a few companies, many of which were owned by the country’s elite, enjoyed guaranteed success, with citizens absorbing the extra costs.

22 Representative of the Central Bank of Costa Rica, confidential interview with the author, 27 Jan 03.

Both the Comptroller General and the Attorney General of the Republic ruled that these contracts were in violation of the law and damaging to the national interest, and called for their renegotiation. But the US State Department – through the Overseas Private Investment Corporation or OPIC intervened, “(...) *directly threatening the Costa Rican government with reprisals*” (Gabriel Rivas-Ducca, Friends of the Earth Costa Rica and the Costa Rican Ecological Federation (FECON), interview with the author, 28 Jan 03).

In the end, the rulings of the Comptroller and Attorney General were disregarded, partly out of fear of penalties, and partly due to the belief that, “*the State or an entity of the State cannot abandon its contracts*” (Ing. Mario Alvarado Mora, Executive Director, Costa Rican Association of Energy Producers (ACOPE), 20 Jan 03). Here we clearly see a clash between what the state saw as an “injurious contract,” and what the US government and local elites considered the “sanctity of contract”. In this case, the state institutions lost the battle for legitimacy.

Neo-liberal shifts toward private contracting also presented interesting opportunities for elites to use public-private “partnerships” for personal gain. A series of scandals erupted in 2004, implicating actors at the highest levels of government. Among them were former President Miguel Ángel Rodríguez Echeverría and former ICE Director José Antonio Lobo, who were charged with accepting millions of dollars from the French company Alcatel for assistance in securing a contract with ICE. Former President Rafael Ángel Calderón Fournier, meanwhile, was accused of illegally obtaining hundreds of thousands of dollars from a loan made to the Costa Rican Social Security Institute by the Finnish government for the purchase of medical equipment. Finally, former President José Figueres Jr. purportedly received a \$900,000 bribe from Alcatel. Critics charge that a greater emphasis on contracting with the private sector, rather than on strengthening the capacity of state institutions from within, created opportunities that allowed elites to benefit personally from these market transactions.²³ These cases cast doubt upon claims that no special interests were behind the push to marketize the public sector in Costa Rica, and that simple efficiency considerations were driving reforms.

23 Iván Molina Jiménez. "Corrupción inherente". *Semanario Universidad*. November 4-10, 2004; Raúl Marín Zamora. "Hijo de la Segunda República", *La Nación*, November 9, 2004.

Those who doubted the efficacy of private participation in public goods sectors as the road to ICE's modernization maintained that what needed to change in the institution, if anything, was political interference. Their explanation for why certain actors were able to push for ICE's greater marketization rested in part with the existence of a so-called "4-3 law", which gave the party losing elections permission to appoint three of the seven members on ICE's board of directors, while the acting government appointed four, one being a presidential delegate. This afforded the two majority parties great control over major decisions of ICE, while workers, technicians, and civil servants had less. A special "mixed commission" of labor, student, religious, women's, and environmental groups was convened shortly after the anti-privatization protests in 2000 to discuss ways to modernize the institution without opening toward the private-sector. These groups all mentioned lack of autonomy as a key factor debilitating the institution, and the politicization of the board of directors as an obstacle to alternatives to neo-liberal reform. The process of political appointments, they argued, resulted in political considerations overriding engineering, technical, scientific, and environmental matters, as people with little understanding of the sector made key decisions (Special Mixed Commission on ICE, 2000).²⁴ This, they believed, led to inattention to sector goals and unnecessary moves toward market openings.

The irony, of course, is that both those who promoted privatization and those who opposed it were using technical arguments regarding the reduction of "political interference", to support their positions. The former based their argument on the primacy of economic expertise and lack of sound options, while the latter based theirs on the importance of scientific expertise, social accountability, and the earnest exploration of still-viable alternatives.²⁵

24 The 2003 "Bill to Strengthen and Modernize ICE," promises to resolve problems regarding ICE's politicization, though the exact form that this will take awaits the passage of the final bill into law.

25 These conflicting discourses are discussed at greater length by Sojo (2004).

3.3 Accounting mischief

The appropriation of ICE's surplus was justified on the grounds that the state assumes a risk in guaranteeing the solvency of state institutions. But this argument appears disingenuous given that ICE has not had a current account deficit in recent memory:

- **Interviewee:** When ICE or any public enterprise invests, the Costa Rican state commits itself to cover this investment if for some reason it is not repaid.
- **Interviewer:** But this has not happened in 20 years (...)
- **Interviewee:** No, it hasn't happened yet, but if you look at the majority of Latin American countries, states and taxpayers have had to cover deficits of the institutions (Representative of the Central Bank of Costa Rica, confidential interview with the author, 27 Jan 03).

If autonomous institutions are nearly always running surpluses, as is ICE, the transfer of funds is virtually uni-directional. Table 3 shows a consistent pattern of surpluses for such institutions (highlighted), ranging from 0.3 to 1.1 percent of GDP annually.

Table 3
Public sector financial Figures, millions of colones (~385 colones/\$US)^{1/}

	1995	1996	1997	1998	1999	2000	2001	2002
Global Public Sector	-63,076	-100,070	-74,802	-72,413	-141,613	-184,903	-157,345	-326,446
% of GDP	-3.0	-4.1	-2.5	-2.0	-3.1	-3.8	-2.9	-5.4
Central Bank of Costa Rica 2/	-30,530	-38,901	-39,849	-42,403	-71,226	-87,679	-63,579	-86,645
% of GDP	-1.4	-1.6	-1.3	-1.2	-1.6	-1.8	-1.2	-1.4
Non-financial public sector	-32,546	-61,169	-34,953	-30,010	-70,387	-97,224	-93,766	-239,801
% of GDP	-1.5	-2.5	-1.2	-0.8	-1.6	-2.0	-1.7	-3.9
Central Government	-72,748	-99,364	-87,983	-89,232	-99,851	-146,568	-156,708	-259,312
% of GDP	-3.5	-4.0	-2.9	-2.5	-2.2	-3.0	-2.9	-4.3
Autonomous Institutions	23,127	18,273	26,904	40,798	29,791	38,708	29,801	19,327
% of GDP	1.1	0.7	0.9	1.1	0.7	0.8	0.6	0.3
Public B usinesses	17,075	19,923	26,126	18,424	-327	10,636	33,142	183
% of GDP	0.8	0.8	0.9	0.5	0.0	0.2	0.6	0.0

Source: Budget Authority of the Treasury Ministry and the Central Bank of Costa Rica

1/ Preliminary Figures for 2002

2/ Financial results for 1998 and earlier years do not account for capitalization adjustments for the Central Bank

Spending limitations are based not only on dubious arguments but also on macroeconomic accounting that treats investment as a cost, thereby overestimating the deficit: “(...) *When ICE lays out a credit, it is identified as a deficit macroeconomically. That is the crux of the issue. I have a balanced loan, with current income and capital income; my financial records say that I have billions in net utility. But (...) this is considered a deficit because (...) everything I do that does not come from current income is counted against me. So even though as a business I am financially successful and healthy, and any bank would want to lend to me, without state guarantees, I am stuck*” (Financial executive, Costa Rican Electricity and Telecommunications Institute (ICE), 18 Dec, 02).

Heterodox economists also critique the basic IMF “financial programming” framework that monetizes the fiscal deficit, thus creating a fusion of fiscal and monetary policy that severely limits policy options for governments (Taylor, 1993).²⁶ It is not that accounting *per se* is problematic; without reliable economic indicators, economic policy making can easily become subject to political whim or will (Toye, 2003). But to prioritize certain accounting mechanisms and variables over alternative indicators is equally misguided, especially when they threaten to debilitate state functioning: “(...) *The ingenious policy of debilitating ICE is to limit its capacity for action from a financial point of view. If it were the independent institution of the Costa Rican state that it should be, it would have the capacity to assume debt, to plan projects into the future, and to address demand; nevertheless, when it is added into the great state package, the problems begin. Why does the IMF, when it measures the indebtedness of the country, include ICE’s investment debt? I don’t have an explanation, but they do it. Obviously, this puts the country in an unfavorable position*” (Rodrigo Alberto Carazo, Jr., PAC Deputy, interview with the author, 29 Jan 03).

IMF backpedaling on the topic of expenditures for infrastructure investment underscores the gravity of the charges leveled by critics such as those mentioned above. Recently, the IMF was obliged to admit that their programs, “(...) may have hurt some countries’ ability to invest in roads, ports, utilities and other public works,” and that IMF board members, “(...) ‘generally supported’ plans to change accounting rules to allow governments to spend more on such projects”.²⁷

26 The IMF framework can be extended to allow for non-monetized fiscal deficit accounting, e.g. through sales of government bonds. But the fusion of monetary and fiscal policy is the norm.

27 Managing Director Anne Krueger quoted in, "IMF Says Loan Policies May Hurt Nations' Road, Utility Spending." *Bloomberg*, April 24, 2004.

Despite these rhetorical changes, there remains a vision of institutions under neo-liberalism that is fundamentally different from that of the “social state.” In the former, institutions are increasingly ruled by political technologies such as accountancy, budgets, and audit rather than social indicators or an ethic of service (Rose, 1993). Neo-liberal analyses of ICE routinely have downplayed or ignored essential aspects of its role in the economy: the significance of investment that bolsters national competitiveness, its role in energy independence, its impact on employment, and its tax contribution. These omissions are what led one critic to label as “strange” the Central Bank’s assertion that, “(...) evaluations of ICE should only be of a quantitative-financial nature, and that matters of quality lie outside (its) purview” Jiménez, H.M (no year).²⁸ The autonomy of Central Banks and technocrats so important for reform in the “political economy of adjustment” literature is recast in the opposition discourse as procedurally problematic and in fact peculiar. It makes sense, however, when viewed as a neo-liberalization project that uses technical discourse to limit policy options. Quantification and costing are rightfully part of public policy, but how they are used varies due to *politics*, and the insulation of decision makers that comes with “autonomy” has a social and political cost.

3.4 Taxation

Fiscal deficits, when they occur, can be addressed either by reducing state expenditures or raising taxes, or both. Though broad-based tax reform was part of the Washington Consensus agenda, neo-liberal policy reform tended to focus most intently on reducing state expenditures. This was certainly true in Costa Rica, where state spending was restricted with the implementation of structural adjustment policies in the 1980s, but tax reform was stranded in the Legislative Assembly until 2006.²⁹ Despite exceptionally progressive social policy, tax evasion is high, and rates are

28 This article, is a parodies an earlier attack on ICE entitled, "The Independent Republic of ICE," in which charges were made that the institution's unions and management were hijacking the institution for personal ends.

29 At the time of this writing, the Libertarian Movement and the Popular Block had managed to stall reform yet again, submitting a complaint to the Constitutional Court that the process of reform was unconstitutional. The resolution of the fiscal problems thus remains unrealized. "Fiscal Plan Loses Battle in the Sala IV", *La Nación*, March 22, 2006.

low and somewhat regressive. Considering their potential for bringing in large sums to resolve fiscal imbalances that placed pressure on institutions such as ICE, why were reforms delayed? After all, "(...) independent of ideology, nobody likes a crisis" (Cornick, *et. al.*, 2004: 24). One reason is that the Libertarian Movement (a political party) worked hard to impede reform, arguing in part that taxing world-wide profits and corporations would drive out foreign investment. Indeed, some argue that progressive taxation is at odds with the neo-liberal model:

"(...) The lack of sufficient discussion regarding efforts at taxation, regarding the fiscal basis of this model of development, has meant that the issue is resolved by cutbacks, always with short-term thinking: cutting back here today, impeding investment. Why? Because the model of the last 20 years made the decision that we were going to initiate offers external to the country, and in order to make us attractive to investors, the winners would not have to pay taxes (...) We went from having approximately a 16% rate to not quite 13%. That is unsustainable. How can we eliminate pressures on institutions like ICE? y raising taxes" (Carlos Sojo, Director, Latin American Social Sciences Faculty (FLACSO), Costa Rica, interview with the author, 30 Jan 03).

Nearly unrestrained global capital movement means that investment from abroad is contingent in part on the taxation system: lower tax rates are more attractive. It is true that investors value other things besides avoiding taxes, such as stability in law and market structures and high-quality human resources. Costa Rica has much to offer in this area: with high levels of human development, an as-yet satisfactory infrastructure, and a long history of democratic stability, the pressures for a "race to the bottom" in taxes should be surmountable. But in reality, taxes have not been collected from many multinationals, which greatly weakens Costa Rica's tax base.³⁰ For example, Intel, a U.S. multinational with important investments in Costa Rica, does not pay taxes. Though Intel has provided many other benefits to the economy, including a contribution of up to 6% to GDP growth over the last decade, it does not bode well for national accounts when even highly competitive corporations are not obligated to contribute to state revenues.

30 "U.S. Investors Will Not Pay Taxes Here." *La Nación*. January 18, 2003.

The current tax reform bill brings with it hopes that fiscal pressures will be somewhat relieved by a general rise in corporate rates from 18% to 30%, with incremental decreases to 25% in 2010. A 13% VAT would replace a more limited 13% sales tax, while capital gains taxes would go from zero to 10%. Proponents of reform hope it will simultaneously redress the regressive taxation structure, with those who have more paying proportionally more; fund state programs that promote equity and social inclusion; and promote infrastructure development (Villasuso, 2005). But as with most economic policy over the last several decades, there are conflicting views on the desired goals of tax reform. The IMF did not hesitate to weigh in with its view that Costa Rica's new income should be spent on inflation targeting and exchange rate flexibilization, not social expenditures.³¹ The Central Bank soon thereafter announced that it will take up to 70% of the income drawn from new taxes for recapitalization, in order to address inflation.³²

It is as yet unclear how these visions for earmarking tax income will be reconciled. Greater freedom to reinvest profits of firms like ICE could strengthen state capacity in public goods sectors. Yet inflation targeting and exchange rate flexibilization are likely to hinder such investments and undermine the fiscal basis of the Costa Rican model. Moreover, the lowering or removal of tariffs as called for by CAFTA are likely to reduce state income even further.

4. Resistance

Having argued that neo-liberal reforms are neither inevitable nor neutral, I now turn to the question of resistance to institutional reforms in Costa Rica. Was it the case, as Ricardo Monge, an economist at CINDE, argues, that those who were in favor of privatization were, "(...) seeking to transfer rents from pressure groups that benefit from ICE's monopoly to citizens as a whole," thus producing, "(...) greater efficiency and lower rates (...) resulting in greater local and international competitiveness" (Jiménez, 2000:304-5)? Similarly, were citizens who opposed the ICE

31 The IMF believes resolving fiscal problems should be a priority for the country." *La Nación*. January 23, 2006.

32 "Mayoría de recursos de plan fiscal para capitalizar Central." *La Nación*. February 24, 2006.

Combo duped by these special interests? Proponents of neo-liberal reform seemed to believe they were, as “those who oppose the change in model will find their position weakened” if only the people could learn of, “the hidden reasons behind [the position of] interest groups,” (Jiménez, 2000:313) and the costs that would befall the country if ICE were not privatized: “high prices, low quality, fewer job opportunities, and poor resource allocation” (Jiménez, 2000:316). In this discourse, privatization was framed as common sense, its opponents as simple rent-seekers, and its champions as neutral, progressive thinkers acting in the public interest.

Such discourse is systematically examined and critiqued by an ICE engineer who documents what he calls the “ideological terrorism” of privatization supporters: “(...) either Costa Rica privatizes services, sells businesses, cuts personnel costs, and reduces wages, or it will (find itself) on the brink of collapse” (Segura Ballar, 1999: 27).³³ History has repeatedly failed to bear out these dire predictions, but the assault continues in the editorial pages of newspapers and in numerous writings by members of the neo-liberal economic team. Unsubstantiated charges of “capture” of ICE by its unions permeate the editorial history of the country’s main newspaper, *La Nación*.³⁴ In 2002 and 2003, a concerted campaign of accusations and insinuations was waged against the company itself, claiming that it had dual system of accounting that obscured its true fiscal situation, that it violated budgetary rules for public institutions, and that it was actually a drain on public resources. All of these claims were found to be false by a special government commission, and ICE and its managers and unions were vindicated (High Commission for the Analysis of the Financial Situation of ICE, 2003). But the effect of the discourse itself was to cast doubt on the institution’s legitimacy. ICE’s defenders claimed that this “smear campaign,” was concocted to undermine support, “(...) with an eye toward privatizing (ICE) under the framework of the Central American Free Trade Agreement.”³⁵

Despite the rhetorical attacks, attempts to privatize autonomous institutions like ICE have failed until now, in part due to the fact that there is

33 Quote is from an article entitled, “The Country Privatizes or Collapses” in the newspaper *La República*.

34 See, for example, “State ‘Combos.’” *La Nación*. June 16, 2004; “New Union Trophys.” *La Nación*. October 7, 2005.

35 Group ICE, 2004. “Commission of Notables: ICE is solvent, with a surplus.” News of Interest, (<http://nuevo.grupoice.com>).

no genuine disaffection for state firms or ghastly experiences to justify rejecting them. Thus, pressures to privatize have not been accompanied by consumer demands for service improvements. On the contrary, attempts at outright rollback in Costa Rica have been met with resistance on many fronts: by the “interest groups” associated with “the politics of economic adjustment,” to be sure, but also by appeals to national pride and appreciation for the Costa Rican solidary model by the general public. Though workers clearly have an interest in opposing privatization, unions represent less than 20% of workers in Costa Rica. They also get low confidence marks from the population at large, so it is doubtful that they should be credited with (or accused of) spurring the massive mobilizations of 2000. It is those very groups that supposedly benefit – housewives, consumers, youth – that have filled the streets in large anti-privatization protests in Costa Rica and throughout Latin America. This creates a quandary for those who believe organized, selfish interests prevent otherwise needed and beneficial reforms from being implemented. If privatization is “generally positive” as claimed (Williamson, 2004), then why the fervent opposition?

A more convincing answer is provided an anti-Combo organizer herself: “(...) *Who was against the Combo, besides unions? All the popular organizations: cooperatives, farmers, municipalities, students, environmentalists (...) housewives; all kinds of people. Because behind this [issue] was a subtext regarding the Costa Rican state (...) the people very quickly realized that everything it had been able to accomplish was at stake in the ICE controversy (...) They were not only hitting the streets to defend ICE, but to defend the Costa Rican model (...) I think people are very worried because they saw their quality of life go down (after neo-liberal reforms) and they understand, broadly speaking, that what is at stake are two very different ways of doing things*” (María Flórez Estrada, “Women against the Combo”, and journalist for *Semanario Universidad*, interview with the author, 30 Jan 03).

Resistance was pervasive among people who supposedly benefit from privatization precisely because there were reasons to believe that it would not, in fact, serve their interests. By resisters, privatization was framed as an extremist assault on deep constitutional principles that many Costa Ricans hold dear. According to the Director of the National Association of Public Workers, a clear notion of Costa Rican national identity has so-far protected it from the penetration of radical ideas: “(...) *We are not communist, but we believe in solidary development. What this means is that both communism and neo-liberalism hold less appeal for us. There is no room for ideological extremists*” (Albino Vargas, interview with the author, Aug 02).

Historically, “public goods” were by definition public, and “citizenship” meant not just economic but also social citizenship. The availability of political space for oppositional discourse, coupled with an educational system that produced knowledge regarding the history and importance of Costa Rican social democracy, kept more extreme manifestations of neo-liberalism in check. Costa Rica’s long history of stable institutions, political compromise, and socially-minded policies (Morales-Gamboa and Baranyi, 2003), coupled with a relatively open media, have afforded resisters the ability to present policy alternatives in institutional spaces that matter for outcomes. The argument here is not that Costa Rica’s social democratic characteristics are either necessary or sufficient conditions for preventing neo-liberal reforms from occurring; only that these characteristics slow the spread of neo-liberal policy and account for the selective manner in which it has been accepted in Costa Rica (Clark, 2001). Moreover, these conditions foster ties across “interest groups” to bolster shared visions of and struggles for the public good.

5. Exclusion and the threat to democracy

Beyond the interested parties vying for rents predicted by theories of the political economy of reform, and even beyond the struggles over definitions and meaning, there is a deeper struggle over who controls the process of reform. Negotiation among social actors has played an important role in Central America during transitions from war to peace and from dictatorship to democracy. Yet they have been largely absent in dealing with changes of economic models and state reform, where an authoritarian culture prevails (Cerdas, 2000). Reforms are presented as politically neutral, technical solutions to common sense problems that should transcend messy political processes. Privatization policy in particular is framed to deny state competence for providing goods and services, to associate markets with optimal outcomes, and to shift economic decision-making to technocrats who ostensibly have no intervening interests of their own. Popular voices – and at times their elected representatives – are silenced as partial and self-interested. Issues of ownership and control are de-politicized, and social criteria such as employment or regional development are considered inefficient or held up as proof of favoritism (Sclar, 2000). Thus neo-liberal actors, “(...) succeed in excluding potential issues from the political process,” those that do not conform to mar-

ket principles (Lukes, 1974).³⁶ The impression of technical inevitability thereby created, as in Thatcher's Britain, undermines the mere consideration of alternative economic approaches.

On the other side, this discursive and substantive exclusion from reform processes has led to an interesting "double movement" (Polanyi, 1944) – everything from demands for inclusion in public debates to riots and revolts – not simply in response to the harms threatened by market-led reforms, but in response to threats to democratic participation itself. In Costa Rica, structural adjustment policies under the neo-liberal framework dismantled relations that had been established as a result of the transformations of the 1940s, thereby marginalizing many social actors, but also inciting demand for more inclusion in social and political negotiation processes (Rojas Bolaños, 2000). The Combo itself was seen as an attack on democracy, due to the underhanded way it was carried out. In a state with a long participatory tradition, exclusion was vexing: "(...) *If the project had been discussed transparently, and not so hastily, probably there would not have been such a feeling of betrayal among people*" (William Vargas, interview with the author, 23 Jan 03). As supporters of the Combo tried to limit discussion and inclusion, citizens refused to cede that space. Standing firm, they drew on the rich institutional, cultural, and ideological history of Costa Rica for the resources to defend their version of the public good, and to demand accountability in economic decision-making.

The conflict over ICE brings into bold relief the political dynamics behind increasing polarization and disaffection for politics in Costa Rica. The institutional and political project of neo-liberalism frames reform as a fight between right (neutral, progressive, economically liberal) and wrong (interested, regressive, static) policies (Vargas Solís, 2005). But what most Costa Ricans are demanding is institutional and participatory diversity, not conformity with some pre-conceived dogma. In order to sustain and consolidate democracy, socio-political "*concertación*" – understood as the search for national agreement regarding governance and the transformation of economic and political structures – is vital, not just in Costa Rica but in all of Central America. Creating the sociopolitical and juridical conditions for these processes to succeed require a great deal of effort (Rivera, 2000), yet neo-liberalism systematically undermines these efforts through

36 Agenda control is an example of the "second dimension" of power, while an acceptance of technocratic logic as "common sense" and overlooking of alternatives by the wider society, is more akin to Lukes' "third-dimension" of power.

policies that not only isolate the powerful from the rest of the community, but also undermine the institutional bases for the consideration and promotion of alternatives.

What is at stake is not simply whether states or markets or some mixed institutional arrangement will provide electricity and telecommunications in Costa Rica; it is whether citizens can continue to pry open policy spaces narrowed by neo-liberalism, and if not, whether they will grow increasingly disenchanted with both their leaders and their political system. There is already evidence of a decline in system support that is worrisome considering the relative stability of Costa Rican democracy (Seligson, 2002). The political divisions and polarization in Costa Rica are real and growing, and are only likely to become more profound as neo-liberal policies continue to encroach on the Costa Rican model of development. The 2006 presidential elections were a case in point, where divisions over CAFTA almost cost the pro-CAFTA candidate Óscar Arias the presidency, despite polls indicating a comfortable victory. His opponent, Otton Solís, advocated strongly for CAFTA's renegotiation, and has vowed to continue working toward that end.

6. Implications of the Central American Free Trade Agreement

Though it is impossible to say exactly how the recently negotiated CAFTA will affect the region, some implications can be inferred from its text, as well as from experiences of signatory countries with the North American Free Trade Agreement (NAFTA). Three issues in particular are relevant to the discussion above: the opening of public monopolies to the private sector, private investor-state dispute arbitration, and the "locking in" of a liberalization agenda that suppresses policy alternatives. On the most obvious level, CAFTA includes provisions that mandate openings of ICE to private sector competition, the core issue behind the struggles of 2000. Short of renegotiation or stopping the implementation of CAFTA, there will be little chance to prevent the precise kinds of openings to private competition proposed by the Combo. Once private investors are allowed to enter electricity markets, the Humpty Dumpty that was once ICE will be difficult to put back together again. By transforming into law the kinds of openings opposed by mass movements, CAFTA suppresses alternative ways of managing public goods by simply removing them from debate. Accompanying these openings are opportunities for corruption presented by increased private contracting. While there have been

strong measures taken against even elite actors involved in the corruption scandals of 2004, the capacity of Costa Rica to monitor even more such contracts will be tested under CAFTA.

Moreover, once-successful state actions designed to address market failures – which have occurred throughout the region and are not particularly uncommon – could be ruled in violation of CAFTA. For example, the 1968 takeover by ICE of the Electric Bond and Share Company, a private distribution company that had, “(...) *reached the heights of negligence, of inefficiency, and of disaster*” (Vice-president of CADEXCO, the Costa Rican Chamber of Exporters, interview with the author, 27 Jan 2003), could under CAFTA, be construed as an attempt to limit competition and threaten the profits of private investors. Indeed, public monopolies have already been threatened under NAFTA, as United Parcel Service’s (UPS) case against the postal services in Canada illustrates.³⁷ UPS based its claim of unfair competition on the argument that Canada Post’s vast public mail service infrastructure illegally subsidizes its parcel and courier services, those areas with which UPS competes. Since most public services, including electricity, health care, and education, have both a public and commercial component, they too could be challenged under these rules. As corporations become increasingly skilled in the use of trade agreements to improve their own market conditions, the threat of such campaigns against public enterprises increases. For a country with Costa Rica’s level of well-established and effective public infrastructure, these kinds of challenges should be viewed with deep concern.³⁸

CAFTA’s chapter on investment, which is modeled after NAFTA’s infamous Chapter 11, presents an even more serious threat. Its provisions grant foreign investors extensive legal and procedural rights that transcend even those provided for citizens or corporations under domestic law, by allowing external arbitration in disputes between investors and governments. Democratic decision-making is completely sidestepped with the

37 For more information on such impacts of investor agreements, see “Trade Secrets: The Hidden Costs of Free Trade,” a film by Jeremy Blasi and Casey Peek (2002).

38 Former US Trade Representative, Robert Zoellick, informed Costa Rica’s negotiators early on that the country’s unique state monopolies were incompatible with the objectives of CAFTA. The threat of exclusion placed the Costa Rican government in an uncomfortable position, compromise to please the U.S., or choose the dangerous path of resistance that honored prior commitments to protect public enterprises. *La Nación*. “The United States suggests a free trade agreement without Costa Rica, due to its telecommunications monopoly”, 3 Oct 2003.

advent of this mechanism, which not only permits companies to win taxpayer money by suing states for lost profits, but also removes arbitration proceedings from the jurisdiction of national courts to a private, unaccountable tribunal with almost no provisions for civil society participation. As Oxfam America contends, "(...) these special tribunals lack the transparency generally afforded by normal judicial proceedings and are empowered to order governments to directly compensate investors for regulations that hurt them, regardless of the public good that the regulations might serve" (Oxfam, 2004). If the people of Costa Rica have any doubt that this mechanism could be used to undermine the safety, health, public interest, or environmental regulations of the country, they need only take a closer look at the history of NAFTA.

A range of attacks on government activity and public policy has occurred under NAFTA, at all levels of government? federal, state and local. Examples include (Public Citizen, 2005):

- the successful challenge by the California firm Metalclad to the denial of a permit by a Mexican municipality for the building of a toxic waste facility strongly opposed by the local community: \$15.6 million paid by Mexican taxpayers to the company;
- the reversal of a Canadian government ban on the cancer-causing gasoline additive MMT: \$13 million in taxpayer money award to its producer, the Ethyl Corporation;
- the still-pending Methanex case, where a Canadian chemical company is challenging California's law banning MTBE, a dangerous source of water pollution.

A recent case of comparable dimensions that could be tried under CAFTA is the case of Harken Costa Rica Holdings. A drilling concession granted to Harken was found to conflict with the country's environmental law. Harken attempted to retaliate by bringing a suit for \$57 in damages to an international arbitrator, but the government refused, instead resolving to fight the case in Costa Rica. Under CAFTA, Harken would have had the right to sidestep the national courts altogether and have its claims heard before an international tribunal, regardless of the wishes of the Costa Rican government or people.³⁹

39 From a National Resources Defense Council and Friends of the Earth press release, "The threat to the environment from the Central America Free Trade Agreement (CAFTA): The case of Harken Costa Rica Holdings and offshore oil."

Perhaps the most profound effect CAFTA may have on the Costa Rican model is in changing the “policy space” within which economic decisions are made. In order for any economic policy to be effective, “(...) developing countries must have the ability, freedom, and flexibility to make strategic choices in finance, trade, and investment policies, where they can decide on the rate and scope of liberalization and combine this appropriately with the defense of local firms and farms” (Khor, 2001). The inclusion of non-trade issues such as investment, competition policy, and government procurement in NAFTA and CAFTA is seen by many countries as an attempt to enforce a liberalizing discipline. They limit decision-making power in precisely those areas where discretionary policy might lead countries down an alternative path, away from privatization and liberalization. The ratification of CAFTA closes this policy space, due in part to the legal ramifications of violating the treaty. CAFTA expands, rather than narrows, which claims may be compensated under NAFTA by including “the assumption of risk,” “expectation of gain or profit,” intellectual property rights, and a new category of government contracts, such as those for natural resource concessions. The ability of the state to provide for basic human rights is seriously threatened by these provisions, and neither citizens nor their elected officials have any meaningful way to influence outcomes. In effect, the rights of investors are enshrined into law, while the rights of citizenship and inclusion, so crucial in Costa Rican struggles over the past two decades, are marginalized.

Unfortunately, these assaults are not without cost. Eleven NAFTA cases filed against the United States, Canada, and Mexico have already garnered \$35 million for foreign investors, and the U.S. government alone has spent millions in legal fees fighting investors’ claims (Public Citizen, 2005). Thirty-one cases are still under review, and are likely to result in more taxpayer money going to reimburse investors for acts “tantamount to expropriation.” There are also political costs of contentious agreements such as CAFTA. Already there have been massive protests and even deaths in clashes over CAFTA in Guatemala, Nicaragua, El Salvador, and Honduras. Meanwhile, Costa Rica’s public sector unions, backed by student, rural, and citizen groups, have vowed to resist CAFTA “in the streets” due to its threat to public institutions.⁴⁰ Though CAFTA is likely

40 *La Nación*, “Union rejection and business support for the (free trade) agreement with the United States”, 26 Oct 2003; *La Prensa* (Panamá), “Presagian días difíciles en Costa Rica por TLC”, 13 March 2006.

to bring benefits to certain sectors of the Costa Rican economy, these should be weighed against the likely costs: financial and political, institutional and human, anticipated or unintended.

7. Conclusions

This paper demonstrates how market openings in Costa Rica were driven not only by those who felt that the market would provide public goods better than the state, but also by actions of interested parties that stood to benefit. False claims of technical necessity led to the implementation of policies that led to the withdrawal of resources essential for the continuation of the Costa Rican model. This paper also shows that resistance was driven not only by interest groups, but also by the efforts of people who honestly believed that greater reliance on the market would threaten the institutional and political foundations of the social democratic state. Finally, this paper argues that rather than strengthening the capacity of the Costa Rican state to adapt to political and economic change, neo-liberal reform processes have actually undermined public institutions and closed spaces for negotiated transformation.

This is of obvious relevance for other countries in the region, which are struggling to overcome decades of polarization, economic marginalization, and political exclusion. As countries look for ways to consolidate democracy, heal polarizing rifts, and create a truly developmental state, there are important lessons to be learned from Costa Rica, where institutional and human capacity-building and “*concertación*” have made it the most stable democracy in the region for the past half-century. Yet opportunities for dialogue and negotiation presented by peace-building processes are diminishing. The rollback of state intervention, increased insulation for technocrats, weakening of legislative oversight, and greater independence for democratically unaccountable bodies such as Central Banks have set a dangerous precedent for democracy.

Despite the fact that neo-liberal discourse has made many inroads against the statist legacy, however, there remain institutional and discursive resources for constructing alternatives. The policy space in Costa Rica and across Latin America remains very much contested. As more and more governments question the neo-liberal model, Costa Rica may yet provide a glimpse of viable alternatives, and regional leadership may yet emerge as a means to ensure that such alternatives are considered.

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