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FEATURED Q&A

Will Costa Rica Be Able to Fix its Budget Problems?

Costa Rican President Carlos Alvarado told the Advisor this month that he is committed to the approval of spending cuts and tax reforms. // Photo: Irene Estefanía González, Inter-American Dialogue.

Q Costa Rican President Carlos Alvarado on June 12 visited Washington in his first foreign trip since taking office in May, telling the Advisor in an exclusive interview that he is committed to getting spending cuts and tax reforms approved this year in order to shrink the country's fiscal deficit. The Organization for Economic Cooperation and Development recently issued a warning about Costa Rica's fiscal deficit, which amounted to 6.2 percent of gross domestic product last year. How big of an economic problem is Alvarado facing? What will it take to restore sustainable public finances? Is Costa Rica's admired social safety net at risk of fraying apart?

A Edna Camacho, economic coordinator in the administration of Costa Rican President Carlos Alvarado: "The fiscal problem stems from the high and continuous fiscal deficit. The deficit has surpassed 4 percent of GDP since 2010 and 5 percent since 2013, and the main consequence has been an increase in the government's debt from 25 percent of GDP in 2008 to more than 50 percent in 2018. At this rate, the debt's trajectory is unsustainable. Moreover, government financing pushes up interest rates in the local market and reduces the availability of credit for the private sector. This undoubtedly affects the country's possibilities of economic growth and job creation. To deal with the critical fiscal situation, Carlos Alvarado's administration has proposed a fiscal reform that is currently being discussed in the Legislative Assembly. It contains measures to increase tax revenues and to control public spending. The main changes are the following: first, transforming the sales tax into a value-added tax to which

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Mexican Town's Police Held After Candidate Killed

The entire police force of the Mexican town of Ocampo, in Michoacán State, was detained for questioning following the killing of a mayoral candidate.

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Brazilian Labor Court Sides With Petrobras Workers

The country's Superior Labor Court ruled against Petrobras and in favor of workers in a class-action case that could cost the state oil company $4.5 billion. At issue is the compensation policy that Petrobras has had since 2007.

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POLITICAL

E.U. Sanctions Top Venezuelan Officials

The sanctions do not directly target President Nicolás Maduro, but they did come in response to Maduro's re-election last month, which the European Union said was neither free nor fair.

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Maduro // File Photo: Venezuelan Government.

POLITICAL NEWS

Mexican Town's Police Held After Candidate's Killing

The entire police force of the town of Ocampo, in Mexico's Michoacán State was arrested Sunday following the killing of a mayoral candidate, El Universal reported. Nearly 30 police officers were detained by the state's Deputy Office of Public Security. Among them was the director of Ocampo's police department, Óscar González García. Several officers resisted arrest, including González García, the newspaper reported. Michoacán's public security director, Venancio Colín attempted to arrest the police officers on Saturday, but was "chased out in a hail of bullets" by more than a dozen Ocampo police officers, El Universal reported. A new operation to arrest the officers was launched the following morning. The arrests follow the killing of Fernando Ángeles Juárez, the Democratic Revolution Party's candidate for mayor of Ocampo. The police officers arrested are suspected of having ties to criminal groups and alleged involvement in Juárez's June 21 murder. Juárez was killed just a day after Omar Gómez Lucatero, an independent candidate for mayor of the town of Aguililla, also in Michoacán State, the Associated Press reported. Drug gangs and vigilantes have been active in the area. In all, 18 candidates for public office in Mexico have been killed, the AP reported June 21. Nearly all of them have been running for local positions in Mexico's July 1 elections. Some politicians have been killed even before they were able to register as candidates. In addition to Michoacán, the states of Guerrero and Oaxaca have also been hit hard by the killings.

Several Ocampo officers reportedly resisted arrest, including the police force's director.

BUSINESS NEWS

Brazilian Labor Court Sides With Workers in Petrobras Dispute

Brazil's Superior Labor Court on Thursday ruled against Petrobras in the largest action in the state oil company's history, Folha de S. Paulo reported. The decision could cost the company some 17 billion reais, or $4.5 billion, in retroactive payments to around 51,000 current and former employees. The labor dispute is over the oil giant's compensation policy since 2007, known as the Minimum Level and Regime Remuneration (RMNR), which was negotiated with unions and aimed to equalize wages across the industry, the Brazilian newspaper reported. Workers claim that payments for special arrangements, such as hazardous or night work, should not be incorporated in the calculation base for RMNR compensation, while the company—alongside the federal attorney general's office—argues for their inclusion, Reuters reported. The head of the labor court, Brito Pereira, cast the tiebreaking vote, bringing the decision to 12 in favor of Petrobras and 13 for the employees. Pereira noted that the court did not take into account the economic implications their decision could bring for the state, saying that "the economic issues are discussed in another forum, not in labor justice." Petrobras plans to appeal the ruling in Brazil's Supreme Court. "Petrobras is absolutely confident that it will reverse the decision," said Taísa Maciel, the executive manager of Petrobras, Folha de S. Paulo reported.

Chile's SQM Reverses Decision to Hire Ponce as Advisor

Chile's SQM announced on Friday that it is reversing its decision to bring on former chairman Julio Ponce as an advisor, the lithium miner said in a statement. Ponce's appointment, announced earlier in June, sparked

NEWS BRIEFS

E.U. Imposes Sanctions on 11 Top Venezuelan Officials

The European Union announced on Monday that it will impose economic sanctions on 11 senior Venezuelan senior officials in response to President Nicolás Maduro's re-election in May, which E.U. officials have called neither free nor fair, Reuters reported. The new measures, in the form of travel bans and asset freezes, add to the European bloc's arms embargo and sanctions on seven other Venezuelan officials. The European Union is seeking to pressure officials surrounding Maduro before directly targeting him.

Colombia Virtually Certain Bodies Are Those of Ecuadorean Journalists

The Colombian defense ministry on Friday said it is 99 percent sure it has identified the bodies of three Ecuadorean journalists kidnapped and killed near the Colombian-Ecuadorean border in March, the Associated Press reported. The defense ministry said it will still test the bodies for DNA. The journalists, who worked for Ecuador's El Comercio, were investigating drug violence in the area when they disappeared, the AP reported. The bodies were found and retrieved on Thursday.

Mexico's Economy Shrinks 0.6 Percent in April

Mexico's economy contracted 0.6 percent in April as compared to March amid declining output across several sectors, the country's national statistics agency announced Friday, Reuters reported. The country's agricultural sector saw the largest decline, shrinking 1.7 percent in April as compared to the previous month in seasonally adjusted terms. The services sector contracted 0.5 percent, while the industrial sector shrank 0.4 percent, the statistics agency said. The economy grew 4.5 percent in April as compared to the same month a year ago.

widespread criticism from politicians and the business community. A former son-in-law of late Chilean dictator Augusto Pinochet, Ponce is a controversial figure in the country, Reuters reported. He left his position as chairman of SQM earlier this year after the company struck a deal with the government that increased its lithium quota but required Ponce's removal, the wire service reported. SQM's president, Alberto Salas Muñoz, said in the statement that while the company did not believe hiring Ponce violated the terms of the government agreement, the subsequent public disapproval pressured the company to reverse its decision. Business leaders and politicians alike welcomed the reversal. Alfonso Swett, president of the Confederation of Production and Commerce, said the hiring decision was "imprudent" and "profoundly damaged social trust [in the company]," according to La Tercera. Economy Minister José Ramón Valente also called it "imprudent," though he said it was not technically illegal under the company's deal with the government.

Antitrust Watchdog Approves Walmart's Sale of Brazil Unit

Brazil's antitrust watchdog agency, the Administrative Council for Economic Defense, or Cade, on Friday approved U.S. private equity group Advent International's purchase of an 80 percent stake in Walmart's Brazil operation, O Estado de S.Paulo reported. Cade approved the acquisition without restrictions and sought no additional asset sales, Reuters reported. Walmart announced its plan to sell an 80 percent stake in its Brazil unit to partially exit a business that has been underperforming. Walmart, based in Bentonville, Ark., plans to retain the remaining 20 percent of the business. As a result of the transaction, Walmart is expecting to record a noncash net loss of approximately $4.5 billion, primarily due to currency fluctuations, CNBC reported earlier this month. Earlier this year, Walmark also announced that it would partially exit its holding in Asda, a British grocer, by merging the operation with J Sainsbury.

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services—which are currently exempt—will be included. Second, capital gains will be taxed, and the tax on capital income will be 15 percent. Third, a new fiscal rule will be introduced, which, among other things, imposes a limit to the growth of non-capital expenditure in accordance with the government's level of debt. And fourth, some benefits that public employees currently receive will be streamlined. In addition to this legislative bill, the government announced a series of administrative measures to contain public spending and an agenda for structural changes in public employment and institutional design. The fiscal reform and the announced measures would produce an adjustment to the deficit of almost 3 percent of GDP between 2018 and 2022."

A **Alberto Trejos, professor of economics at INCAE Business School:** "The Alvarado administration is facing a huge problem: since the difficult years of the 1980s dealing with the consequences of fiscal excesses, Costa Rica carefully kept financial and macroeconomic stability, aiding both its economic transformation and its social and environmental achievements. In the last decade, fiscal excesses are back, and although the underlying economy is now much stronger and more modern, this type of problem always takes its toll. It is nearly impossible for the administration to escape major financial crisis unless it fixes the problem. Massive expansion in the public sector payroll and the average wages paid to the bureaucracy at the very top created the problem. Relative to its paying capacity, Costa Rica is the OECD member/candidate with the second most expensive public payroll, and with abundant examples of individually abusive salaries, 'benefits' and pensions. As such, macroeconomic instability was brought about by expenditures aimed at something the population never quite asked (over-paying the same people to do the same job descriptions under the same standards), rather than spending on something we care for (the safety net, the environment) or desperately need (for example, infrastructure). It can only be solved with a combination of tax increases (hard to justify since the population does not feel it is getting or would get anything more from the state than it was before) and expenditure cuts. The only way to do the latter is to bring the payroll back to normal. There are reasons to be optimistic: the new president seems to have the right attitude, is a smart political strategist, and has appointed a good economic team. The composition of the new congress seems to be far more apt at taking this kind of decision than previous legislatures. But there are also motives to be cautious: the president's party is a political movement representing first and foremost the very bureaucracy that benefits from the status quo, and congressional rules make the approval of anything glacially slow. The administration's initial proposals have been insufficient and incomplete, but one can hope they can put something together soon."

> **"It is nearly impossible for the administration to escape major financial crisis unless it fixes the problem."**
> **— Alberto Trejos**

A **Carlos Ricardo Benavides, National Liberation Party leader in Costa Rica's Legislative Assembly:** "The potential economic problem can be huge if the government does not carefully manage the urgent current situation. It must present a fiscal adjustment that is clear, convincing and sufficient to avoid a fiscal problem that spills over onto the economy, affecting production, employ-

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ment and consumers' spending capacities. The risk of losing investment, which would negatively affect economic growth, interest rates and/or inflation, is high. It is clear that the country requires a comprehensive, integral and gradual reform that is also definitive, progressive, balanced and sufficient. The current debt levels and the recurrent, chronic fiscal deficit—which surpasses 6.2 percent of GDP—makes an adjustment of at least 4 percentage points imperious, in order to stabilize the debt. The legislative faction that I coordinate has clearly stated that any measures must be drafted and proposed by

> **The entire Costa Rican institutional apparatus and our major public programs are at risk..."**
>
> **— Carlos Ricardo Benavides**

the president, including expenditure rates, revenues and fiscal governance. Congress has requested such measures from the administration, in order to have more clarity on the complete reform agenda and thus resume the national conversation with appropriate technical and specialized criteria. The entire Costa Rican institutional apparatus and our major public programs are at risk if they are not adequately financed and if we don't improve the efficiency, efficacy and quality of our spending. Indeed, the entire Costa Rican social pact—which has maintained robust economic growth for more than 60 years alongside important public and social investments that are in line with the environment and that bring economic well-being and an extraordinary network of public services that has allowed high social mobility—is at risk. All of this has been built on solid democratic institutions. The social safety net may also be at risk if we don't stabilize the public debt in the short term and guarantee healthy public finances for a long time."

A **Juan José Urbina, senior economist at the Instituto Centroamericano de Estudios Fiscales:** "Various social indicators show how the Costa Rican population currently enjoys a social well-being that is above that of the rest of the region. This has been due, in good measure, to a state model in which public services are oriented toward the needs of the population throughout the past several decades. A study by the Instituto Centroamericano de Estudios Fiscales (ICEFI) found that, by 2013, Costa Rica allocated $4.91 per capita per day at constant prices in terms of public investment toward children and adolescents, while other countries in the region invested between 40 cents and $4.32. This is evidence of the major attention Costa Rica dedicates to this vulnerable group. However, from the ICEFI, we have been warning that the critical situation of public financing in the country, especially the accelerated increase of public debt (13.5 percent between 2016 and 2017) and its respective service (currently 15.1 percent of total spending), threatens the state's capacity to keep answering to the population's needs as it has to date. For this reason, the new administration's main challenge will be achieving political and social agreements that will bring an integral reform of the country's fiscal policy (something that has not been done in 20 years). Nevertheless, the goal should not only focus on stabilizing the public debt's growth rate or controlling fiscal deficit—that largely worries politicians—but also, at the same time, ensure that the state will be able to maintain and improve how it serves its people."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

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