

AID-FOR-TRADE: CASE STORY

COSTA RICA

Trade Opening as a Key Element of the Development

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EXECUTIVE SUMMARY

Starting in the 1980s, Costa Rica embraced trade liberalization as one of the main elements of its development strategy. The country has managed to combine an active agenda at the WTO with the negotiation of several preferential trade agreements (PTAs). As a result, the country has created a robust export platform where both multilateral agreements and eleven PTAs provide for security and predictability of about 83 percent of total exports. These policy actions have led to a profound diversification of the export portfolio, along with the emergence of new export, business and employment opportunities. These actions combined with the appropriate social policies and structural reforms have been conducive to better living standards, with the number of Costa Ricans living in poverty conditions dropping by one third over the last twenty years.

Nevertheless, trade reform demands additional capabilities and resources, hence presenting a significant challenge to a developing country in light of institutional and budgetary constraints. In this regard, the Ministry of Foreign Trade (COMEX) has received valuable technical assistance and capacity-building from an array of institutions, including the Inter-American Development Bank (IDB) and the WTO. As a result, the country has been able to successfully participate in bilateral, regional and multilateral negotiations, as well as to implement and manage the resulting agreements.

ISSUES ADDRESSED

Costa Rica is one of the strongest proponents in Latin America of using trade liberalization as a key element in its mid- and long-term development strategy. It has long participated in and contributed to both multilateral and bilateral negotiations. Starting in the 1980s, the country slashed its import duties, going from an average of 46.3 percent in 1982 to 16.8 percent in 1989. In 1990, Costa Rica became the 100th member of the GATT. Then in 1994, Costa Rica started an era of PTA negotiations aimed at improving and deepening access to foreign markets for Costa Rican exports.¹ Continued liberalization has further reduced the average import tariff to 5.87 percent in 2010.

¹ Costa Rica has PTAs with Central America, Mexico, Chile, the Dominican Republic, Canada, the CARICOM countries, Panama, and the United States. Agreements with China and Singapore are awaiting congressional approval, while the one negotiated with the European Union is in the legal scrubbing process (see Chart 1).

The ambitious trade agenda pursued during the last two decades has demanded significant resources from the government and increasing technical expertise. Given the constraints of a limited budget and of a relatively small staff, COMEX has had to look for assistance from international institutions and donors to help with expert advice on key issues, equipment, organization and participation in the negotiations, and outreach and information with civil society, among others.

OBJECTIVES PURSUED

Costa Rica's trade opening process has been a fundamental ingredient of the development strategy. As such, it aims to create opportunities for increasing exports, production, employment and income, while facilitating the diversification of the export portfolio and getting access to leading technologies. Combined with the correct social policies, capacity building programs for small and medium enterprises, and investment in infrastructure, the country's ultimate purpose is to ensure sustainable economic development and provide better opportunities to its citizens.

DESIGN AND IMPLEMENTATION

In order to overcome the costs and technical difficulties associated with the different negotiations, the implementation and application of PTAs, COMEX has received technical support over the last decade from organizations such as the IDB, the Central American Bank of Economic Integration (CABEI)², the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), the United Nations Conference on Trade and Development (UNCTAD), the Organization of American States (OAS), and the WTO.

This assistance has focused on training negotiators in topics related to services, market access and agriculture negotiations, and other rules of international trade (such as rules of origin, customs procedures, trade defense and intellectual property rights); acquisition of hardware (including computers for negotiators and related equipment to allow for proper security of the information) and specialized software programs; funding used to help cover costs related with the organization and participation in negotiations (to provide adequate venues to hold meetings and travelling expenses) and the hiring of external consultants for advice in specific topics (such as the technical regulations applied to imports in markets of interest); as well as the publication of information material concerning the PTAs. Assistance has also focused on more specific and targeted projects aimed at broadening the scope of the benefits of trade opening, by providing opportunities to more participants. For example, initiatives have focused on helping small rural farmers engage in international trade by increasing their knowledge and access to international certification schemes for organic production; and on strengthening the capacities of small and medium-sized enterprises through specialized trainings to upgrade the quality of their product or service so as to satisfy the standards and demands of multinational exporting companies, and therefore allow them to participate in the production chain and export indirectly.

PROBLEMS ENCOUNTERED

Despite the many years Costa Rica has been involved in the trade liberalization process, it has not been free of challenges. Some challenges are directly linked to the trade policy structure, while others refer to complimentary policy areas that are essential for establishing a successful connection between trade liberalization and economic development.

- **Limited resources and staff:** Negotiations of free trade agreements are costly, take time, and require a significant number of technical experts. When resources are limited, the country needs to prioritize and decide among possible negotiating partners. Also, it takes time to train government officials in charge of negotiating and administrating PTAs.
- **Political opposition:** Interest groups who benefit from tariff protection and other have

² See Chart 2 in the Annex for an example of the technical assistance provided by CABEI.

normally sought the preservation of the *status quo*, thus creating difficulties for congressional approval of market-access reforms and PTAs. The approval of the Central America-United States-Dominican Republic Free Trade Agreement (CAFTA-DR) by referendum is the most significant expression of the political economy difficulties associated with the process of trade liberalization.

- **Institutional efficiency:** The country's trade platform involves a variety of government institutions and agencies related with the exportation and importation of goods and services. Institutions that are not efficient in their operations tend to make trade more costly and less competitive.
- **Deficient infrastructure:** Investment in roads, ports and airports is necessary to improve delivery times and the competitiveness of Costa Rican export products.
- **Regulatory framework:** An excess in the number of regulations required has an effect on the time and costs needed to carry out any business transaction. More work remains to be done in order to eliminate and simplify regulations.

FACTORS FOR SUCCESS

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RESULTS ACHIEVED

- **Opening of new markets through trade agreements:** After joining the Central American Common Market (CACM) in the early 1960 and the GATT in the 1980s, Costa Rica negotiated its first contemporary agreement with Mexico (1995). These agreements were followed by those with countries like Chile (2002), Canada (2002), and the United States within the context of CAFTA-DR (2009).³ Recently, Costa Rica and its Central American neighbors concluded negotiations for an Association Agreement with the European Union. Agreements with China and Singapore are

³ See Chart 1 for more details.

currently under congressional discussion and their entry into force is expected for the second semester of 2011. These market-access instruments have granted duty-free access to a wide variety of products and significantly expanded the volume and value of Costa Rican exports to these destinations.⁴

- **Improved investment climate:** Free trade agreements establish permanent rules that provide security and predictability. They often also require legal reforms that help correct deficiencies and compel government institutions to reorganize and improve their services. In the specific case of Costa Rica, it was through the negotiation of CAFTA-DR that the telecommunications and insurance monopolies opened up for competition.
- **Improved supply chains:** The reduction of tariff barriers has allowed Costa Rican manufacturers to acquire inputs at lower costs. The arrival of investment has also fostered technological transfers and has created opportunities for local companies to become suppliers of goods and services for exporters.
- **Poverty reduction:** The percentage of Costa Rica's population under poverty decreased 35 percent in a twenty year period. In 1989, 28.3 percent of Costa Ricans lived in poverty conditions while the number decreased to 18.5 percent in 2009. This result is the product of well conceived social and economic policies applied in a consistent manner throughout the years, during which trade liberalization and its results have played a decisive role.

LESSONS LEARNED

There are four main lessons learned from Costa Rica's process of trade opening. The first regards the importance of a balanced political economy setting, in the sense that groups in favor of trade opening must have an active participation in the process. The second one has to do with the development of improved communication mechanisms with the private sector and with civil society in general. Another lesson learned has to do with the importance of institutional coordination within the government for succeeding in negotiating, implementing and administrating trade and investment agreements. Last but not least, appropriate training of the human resources and learning from the experiences of other countries becomes a best practice for minimizing the costs of adjustment and reform. In all of these four areas, technical assistance has proven to play a key role for the success of a process that involves such a great deal of technical and political complexity as the liberalization of trade.

CONCLUSION

Costa Rica has embraced trade liberalization as one of the key ingredients of its development strategy. As a result, the country has created a robust export platform providing for security, predictability and preferential access to trade with 42 countries –accounting for more than three quarters of the total. A key success factor has been the technical assistance received by COMEX, to the extent it has helped to overcome many of the technical and financial challenges stemming from such a long-standing development strategy.

Costa Rica's trade, production, investment and employment figures speak about the success of trade liberalization in terms of creating more opportunities for a better living. However, the challenges stemming from the negotiation, implementation and administration of trade and investment agreements highlight the need for continued assistance, particularly in those areas related to institutional and structural reforms.

⁴ For example, the number of Costa Rican exports to Mexico increased fivefold between 1994 and 2008, while their value increased tenfold.

Chart 1
PTAs Negotiated by Costa Rica

PTA	Current Partners	Entry into force	Exports (US\$ million)		Imports (US\$ million)	
			Average 2007-2009	Share in Total	Average 2007-2009	Share in Total
CACM	El Salvador Guatemala Honduras Nicaragua	23/09/1963	1.244,2	13,6%	587,4	4,4%
Costa Rica - Mexico	Mexico	01/01/1995	223,3	2,4%	810,7	6,1%
Costa Rica - Chile	Chile	15/02/2002	23,2	0,3%	187,8	1,4%
Costa Rica - Dominican Republic	Dominican Republic	07/03/2002	200,8	2,2%	51,8	0,4%
Costa Rica - Canada	Canada	01/11/2002	55,9	0,6%	126,8	1,0%
Costa Rica - CARICOM	Trinidad & Tobago	15/11/2005	45,3	0,5%	59,7	0,5%
	Guyana	30/04/2006	3,8	0,0%	0,0	0,0%
	Barbados	01/08/2006	11,4	0,1%	0,2	0,0%
Costa Rica - Panama	Panama	24/11/2008	391,6	4,3%	227,5	1,7%
CAFTA *	United States El Salvador Guatemala Honduras Nicaragua Dominican Republic	01/01/2009	3.189,4	34,8%	5.443,0	41,1%
Costa Rica - China	China	**	765,1	8,3%	787,5	5,9%
Costa Rica - Singapore	Singapore	**	27,6	0,3%	27,9	0,2%
AACUE	EU - 27	***	1.467,6	16,0%	1.217,8	9,2%
TOTAL			7.649,4	83,4%	9.528,1	72,0%

Source: Monge-Ariño (2010)⁵.

* Coverage of exports and imports computed with respect to the United States only.

** Negotiation finished in early 2010 and submitted for legislative approval; entry into force expected in 2011.

*** Negotiation completed in early 2010; legal scrubbing is expected to be completed in early 2011.

Chart 2

⁵ Monge-Ariño, Francisco. **Costa Rica: Trade Opening, FDI Attraction and Global Production Sharing**. WTO Research Paper, 2010

Example of trade-related assistance received by the Ministry of Foreign Trade in support of its functions	
Donor	CABEI
Project	Non-refundable financial assistance to support the participation of the countries of Central America in the negotiation of an Association Agreement with the European Union
Execution date	First phase: 2008-2010 / Second phase: 2010-2011
Amount of funding	US\$ 1.350.000 total (1.000.000 executed during the first phase, 350.000 during the second)
Components and activities	<ol style="list-style-type: none"> 1. <u>Expert advice</u>: funding provided in this component was used to hire external consultants that provided expert advice on specific topics of relevance to the negotiations, such as the functioning of institutions in the EU, technical regulations applicable to imports in the EU, etc. 2. <u>Equipment</u>: the institutional hardware and software of the Ministry was updated to ensure the existence of a technological platform capable of handling information in a secure and efficient manner. 3. <u>Organization and participation in the negotiations</u>: activities funded within this component included the provision of adequate venues to hold meetings and negotiations, travelling expenses for negotiators, and logistics related to the organization and participation in the process. 4. <u>Monitoring, information, outreach and consultations with the private sector and Civil Society</u>: aid in this area facilitated the production and distribution of information materials to the public throughout the negotiations, public events to discuss the developments of the process and elements to define and defend the position of the country, and activities to disseminate the contents of the agreement and an understanding of its opportunities and benefits, among others.