Between the time gap of 2007 to 2012, the Costa Rican economy maintained a deficit in their current account owing to a negative trade balance which contributed to a continual decline of their current account balance through this period. This case study will analyze the global recession of 2008 in Costa Rica and how it had affected the balance of payments yet maintained an overall surplus due to strong inflows of foreign investment. In this paper, the deficit will first be analyzed, and how the foreign investment and a strong financial account had sustained Costa Rica through the global slowdown of 2008. This foreign investment and its effect in the 2008 global slowdown will be the central point of this paper, while focusing also on how Costa Rica financed this constant current account deficit through means of its capital and financial accounts due particularly to substantial inflows of foreign direct investment, portfolio investment, and high levels of both public and private borrowing.

This consistent deficit is found in the current account balance, most noticeably the trade deficit. Following the IMF’s balance of payments sheet in the years of 2007-2012, there was a trade imbalance with a total current account balance deficit of -$1,755 million. Meanwhile, the financial account had a surplus average of $2,502 million and a capital account surplus average of $35 million (comparisons found in Graph 1); putting the country’s balance of payments at a surplus average of $781 million (IMF). These averages show that the inflow from FDI covers the expense and deficit of the current account. An executive summary by the World Trade Organization goes on to say that the deficit in this period was offset, “by the surplus on the capital and financial accounts, fueled by strong foreign capital inflows of both FDI and portfolio investment.” A senior economist at CEPR, Cordero, writes, “In spite of high import bills (due partly to high prices of oil and raw materials), the capital and financial account more than offset the current account deficit, giving rise to an accumulation of international monetary reserves in both 2006 and 2007”. This direct investment was used for the development of new production facilities for export purposes, but an important portion of investment flows was associated with real estate development, especially in the tourism sector. While the “funding for these facilities was provided by U.S. banks”, the 2008 recession restricted credit lines upon the crash (Antonio-Cordero). According to Jorge Guardia, another senior economist, lawyer, and former president of the Costa Rican Central Bank, the period beginning in 2006 going up to early 2008 was a planned expansionary period in an expansionary-fiscal-policy. According to the former central bank president, this period held exceptionally strong FDI and a drop in the exchange rate during which liquidity of Colones and Dollars increased. However, this expansionary period was reaching what La Universidad de Costa Rica calls the “Cacique Effect”, whose title originates from a popular liquor brand and is the same idea as being hung-over – where one must pay the price of the previous fun night (O’neil-Coto).

This ‘night of fun’ is coming to an end as the nation enters year 2008, which begins with a rocky and scary start – the U.S. just started a major recession which would be felt globally. Simultaneous to this oncoming recession was this planned “Cacique effect” now that the expansionary period has ended. Former president of the Central Bank, Jorge Guardia noted that due to the end of the expansionary period combined with the oncoming recession, there will be a drop in exports as the recession hits other countries (Graph 2). He also predicted that by July the nation will see heavy drops in employment, real wages, and rises in poverty and redistribution of wealth. This is because recessions hit those with less opportunities and wealth significantly harder. The global slowdown and the end of the expansion period conjoined (O’neil-Coto). This change can be seen on Costa Rica’s balance of payments as a drop in all forms of national income in the time between 2007-2008. Despite this, the financial and capital accounts didn’t stray much between 2007 and 2008, and in 2009 the financial account dropped to less than a quarter it was in 2008 but managed to stay in total surplus. Despite this major drop, there was a near complete recovery by 2010 (Graph 3) (IMF).

After this 2008 global slowdown, the financial account gradually rose. This was mostly due in part to FDI, which stayed net positive despite the global slowdown and began to rise after 2008 and even doubling its 2007 number by 2012 due almost entirely to FDI and loans (WTO). Many of these FDI and these loans were plans that were set to happen earlier but got pushed out by the recession. One such case was a “US$800 million facility” that was “put on hold after the collapse of Lehman Brothers”, who was funding the project (Antonio-Cordero). Costa Rica was able to push through this global slowdown by, “expanding public spending while maintaining financial stability” and despite the slowdown the, “economy grew at an annual average rate of 3.2% between 2007 and 2012” (WTO). This would show continual growth and expansion despite such a heavy global economic impact in 2008 and how borrowing and FDI played a major role in assisting this growth and stability.

Costa Rica financed a consistent current account deficit through means of its capital and financial accounts, and this was done particularly through substantial inflows of foreign direct investment, portfolio investment, and high levels of both public and private borrowing. The level of stability and growth through the global slowdown of 2008 relied almost entirely on FDI and loans. These two aspects carried the Costa Rican economy through the slowdown and kept the balance of payments in net positive, despite such a deep deficit in the current account.

Graph 1:

Graph 2:

Graph 3:

Works Cited

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