Costa Rica
Recapturing Momentum for Poverty Reduction
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Introduction

Costa Rica is well-known for its socio-economic achievements with low levels of poverty and inequality by Latin American standards. It also performs well in health, access to improved water supplies, suitable housing and other basic services, including electricity and sanitation, relative to comparable countries.

Nonetheless, the country faces important challenges in the on-going fight against poverty.

- Following a period of significant decline in the 1990’s, the poverty rate has not declined over the last decade: in 2004, 23.9 percent of the Costa Rican population was still considered poor.
- Income inequality has been rising. While still relatively low by regional standards, inequality in Costa Rica, as measured by the gini coefficient, a widely used indicator of income equality, rose from 0.44 in 1989 to 0.48 in 2004 – an increase that is economically significant.
- Costa Rica lags behind the Latin America and upper-middle income country averages for access and attainment at the secondary school level, despite considerable investment. Moreover, the poor still lag behind the non-poor in educational access and attainment, and this adversely affects their ability to participate in and benefit from economic growth.
- Even though Costa Rica has a relatively well developed set of social protection programs, many of its poor still fall outside the reach of the safety net.

The study referenced in this note\(^1\) examines recent developments on the poverty front in Costa Rica, with particular emphasis on examining why poverty rates have not declined over the last 10 years, despite relatively consistent economic growth over the period. The report was undertaken as part of an ongoing dialogue between the World Bank and the Government of Costa Rica on economic and social policy.

What is the Current Poverty Situation in Costa Rica?

Poverty in Costa Rica is low by Latin American standards. If poverty is defined as households with income of $2 or less per person per day (purchasing power parity, PPP), then 9 percent of Costa Rica’s people are found to live in poverty, a lower rate than for any Latin American country except Uruguay and less than half the regional average of 25 percent. Applying a $1-per-day poverty line (PPP), the poverty rate in Costa Rica is only 2 percent, one-fifth of the Latin American average.

Poverty declined significantly between 1989 and 1994, but has remained essentially constant since then. The proportion of the population that is poor declined from 31.7 to 22.9 percent between 1989 and 1994, and has hovered in the 23-24 percent range since 1994. Similarly, extreme poverty fell from 9.9 percent in 1989 to 6.8 percent in 1994, but remained at 6.6 percent in 2004. This lack of progress over the last decade is surprising given that per capita GDP growth averaged 2.4 percent over the 1994-2004 period. Indeed, many empirical studies show that economic growth is normally associated with declining poverty.

Poverty has distinct geographic patterns with the highest poverty rates occurring in the less populous Brunca and Chorotega regions but the highest concentration of poor people occurring in the more densely populated Central region, home to nearly half of Costa Rica’s poor and about 40 percent of the country’s extremely poor people. These regional differences in the incidence and concentration of poverty have important implications for policy and investment approaches to reducing poverty at the local level.

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Health outcomes are generally good by regional standards. Infant and child mortality rates are significantly lower than in comparable countries, while the average life expectancy is substantially higher. While there are some measurable differences in health status between the poor and non-poor, the differences are not as pronounced as in other countries in Central America. Levels of health insurance and other social security coverage are also relatively high in Costa Rica, among the highest in Latin America. Nonetheless, coverage rates are significantly lower among the poor than the non-poor. In 2004, more than 30 percent of the extremely poor and 25 percent of all poor still lacked health insurance coverage, in contrast to only 16 percent of the non-poor. Moreover, recent declines in measles and poliomyelitis vaccination rates, as well as sharp increases in the incidence of malaria, dengue and tuberculosis, signal emerging challenges for the health sector.

The country continues to face important challenges in education. Costa Rica lags behind Latin America and other upper-middle income country averages in net secondary school enrollments, despite considerable progress since the country experienced significant education setbacks in the wake of the 1982 financial crisis. Moreover, while education gaps have narrowed, the poor still lag well behind the non-poor in a number of important areas. In 2004, primary school net enrollment rates were still only 70 percent among children in the poorest income quintile, compared to 95 percent among those in the wealthiest quintile; secondary-school net enrollment rates were only 33 percent among those in the lowest quintile, compared to over 70 percent for those in the highest quintile. Drop-out rates remain higher for poor students, and completion rates remain low, particularly at the secondary level. The quality of education in poor areas lags considerably behind that in non-poor areas.

Why Hasn’t Poverty Declined in Costa Rica over the Last Decade?

The absence of progress in poverty reduction in Costa Rica since 1994 presents something of a puzzle, at least at on the surface, as poverty has stagnated in the face of consistent economic growth during most of the period. Nonetheless, the evidence indicates that several factors combined to reduce the impact of growth on poverty over the last decade – factors related to the levels and patterns of growth, as well as to recent developments in Costa Rica’s labor market.

Growth in average per capita household income declined over time. After rising by nearly 5 percent per year from 1989 to 1994, it grew only 1.5 percent per year from 1994 to 2000; between 2000 and 2004, average per capita household income barely changed (incomes grew by less than one-tenth of one percent per year).

The poor have benefited less from the growth that did occur. While from 1989 to 1994, average per capita household income among the poor grew 25 percent, nearly the same as the national average of 28.0 percent, from 1994 to 2000, average per capita household income among poor households grew only 3 percent, roughly one-third of the national average (9.2 percent). Since 2000, average income growth among the poor has been slightly negative; only households in the top income quartile experienced positive income growth (a relatively small 2.2 percent between 2000 and 2004). In general, growth has been faster in relatively wealthy counties (cantones) and in sectors that tend not to employ much poor or low-skilled labor – such as finance, commerce, and public administration.

Shifts in relative demand and supply of skilled and unskilled workers have resulted in greater earnings
inequality and significantly higher unemployment among the poor and extremely poor since the early-to-mid 1990s. Changing patterns of investment and trade, along with technological changes, led to increased local demand for relatively skilled labor at a time when Costa Rica experienced a decline in the relative supply of such workers (a long-term effect of the 1982 financial crisis on education levels in the labor force). Increases in female labor force participation along with a surge in the supply of Nicaraguan immigrant labor in the mid-to-late 1990s, further contributed to an increase in the supply of low-skilled labor relative to demand.

An increasing number of poor women are working less than full-time. The data show an increase in the proportion of workers – specifically poor, female workers – working less than the standard work week (40 to 48 hours) since the end of the 1980s. The increase appears to reflect the rapid increase in the share of female headed (largely single-parent) households in the population between 1987 and 2004 – from 17.0 percent of all households to 26.4 percent – and an even larger increase in the share of female headed households among poor households over the period – from 19.7 percent to 33.6 percent. Because part-time workers earn less than full-time workers for any given hourly wage, these trends have almost certainly contributed to the observed increase in poverty among female-headed households over the period.

Certain labor market policies also may have contributed to stagnating poverty rates, for example: (i) while Costa Rica’s complex, multi-tiered system of minimum wages increases hourly wages for many workers already employed in the formal sector, evidence indicates it also reduces formal sector employment among poor and near-poor workers; and (ii) regulations that restrict women’s ability to work non-standard hours – specifically night work – may be contributing to the rising levels of part-time work among poor female workers and poverty among predominantly single-parent, female headed households.

Has immigration from Nicaragua hindered poverty reduction since 1994? Despite popular perceptions that the influx of poor Nicaraguans has contributed to stagnating poverty rates in Costa Rica, the data suggest that inflows of immigrants to Costa Rica have been too small to have had much of an impact on aggregate levels of poverty, particularly since 2000.

Can the Social Sectors be a More Effective Force for Poverty Reduction?

Costa Rica has had a long-standing commitment to social development and to universal access to core social programs in education and health. At 15.5 percent of GDP, Costa Rica’s overall social sector spending is higher than the Latin America average and the highest of any other Central American country. Public spending in several sectors – including in basic education, health, and social assistance – is also pro-poor. These factors have helped contribute in important ways to Costa Rica’s socio-economic progress.

Nonetheless, there is considerable scope for increasing the efficiency and impact of social sector spending and policy. Analysis of public spending on education in 16 Latin American countries shows that primary and secondary school outcomes in Costa Rica are significantly lower than would be expected given the level of spending (as a percentage of GDP). Moreover, while Costa Rica’s social safety net is relatively well developed by Latin American standards, a significant proportion of the poor are neither covered by social security nor have access to basic social programs, such as school feeding (Comedor Escolar), child care (Centros Infantiles) or social assistance pension benefits (Pensiones no Contributivas).

There are potentially large gains to spending “better”. There is thus considerable scope for increasing the impact of the social sector on poverty reduction through concerted efforts to increase access to quality services by the poor, particularly in education and social protection. Given already high levels of public spending, the evidence suggests that significant gains could be made within current budget settings through strategic reallocations of resources to areas of high impact (e.g., secondary education for all Costa Ricans), through greater internal efficiency of public spending (e.g., increased spending on quality enhancing inputs), and through the strengthened use of targeted approaches to reaching the poorest, most vulnerable, Costa Ricans (as a complement to Costa Rica’s universal programs). Given Costa Rica’s current fiscal constraints, spending “better” – as opposed to spending more – will be critical to its success in harnessing the social sectors for effective poverty reduction as well as for increased economic growth.

Policy Options: A Strategy for Recapturing Momentum for Poverty Reduction

The evidence presented in the report argues for a multidimensional strategy for poverty reduction to ensure that the poor are better able to participate in and benefit from future socio-economic progress. Elements of such a strategy would include:

Promoting economic growth. Robust economic growth is critical for sustained poverty reduction in the long-term. Indeed, economic growth is critical to providing expanded economic opportunities for all Costa Ricans, including for the poor. Key areas for attention include: investments in
infrastructure, financial sector deepening, increased trade openness, strong macro-economic and fiscal management, and strengthening of the country’s education, research and innovation systems. Yet, as Costa Rica’s recent experience indicates, growth alone will not engender poverty reduction. It will be critical to create conditions in which the poor are adequately prepared to take advantage of new and emerging economic opportunities through:

**Strengthening human capital, with special emphasis on the poor.** At the core of any poverty reduction strategy for Costa Rica, efforts should focus on investments and policies to:

- **Improve secondary school outcomes.** This will require reallocation of education-sector resources and attention toward increasing secondary school access and achievement among the poor, particularly in rural areas, and enhancing education relevance and quality (both at the primary and secondary levels).
- **Increase the capacity and employability of poor, low-skilled workers.** Bridging the skills gap between low-skilled workers and the growing demand for higher skilled labor will be critical to reducing unemployment and raising earnings among the poor.
- **Address emerging health risks.** Health sector resources should be aimed toward reversing the decline in vaccination rates for measles and poliomyelitis, and at preventive health measures and public information to deal with malaria, dengue, and tuberculosis.

**Ensuring social protection for the poorest, most vulnerable groups.** Social protection systems should reduce people’s vulnerability to poverty, and increase the economic mobility of the poor by ensuring that even the poorest families have access to basic services and the ability to invest in human capital. This will require:

- **Strengthening the strategic focus of Costa Rica’s social protection system** on areas of particularly high returns, such as early childhood interventions and programs that increase human capital development among poor children,
- **Rationalizing and consolidating existing social-assistance programs** to increase the impact of public spending, consistent with strategic priorities for poverty reduction, and
- **Expanding social protection coverage** (including support for human capital development, and health insurance and pension coverage) to the poor and extremely poor who currently fall outside the system. The latter can be accomplished through greater emphasis on targeted programs to complement exiting universal approaches and through strengthening program targeting mechanisms.

It should be noted that there is a special role for “demand-side” programs to help poor families overcome financial constraints to investing in their children. Demand-side programs, such as conditional cash transfers, provide financial support to poor households provided they ensure that their children attend (and complete) secondary school. They have been effective in raising educational enrollment and attainment among the poor in such Latin American countries as Mexico, Colombia, and Brazil. Such programs hold considerable potential in Costa Rica.

**Creating an enabling environment for poor female workers:**

Key priorities include: (i) providing greater social support, in the form of affordable child care options, for female workers, whether poor single mothers or female spouses, so that they can work full-time and generate higher earnings, and (ii) reducing legal barriers to women working non-standard hours, so they have the same working-hour flexibility as men.

**Defining regionally differentiated investment strategies.**

Differences across regions in the levels of poverty and concentrations of poor people suggest that regionally differentiated policies and investments may be warranted. In areas like the Central Region, where the poverty rate is low but concentrations of poor people are high, investing in infrastructure and improving the investment climate could be particularly effective in raising labor demand for poor workers. In places where the poverty rate is high but the concentrations of the poor are low, investments or targeted support for education, training, and technical assistance, all of which raise people’s economic mobility, may be more effective.

**Strengthening information systems and improving transparency.** Costa Rica’s poverty reduction efforts would benefit from strengthening and increasing the transparency of data, information and management systems, most notably by (i) improving poverty measurement and monitoring, and (ii) strengthening mechanisms for targeting interventions to the poor.

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