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**U.S.-CENTRAL AMERICA FREE TRADE AGREEMENT**

**INTEGRAL COOPERATION AGENDA**

**CONCEPTUAL PROPOSAL FOR A NATIONAL ACTION PLAN**

**COSTA RICA**

**DECEMBER 2002**

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## **EXECUTIVE SUMMARY**

Costa Rica is a small, developing economy highly dependent on trade and investment flows. CAFTA will entail the culmination of a trade policy reform process that, for almost twenty years, has been fostering an optimal insertion of Costa Rica to the international economy. This National Action Plan presents a general overview of the Costa Rican context in which the CAFTA negotiations will take place. After identifying the main challenges Costa Rica will face as a result of integrating its economy to that of its main trade and investment partner—which is also the bigger economy of the world—, this document purports to submit a preliminary conceptual proposal identifying the main priorities where international cooperation could be sought in the context of CAFTA.

During the first trimester of 2003 the Costa Rican government will undertake a broad and transparent process of consultation and dialogue with different segments of its civil society to, *inter alia*, explore their views on how to best implement the Integral Cooperation Agenda. Thus, the identification of the priorities of the National Action Plan in each stage of the CAFTA process included in this document purports to be a proposal which could be enriched with the views and inputs derived from the consultation process.

This conceptual proposal envisages the following priorities: In the first stage, i.e. preparation for negotiations, the main priority of the Costa Rican government resides in further educating and discussing with the national civil society on the benefits of free trade in general and CAFTA in particular. In the second stage, i.e. implementation of trade rules and disciplines, the main challenge Costa Rica will need to address is to continue the institutional modernization of some key agencies in charge of applying trade agreements, in particular at the country's borders. Costa Rica's priority is to have a world-class customs office, efficient, transparent and capable to respond to the needs posed by an expanding economy fostering increasing flows of trade and export-oriented investment. To complement this effort, the continuation of the modernization of agencies in charge of applying SPS and TBT measures should also be promoted. The third stage, transition to free trade, is the phase where Costa Rica places particular importance. The need to enable all segments of the Costa Rican society to fully rip the benefits of the future CAFTA ranks at the top of the objectives list of Costa Rica in the Integral Cooperation Agenda. To reach that goal, four broad areas for action have been identified, i.e. rural development, improvement of the business environment and investment climate, maximization of benefits for small and medium enterprises (SMEs), and science and technology as a tool for promoting a new dynamic entrepreneurial sector.

In the first area of action, i.e. rural development, the main priority of the government is to device specific, coherent and realistic set of projects aiming at bringing further farm and non-farm opportunities to the inhabitants of the Costa Rican rural areas. In the

second area of action, i.e., improvement of business environment and investment climate, among the areas requiring immediate attention are the improvement of the country's physical infrastructure (roads, ports, airports, sewage systems, and other public works projects) and the qualitative improvement in the education of the Costa Rican labor force, in particular in fostering English proficiency and computer literacy. Maximization of benefits for small and medium enterprises (SMEs) is the third area of action for the phase of transition to free trade. There is a need to implement effective mechanisms to internationalize Costa Rican SMEs, attempting to enable these enterprises to fully participate from the benefits of free trade and to compete in international markets. Last but not least, the fourth priority action area is the use of science and technology as a tool for promoting a new dynamic entrepreneurial sector. The promotion of the entrepreneurial spirit, the development of new enterprises based on creativity and innovation and the incorporation of information technology in the diverse faces of governmental activity is fundamental for the present and future development of Costa Rica.

This action plan does not purport to be a definitive document. Rather, the intention is to serve as an initial guidance in order to identify possible areas of cooperation, keeping in mind that some key priority areas may need further specification, and particular priorities may emerge as the national context constantly changes. Furthermore, being one of the oldest democracies in the Western Hemisphere, the Costa Rican government considers that a National Action Plan to implement the Integral Cooperation Agenda should also take into consideration the views, inputs and contributions of several sectors of the Costa Rican society, including producers, consumers, workers, students and in general the broadest segments of its population. Thus, during the first trimester of 2003 the Costa Rican government will undertake a broad and transparent process of consultation and dialogue with different segments of its civil society to also explore their views on how to best implement the Integral Cooperation Agenda.

## **PART 1. INTRODUCTION**

Costa Rica is a small developing economy located in Central America. It is the oldest democracy in Latin America, and it is the only country in the world where more than a half century ago, the army was abolished by national consensus. With a population of approximately 4 million, in 2001, Costa Rica had a gross domestic product (“GDP”) of US\$ 16,360.0 million, and its GDP per capita was approximately US\$ 4,060.2. Over the past five decades, the Government has invested significant resources in health care and education. Costa Rica hosts a large diversity of animal and plant species, and approximately one quarter of its territory consists of public or private reserves dedicated to environmental conservation and preservation of this biological diversity.

Historically, the Costa Rican economy has relied on agricultural production for export. The production and export of coffee, and, subsequently, bananas, drove economic growth in Costa Rica through the 1960s. In the 1960s, Costa Rica’s import substitution industrialization strategy created the conditions for an industrial manufacturing sector oriented toward the production of consumer products for the domestic market. This industrial process generated significant economic growth, permitting the modernization of the economy, and created the conditions for significant improvements in Government-provided social services as well as in income levels of the population. Nonetheless, the dependence of the domestic industrial manufacturing sector on imported primary materials and the relatively small size of the Central American market, together with the growing public external debt, became the main weaknesses of this economic model.

The economic crisis experienced during the early 1980s demonstrated the weaknesses of the import substitution industrialization model for development. The magnitude of the economic imbalance registered between 1981 and 1982 led to the implementation of a successful stabilization program by the Government, which reduced the rate of inflation from more than 80.0% in 1982 to 10.7% in 1983. During the latter half of the 1980s, the Government implemented structural adjustment programs under the auspices of the World Bank and the Inter-American Development Bank (IDB). These structural adjustment programs aimed to liberalize the Costa Rican economy by reducing protective trade barriers, creating incentives for the export of non-traditional products, and reforming the financial system and public sector.

Since the mid-1980s, Costa Rica has expanded its economic activity from its historical dependence on the production of agricultural goods for export. It has sought to diversify its exports, attract investment in high-value-added manufacturing, and promote tourism based primarily on the country’s environmental diversity. During the late 1980s and early 1990s, Costa Rica undertook certain structural reforms, primarily (i) the liberalization of trade, capital flows, and the foreign exchange market; (ii) the development of a dynamic non-traditional export sector; and (iii) reforms in the financial

sector. During the same period, Costa Rica suffered from a persistent Government fiscal deficit which led the Central Bank to adopt restrictive monetary policies in order to maintain the internal and external stability of the economy. The issuance of domestic debt to finance the Government fiscal deficit generally led to increased domestic interest rates, hindering private investment.

The negotiation of the U.S.-Central America Free Trade Agreement (CAFTA) will represent the culmination of a trade policy process that for almost twenty years has been fostering an optimal insertion of Costa Rica to the international economy. From a broader macroeconomic perspective, the negotiation of CAFTA will also be a cornerstone in the consolidation of the process of economic reform initiated in the 1980s. The gradual integration of Costa Rica to the bigger and most advanced economy in the planet, that in turn represents –by far– not only the most important market for Costa Rican exports but also the main source of its imports, foreign direct investment (FDI) and technology will definitively bring the opportunity for the country to fully profit from the benefits entailed by free trade. However, at the same time, such challenge may seem overwhelming for an economy the dimensions of which are equivalent to the smallest states of the American Union.

The negotiations of CAFTA will also have a social and political dimension. They will enable the inhabitants of Costa Ricans to accede into real opportunities for better standards of living, not only for themselves, but also for future generations. The possibilities of getting jobs in increasingly technologically advanced businesses, in either the manufacturing, agriculture or services sector is one of the opportunities that the process of integration of Costa Rica with the U.S. economy could bring.

To rip the benefits of free trade and economic integration, at least in the case of a small, developing economy like Costa Rica requires, however, an integrated approach. The condition of being a developing economy clearly evidences the existence of a series of development bottlenecks and distortions which for decades have impeded Costa Rica to reach the economic performance of industrial countries. The solution of these obstacles for development is clearly a national responsibility. The government, entrepreneurs, workers, professionals and in general all civil society must work in a joint effort to enable Costa Rica to pass to the league of developed nations. However, in this process, international cooperation can play a key role enabling national actors to pursue this goal.

The preliminary identification of possible areas for trade-related capacity building is the main objective of this document. It purports to provide a preliminary and general contextual overview of the diverse areas where international cooperation could play a significant role complementing national efforts and policies geared at promoting better standards of living for all the inhabitants of Costa Rica.

The document is divided in three additional sections. Part 2 focuses on the description and a brief analysis of the legal, economic and political context in which the Agenda for Integral Cooperation has been launched. This Part purports to identify the main challenges Costa Rica will need to face in the three main phases of the process of the integration derived as a result of the negotiation of CAFTA, i.e. (i) preparation for the negotiations, (ii) implementation of the trade agreement, and (iii) transition to free trade.

Part 3 contains a schematic identification of the main areas in which international cooperation is being sought. Part 4 contains the conclusions of the document, and attempts to present a broad overview of the whole strategy underlying the National Action Plan. In addition, this part briefly summarizes the main priorities Costa Rica is pursuing in each of the three phases of the negotiation process referred to above.

This action plan does not purport to be a definitive document. Rather, the intention is to serve as an initial guidance in order to identify possible areas of cooperation, keeping in mind that some key priority areas may need further specification, and particular priorities may emerge as the national context constantly changes. Furthermore, being one of the oldest democracies in the Western Hemisphere, the Costa Rican government considers that a National Action Plan to implement the Integral Cooperation Agenda should also take into consideration the views, inputs and contributions of several sectors of the Costa Rican society, including producers, consumers, workers, students and in general the broadest segments of its population. Thus, during the first trimester of 2003 the Costa Rican government will undertake a broad and transparent process of consultation and dialogue with different segments of its civil society to also explore their views on how to best implement the Integral Cooperation Agenda.

As it is clearly stated in Part 4, Costa Rica's strategy for cooperation places particular emphasis on the third phase of the U.S.-Central American economic integration process, that is, the transition to free trade. Thus, most of the core priorities of Costa Rica in this National Action Plan are concentrated in that phase. The need to enable all segments of the Costa Rican society to fully rip the benefits of the future CAFTA ranks at the top of the objectives list for Costa Rica in this process. To reach that goal, four broad areas for action have been identified, i.e. rural development, improvement of the business environment and investment climate, maximization of benefits for small and medium enterprises (SMEs), and science and technology as a tool for promoting a new dynamic entrepreneurial sector. This National Action Plan contains a preliminary identification of some concrete cooperation steps which could be taken in each of these four areas



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## PART 2. BACKGROUND AND NATIONAL CONTEXT

### 2.1 Organizational structure

By Costa Rican law, the Ministry of Foreign Trade (Ministerio de Comercio Exterior, “COMEX”) is the entity in charge of designing, directing and implementing –in consultation with other Ministries and public agencies– the international trade and investment policy in the country. COMEX is a relatively new institution<sup>1</sup>. Established as a part of the market-oriented reforms implemented in Costa Rica since the mid 1980s, COMEX’s main role has been, in the external front, to foster the opening of international markets for Costa Rican exports and services, as well as to promote international legal regimes capable of enhancing the predictability and certainty international trade and investment flows require for their development. In the domestic front, COMEX’s main role has been to work together with other Ministries and public and private institutions in order to continue the process of economic reform required to achieve an adequate insertion of Costa Rica into the international economy.

COMEX has been successful in articulating a series of mechanisms to ensure that other public agencies, as well as the private sector, participate in the negotiations of the various international trade agreements. Thus, the preparation and execution of international trade negotiations are fronts in which Costa Rica has made a significant progress, and such achievements explain, to a great extent the leadership the country has maintained in different international trade fora such as the FTAA and the WTO during the last decade.<sup>2</sup>

While the negotiation of international trade rules and disciplines is usually easier to coordinate, as the ultimate responsibility of conducting the process falls under the direction of a single institution –COMEX in the case of Costa Rica– in most countries reaching an effective implementation of those rules poses a more difficult challenge. Indeed, trade rules and disciplines touch upon a myriad of subject matters, and consequently, the application of those rules entails the involvement of numerous public

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<sup>1</sup> COMEX was originally established in 1986 as a Ministry, however, it was not until 1996 when the institutionalization of COMEX was completed with the enactment of the Law creating the Ministry of Foreign Trade and the Costa Rican Foreign Trade Corporation (“PROCOMER”).

<sup>2</sup> In addition to its membership in the Central American Common Market and the WTO, during the last decade Costa Rica has negotiated several free trade agreements. Costa Rica was the first Latin American country that negotiated a NAFTA-like agreement with Mexico in 1994. Other NAFTA-like FTAs have been negotiated with Chile, Dominican Republic, and most recently with Canada and Trinidad Tobago (currently under expansion to the rest of CARICOM). Further, Costa Rica is one of the only three countries in the Hemisphere that has continuously chaired a working group and a negotiating group since the launch of the FTAA process in 1995.



agencies. A successful implementation of a trade agreement requires each one of those agencies to fully understand and perform their respective responsibilities.

In the case of Costa Rica, the institutions that are more often involved in the application of international trade agreements are the following:

- Customs Service (which is under the aegis of the Ministry of Finance)
- Ministry of Economy, Industry, and Commerce (MEIC)
- Ministry of Agriculture (MAG)
- Costa Rica Foreign Trade Corporation (PROCOMER)
- Costa Rican Investment Board (CINDE)
- Ministry of Health
- General Auditor Office of the Republic (CGR)
- Ministry of Justice

## **2.2 Challenges preparing the negotiation**

As was mentioned in section 2.1.above, COMEX is the main agency responsible for negotiating and supervising the implementation of international trade agreements in Costa Rica. With less than 50 employees in the whole Ministry –including administrative support– COMEX is probably the less bureaucratic Ministry of the country and at the same time, among the most efficient. This factor has enabled COMEX to attract and build a capable team of professionals interested in being involved in international trade matters.

In COMEX, the professionals directly involved in the negotiation of international trade agreements, who comprise a team of approximately 25 people, fall within two broad categories. First, there is a small number of professionals, mostly economists and lawyers, who in addition to their first university degree have had the opportunity to obtain post-graduate education in major universities in the United States and Europe. These professionals are usually responsible for major trade policy issues, and are assisted by younger officials, who in most of the cases have recently graduated from university and consequently, have had lesser exposure to the practice of international trade law and policy. The latter are the main beneficiaries of the courses offered as part of international technical assistance programs. These professionals tend to attend courses, seminars, and workshops focused on basic concepts and features of international trade agreements. Senior officials participate less in technical assistance activities, the exception being seminars or symposia addressing current juncture issues of general interest being addressed in any of the international trade fora (such as e-commerce, biotechnology, etc).

In any case, the CAFTA negotiations will not be the first negotiation exercise for the team of professionals working at COMEX. Significant experience has been gained as most of negotiators have participated in multiple negotiation processes, among them, the negotiations of other free trade agreements with Mexico, Chile, Dominican Republic, and Canada. Within this context, the challenges for COMEX in preparing the negotiations do not lie in strengthening the capacities of its team of negotiators but rather elsewhere.

In the phase of preparation for negotiations, the main task COMEX needs to undertake is to foster and deepen a broad, open, and transparent dialogue with the Costa Rican civil society to discuss the benefits of negotiating CAFTA on an objective and well-informed basis. Costa Rica is one of the oldest democracies in the Western Hemisphere. Given the great importance of CAFTA for Costa Rica's development, it is paramount that such initiative be fully understood by the broadest segments of the national population in order to ensure not only its Congressional approval, but also to positively engage broad segments of the civil society in taking advantage of the opportunities that CAFTA will entail for them.

### **2.3 Challenges of implementation of international disciplines**

During the last decade, Costa Rica has undertaken a process of deep institutional modernization, and although significant accomplishments have been reached, the process has not yet been completed. Thus, a comprehensive National Action Plan should also take into consideration the need to continue with the process of modernization of diverse agencies in charge of implementing international trade rules and disciplines. To count with a world-class customs office ranks at the top of the priorities in this stage. However, there are also other areas where international cooperation could be useful. In particular, in the following areas:

- Sanitary and Phytosanitary Measures
- Technical Standards and Metrology
- Simplification of procedures
- Consumer rights protection
- Trade remedies
- Statistical data

### **2.4 Challenges for Transition to Free Trade**

### **2.4.1 Rural Development**

As in many developing countries, one of the main challenges Costa Rica faces in its process of economic development is to make the benefits of a more open and modern economy reach the rural population. Living conditions in rural areas have traditionally been closely linked with the state of agricultural activities, which tend to represent the main source of income to rural households. Living conditions in rural communities have also been traditionally affected by the level of reach of the State in providing basic services, such as potable water, electricity, telecommunications, healthcare and basic education to a population which is geographically dispersed, and consequently less organized. Within this context, living conditions in rural communities, especially those geographically remote from bigger urban centers have tended to be fall below national standards. Indeed, in Costa Rica, the incidence of poverty is higher on isolated rural areas, in particular in the North Pacific and South Pacific regions, as well as in the North part of the country, where the percentages of poor households reached extremely high levels<sup>3</sup>, well beyond the poverty levels in the metropolitan area and the national average.<sup>4</sup>

Thus, the success of the process of market-oriented reform in Costa Rica depends, to a great extent, in incorporating the rural communities to the wave of economic modernization of the rest of the country. To strengthen and diversify the sources of income of rural households, and to improve the basic infrastructure and access of technology in the rural area are two needs that require urgent attention in Costa Rica.

The primary sector (agriculture, forestry and fishing) is the third largest sector of Costa Rica's economy. In the year 2000, the sector generated approximately 10.6% of real GDP and accounted for approximately 18.1% of total exports and approximately 15% of domestic employment. These figures evidence the significant weight of the primary sector not only in Costa Rica's economy but also in the country's socio-economic structure and stability.

To a great extent, Costa Rica has been successful incorporating some agricultural segments into the international economy. In fact, during the last 11 years, Costa Rica has maintained a surplus trade balance with respect to agricultural products. Costa Rica's principal cash crops are bananas, coffee and sugar cane, the majority of which are grown for export. In addition, the country has been able to diversify its agricultural export supply, and non-traditional agricultural exports, such as pineapples, tuna, mangoes, ornamental plants among others, have expanded considerably during the last

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<sup>3</sup> 36.3%, 35.3% and 30.1% respectively. Source: Estado de la Nacion 2000.

<sup>4</sup> 15.8% and 21.1% respectively, Source: Estado de la Nacion, 2000.

decade. However, despite these positive results, a significant part of the agriculture in Costa Rica is facing difficult times.

The primary sector in Costa Rica is heterogeneous, and consequently, the critical situation currently affecting this segment of the economy cannot be explained by a single set of variables. The causes of the difficult current context vary along different sub-sectors. The difficult times through which the diverse kinds of agricultural activities are currently passing through have multiple dimensions. There is a social dimension, where the high levels of poverty among rural and agricultural households raise questions of equity and efficiency. There is an economic dimension, with serious problems of profitability. And there is an environmental dimension, where the pressure over some natural resources has overtaken the ability to properly administer them, entailing serious problems in use of soils, protection to hydro and forestry resources and management of industrial waste, among others.

There is a need to stimulate both farm and non-farm income growth in the rural economy. Broadening opportunity and fostering sustainable improvement in livelihoods (income) of the poor require diversification of agriculture and out of agriculture to reduce over-reliance on traditional crops, the prices of which are highly volatile and face increasing competition in both domestic and international markets. It is important to promote higher-value niche crops and value-added agricultural products. Recognizing that rural households, with scarce assets, strategically pursue diverse sources of income --including migration of family labor to urban jobs-- it is also important to keep agricultural investments within a broader rural enterprise approach that taps Costa Rica's potential for eco-tourism, aquaculture, certified timber and other forest products, artisan crafts and rural services.

To take advantage of farm and non-farm opportunities, rural farmers and entrepreneurs need market information, business development skills, quality assurance, reduced transactional constraints, and access to requisite assets. The menu of activities to pursue to foster rural development and poverty alleviation includes, *inter alia*, the following areas:

- Business development and market access services, e.g. assistance with entrepreneurial and technical skills, including those related to applications of science and technology such as biotech, market information, export promotion, quality and consistency of supply, e-commerce and other technological applications.
- Competitiveness activities, e.g. cluster development, competitiveness councils, and workforce development strategies.

- Innovative financial services, e.g. venture capital, small and micro-scale rural finance, savings mobilization, and remittances.
- Improvement of infrastructure, in particular the rural road network --including pragmatic solutions to ensure its sustainable maintenance—and increased access to basic information technology.
- Sustainable development programs, including assistance to foster the use of clean production techniques and technology, modern means to handle waste, management skills to foster a rational and sustainable use of available resources.
- Social programs, including initiatives aimed at poverty alleviation.
- Programs designed to promote gender equality in rural households and culture.

These types of competitiveness enhancing measures need to be packaged together around needs of a particular commodity or across a secondary-city corridor where both poverty and economic opportunity co-exist. Further any cooperation effort should be linked with governance or education activities, e.g. information networks or municipal development. Further, these activities need to complement existing or future cooperation initiatives aimed at improving off-farm infrastructure, market town development or community economic development.

#### **2.4.2 Improvement of Business Environment and Investment Climate (Systemic Competitiveness)**

Since the mid 1980s, Costa Rican economic policies have been oriented towards fostering an optimal insertion of the country into international markets. Despite representing the success story of a small economy being able to increase and diversify its exports and to attract significant FDI inflows, the process of efficiently inserting the Costa Rican economy into the world market is still an unfinished task. Costa Ricans will have to face key challenges to enable their economy to reach the competitiveness required to ensure in the long term better standards of living for all its inhabitants.

At the beginning of the 1980s, when the debt crisis evidenced the limitations of the import substitution industrialization (ISI) model, Costa Rica opted for an export-led development strategy, based on the increase and diversification of its export supply. As a result of this policy paradigm Costa Rica not only implemented a trade liberalization program –which to a great extent covered the manufacturing and agricultural sector, not so much the services sector— but also became more assertive in penetrating

international markets. The strategy aimed to diversify Costa Rica's export supply away from its traditional export commodities, i.e. coffee, bananas and beef. For that purpose, several programs including tariff and other fiscal concessions lured business towards non-traditional export activities such as manufacturing.

In terms of export growth and diversification, these policies succeeded. Indeed, during the 1990s, the Costa Rican export supply experienced a significant change in its structure, which has been mainly reflected in the considerable share manufacturing exports and trade in services have gained within total exports, gradually decreasing the dependence of Costa Rica's economy on traditional export commodities. The diversification in the Costa Rican export supply is owed in a significant part to the impressive growth of manufacturing exports. This growth is in turn owed in part to the production of foreign enterprises that have integrated their Costa Rican plants into a broader network of international production.

A new synergy between trade and investment has emerged as two complementing modes to service a particular market. Indeed, the bulk of FDI flowing into Costa Rica is originated in the United States, it is export-oriented –mainly to the U.S. market— and flows towards the manufacturing sector. In other words, the bulk of FDI flowing into Costa Rica is then U.S. efficiency-seeking FDI that has found in the internationalization of production the best strategy to service its own domestic market. U.S. enterprises have then articulated an international production system in which Costa Rica is gradually becoming integrated, thanks to the market-access concessions the latter has enjoyed under the U.S. Caribbean Basin Initiative. This phenomenon also explains the concentration of U.S. FDI in the manufacturing sector and the significant impact it is having in transforming Costa Rica's export supply, traditionally centered on export commodities, towards manufactures of increasing levels of technology.<sup>5</sup>

The experience of Costa Rica during the last decade clearly illustrates that the future development of the country passes through two main goals. First, to generate the optimal business climate to enable domestic and foreign enterprises to operate competitively in and from the country, leading them to increase exports and consequently to increase flows of domestic and foreign investment into the Costa Rican economy. Second, to generate increasing linkages between foreign investment and the domestic productive sector, enabling the latter to increasingly integrate with the international market.

In the current increasingly competitive and integrated international economy, systems, rather than isolated enterprises, are those competing against each other. Although the

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<sup>5</sup> During the last decade, Costa Rica has managed to attract some of the most important high tech and business companies in the world. That is the case of Intel, Abbott Laboratories, Procter & Gamble.



enterprise constitutes the cornerstone for innovation, the latter is closely integrated to a network that includes suppliers of goods and services as well as several systems that have a direct impact on the competitiveness of the business. Thus, the enterprise is increasingly vulnerable to the efficiency of systems such as the financial, educational, technological, energy, transport, telecommunications, among others. In Costa Rica, there is a need to ensure that these systems effectively support the competitiveness of enterprises located in the country .

Among the areas requiring immediate attention are the improvement of the country's physical infrastructure (roads, ports, airports, sewage systems, and other public works projects) and the qualitative improvement in the education of the Costa Rican labor force.

Costa Rica needs an effective and operating system capable of enabling increasing private investment in the reconstruction and expansion of the deteriorated and insufficient physical infrastructure of the country. Since the debt crisis at the beginning of the 1980s, due to fiscal constraints, the capacity of the government to pursue and finance public works decreased significantly. In a country where most physical infrastructure supporting the productive sector remains in the hands of the State<sup>6</sup>, the contraction in public investment meant almost a complete paralysis in infrastructure development for more than a decade. In Costa Rica, public works projects are urgently needed to improve the quality of life for citizens, to increase the competitiveness of the productive sectors and to facilitate the attraction of investment and new technology.

Given the tight budget constraints to finance public investment in the country, promotion of public work concessions has been identified as the means by which these urgent needs can be satisfied. Highways, railroads, seaport terminals, networks of sewer systems and other public works concession projects have been promoted. However, most of these projects remain stuck in the planning phase. More than four years after the Law of Public Works Concessions was passed amidst great enthusiasm and an ambitious list of projects drafted, not a single concession has been awarded at this date.

Some of the factors mentioned and associated with these disappointing results are the following: the inevitable learning curve of public officials and private sector with the new system; various deficiencies in the concessions law and the prevailing view among public officials and public opinion that concessions are seen as public contract and not a true partnership between the public and private sector. Last but not least, another cause that seems to be affecting the proper operation of the concessions law is the profit margin of some of the proposed projects, which may be unattractive. These apparent

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<sup>6</sup> By Costa Rican Law, seaports, airports, railroads, sewage, water distribution, telecommunications and energy are State monopolies.



causes should be taken into consideration and solved, once for all, to enable public concessions to flourish in Costa Rica. Thus, the identification of mechanisms to enable this system of adjudication of public contracts to operate efficiently ranks among the most urgent needs the country currently faces in the field of infrastructure development.

Another area where Costa Rica urgently needs to devote attention in order to promote further systemic competitiveness of its economy, is the field of massive education and strengthening the training of its current and future labor force. Despite having one of the highest literacy rates of the Western Hemisphere (95%) given its particular context Costa Rica must reassess its concept of literacy in order to include two urgently needed elements: English proficiency and computer literacy.

For Costa Rica to fully be able to integrate its economy into the international market, its population must undertake a qualitative leap in their education and be able to speak English and be able to manipulate at least the basic information technology skills. These two objectives have gradually become a basic requirement to accede into any kind of professional, technical or even some sophisticated manual jobs. Thus, to provide the majority of the population with this basic skills has become increasingly important, not only as a means to promote better opportunities for all the inhabitants of the country, but also to ensure the competitiveness of the Costa Rican economy as a whole.

### **2.4.3 Maximization of benefits for small and medium enterprises (SMEs)**

Among the 4.842 enterprises that comprise the formal industrial sector in Costa Rica, 95% are small and medium enterprises (SMEs)<sup>7</sup> with less than 100 employees.<sup>8</sup>

<sup>7</sup> Any discussion involving the reality of small and medium enterprises (SMEs) must start by clarifying the parameters used to consider a particular business as part of this business category. The criteria used for this purpose vary significantly, not only between countries, but also among different institutions in the same country. The chart below illustrates that different definitions used by diverse institutions in Costa Rica. One criticism against the use of this criteria has been that the definition of SMEs must be more dynamic and not be restricted to the number of employees or volume of sales, specially in the context of a dynamic and open economy, where exports can fluctuate and where the criteria used by other countries should also be taken into consideration.

PRONAPYME	CABEI	CRIC	CCSS
Micro enterprise 1-9 employees	Micro enterprise 1-5 employees	Micro enterprise 1-5 employees	Range-based classification
Small enterprise 10-20 employees	Small enterprise 6-40 employees	Small enterprise 6-20 employees	1-4 employees 5-9 employees 10-19 employees 20-99 employees
		Medium enterprise 21-100 employees	

PRONAPYME: Programa nacional para la pequeña y mediana empresa, Program for SMEs.

According to some recent studies,<sup>9</sup> these SMEs –that is, enterprises with less than one 100 employees— represent 28% of the Costa Rican GDP, 90% of the total manufacturing enterprises and generate 50% of the salaries and 80% of the jobs in the manufacturing sector. The national institute of statistics indicates that the workers hired by SMEs *with less* than 20 employees represent 26% out of the country's total employees. Further, it also indicates that private enterprises *with less* than 20 employees provide 51% of the total jobs in the private sector.<sup>10</sup>

The importance of SMEs in the Costa Rican domestic economy contrasts with their relative weight the external sector. The majority of SMEs in Costa Rica are geared towards the domestic market, and those SMEs that in fact export, only represent a modest share of total exports from Costa Rica. Indeed, despite comprising 62% of the total number of exporting enterprises in the country, in 1999 participation of SMEs in the country's total exports represented only 13% of the total value of Costa Rican exports. Further, most exports of these SMEs tend to be concentrated in agriculture and final consumption manufacturing products (mostly foodstuffs).<sup>11</sup> Furthermore, in most cases, SMEs target markets are located in other Latin American countries, and in particular in Central America and the Caribbean, rather than in the United States, Europe or Asia. Within this context, there is a need to implement effective mechanisms to internationalize Costa Rican SMEs, attempting to enable these enterprises to participate from the benefits of free trade and to compete in international markets. A strategy aimed at promoting this objective should contemplate aspects such as the following:

- Negotiation of trade and cooperation agreements aimed at fostering the establishment of new SMEs and horizontal links among diverse enterprises.
- Promotion of SMEs as suppliers of bigger multinational exporting enterprises, fostering an integration of the productive sector as a whole.

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CABEI: Central American Bank of Economic Integration

CRIC: Costa Rican Industrial Chamber

CCSS: Caja Costarricense del Seguro Social, Social Healthcare Institute

Thus, Broadly speaking, in Costa Rica a micro enterprise tends to comprise less than 15 employees, a small enterprise tends to comprise around 50 employees and a medium enterprise less than 1000 employees

<sup>8</sup> Source: Caja Costarricense del Seguro Social (CCSS)

<sup>9</sup> Source: Fundacion para el Desarrollo Sostenible (FUNDES)

<sup>10</sup> Source: Instituto Nacional de Estadística y Censo (INEC)

<sup>11</sup> Source: PROCOMER.

- Strengthening of trade promotion services, including basic training, professional update activities, establishment of trade promotion offices, participation in trade missions and fairs, access to data bases and other support activities.
- Generation of business development programs, e.g. assistance with entrepreneurial and technical skills, including those related to applications of science and technology such as biotech, market information, export promotion, quality and consistency of supply, e-commerce and other technological applications.
- Promotion and execution of programs specifically aimed at fostering the incorporation and use of information technology by SMEs.
- Development of competitiveness activities, e.g. cluster development, competitiveness councils, and workforce development strategies.
- Generation of new and innovative financial services, e.g. venture capital and small and micro-scale finance
- Promotion and execution of sustainable development programs, including assistance to foster the use of clean production techniques and technology and modern means to handle industrial waste.
- Promotion and execution of programs designed to incorporate the feminine sector into entrepreneurial activities, in particular the establishment of SMEs.

#### **2.4.4 Science and Technology as a tool for promoting a new dynamic entrepreneurial sector**

The promotion of the entrepreneurial spirit, the development of new enterprises based on creativity and innovation and the incorporation of information technology in the diverse faces of governmental activity is fundamental for the present and future development of Costa Rica.

In some corners of Costa Rica there are small groups of professionals making a great effort to contribute to a process of attitude change for Costa Rica to take advantage of the opportunities provided by the current globalization process, the information technology era and the development of knowledge-intensive products and services. Efforts have also been made –with some success— to attract new foreign direct investments, specially in the high tech manufacturing sector, and to promote linkages between the latter and the rest of the Costa Rican economy. Further, there have been

attempts to introduce the public administration to the information technology era, opening a wide range of possibilities to interact with civil society as well as enabling the development of a series of new services to provide to most citizens.

For many reasons, efforts to promote knowledge-based enterprises constitute the best model for wealth creation. Recently a study was performed to identify the key factors that have an incidence in the birth and development of new enterprises in Latin America and Asia.<sup>12</sup> The study also analyzed the profile of the new entrants to the entrepreneurial sector. The study showed that the new generation of young entrepreneurs usually are well-educated, come from middle class sectors and establish their first business when they are 30 years old. The average age of the enterprises surveyed were 6 years old and 70 percent are located in metropolitan areas. Most importantly, the survey showed that one of every three new enterprises is based in knowledge-intensive activities, and quickly become small and medium enterprises (SMEs). The study also evidenced that among the key factors that enabled these new business to emerge were the following:

- acquisition of technical knowledge in a university
- previous professional experience
- availability of specialized equipment
- identification and penetration of a specialized niche market for the product or service produced.

The universities can play a key role in the promotion of innovation and technological development. These institutions can be instrumental in assisting governments in generating a new, young entrepreneurial sector able to use information technology and other knowledge-intensive activities to insert themselves in an increasingly competitive and integrated economy. For this important objectives to be attained, a joint efforts between diverse governmental agencies, universities and financing institutions should be developed in order to promote, *inter alia*, the following objectives:

- a positive attitude towards life and work
- a scientific approach to production
- a new way to understand financing of emerging enterprises
- a new culture of networking to develop a social process
- a new culture of regional development based on promotion of production clusters

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<sup>12</sup> The study was conducted by a team of researchers of Argentina, Brazil, Costa Rica, Peru, Mexico, Japan, Korea, Taiwan and Singapore. The study included the circulation of a survey which focused on the different stages of the launch of a new enterprise, as well as on the key factors considered key for the sample interviewed. The survey was conducted in the eight countries mentioned above and involved more than 1200 new entrepreneurs.

- a modernization of the public administration, fostering e-government initiatives aimed at generating synergies with the initiatives in the private sector.

In particular, activities the implementation of which could explored to foster the diffusion an use of science and technology as a tool for promoting a new entrepreneurial sector could be the following:

- Generation of new and innovative financial services, e.g. venture capital and small and micro-scale finance specifically geared to the needs of emerging high tech and knowledge intensive businesses.
- Promotion of specific cooperation programs among universities.
- Development of professional internship programs with the private sector, aimed at allowing young entrepreneurs to learn, through hands on experience, best international management practices.
- Generation or expansion of scholarship funds.
- Promotion of student and professor exchange programs.
- Promotion and execution of programs aiming at fostering a higher participation of women in science and technology based-business.

## **PART 3. PRELIMINARY IDENTIFICATION OF PRIORITIES**

### **3.1 Trade Negotiation Preparation and Participation**

#### **3.1.1 Horizontal Needs**

<b>Capacity Building Issue</b>
Promotion of a better understanding and dialogue on the benefits of free trade and CAFTA in the Costa Rican civil society

### 3.2 Trade Agreement Implementation

#### 3.2.1 Rules of Origin and Customs Procedures

<b>Capacity Building Issue</b>
Institutional strengthening: creation of a specialized department of implementation of trade agreements within the customs administration
Update of information systems
Incentives to promote further mobilization of personnel to frontier posts
Training in specialized areas such as origin, intellectual property, and antidumping and countervailing duties
Risk management controls and automated methods of selection
Scientifically based methodologies to conduct physical and documentary inspections

#### 3.2.2 Sanitary and Phyto-Sanitary Measures (SPS)

<b>Capacity Building Issue</b>
Benchmarking studies of specific dependencies of the MAG in charge of establishing and administering SPS standards in the following areas: - food safety - animal life and health - plant life and health
Identification of specific weaknesses of each department and proposal of an action plan
Control, inspection, and approval procedures according to the rules and disciplines of the SPS Agreement of the WTO
Capacity building to enhance enforcement skills
Improvement of SPS-related infrastructure in border posts, including upgrading of technical equipment for adequate standard compliance and verification
Improvement of information technology infrastructure, including specialized databases
Provision of information resources, including market data and requirements to access the U.S. market

### 3.2.3 Standards: Technical Barriers to Trade (TBT)

<b>Capacity Building Issue</b>
Benchmarking studies of specific dependencies of the MEIC in the fields of: <ul style="list-style-type: none"> <li>- Normalization</li> <li>- Technical standards</li> <li>- Metrology</li> </ul>
Identification of specific weaknesses of each department and proposal of an action plan
Highly specialized capacity building to enhance enforcement skills
Improvement of information technology infrastructure, including specialized databases
Guidance to regulators and standard bodies to prevent creation of unnecessary trade barriers
Strengthening of information resources available to the public to promote further transparency in this specific matter
Institutional strengthening in the area of simplification of procedures
Capacity building for health authorities in charge of implementing related regulations
Provision of information resources, including market data and requirements to access the U.S. market

### 3.2.4 Subsidies, Antidumping and Countervailing Measures

<b>Capacity Building Issue</b>
Modernization of the Unfair Trade Practices Office at the MEIC
Improvement of statistical information available
Institutional capacity building: specialized investigative and enforcement skills development to strengthen personnel capacities
Upgrading of information technology capacities, including modernization of technical equipment



### 3.2.5 Competition Policy and Consumer Protection

<b>Capacity Building Issue</b>
Benchmarking studies of Commission for Protection of Competition and Commission for Protection of Consumers
Assistance to newly established consumer associations
Identification of specific weaknesses and proposal of actions plans
Capacity building to enhance enforcement skills
Improvement of information technology infrastructure, including specialized databases
Promotion of dissemination initiatives to contribute to the generation of a gradual culture that recognizes the value and respect for competition policy rules and disciplines

### 3.2.6 Intellectual Property

<b>Capacity Building Issue</b>
Strengthening capacity building on the rules and disciplines of trade-related intellectual property rights agreements to different sectors of the administration and judiciary, including police forces and customs officers
Application of Information Technology (hardware and software) to IP administration (including automation and internet connectivity)
IPR Statistics, databases and/or Technical information and literature

### 3.2.7 Others

<b>Capacity Building Issue</b>
Improvement of statistical information systems in government procurement, including the development of a common classification system or statistics

Improvement of services statistics, databases and/or technical information, and analysis of the relevance and applicability of international standards in various services sectors, including telecommunications
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### 3.2.8 Horizontal areas

Capacity Building Issue
Improvement of internal procedures to adequately administer trade agreement compliance
Development of information databases for statistical monitoring and measuring of the impact of trade agreements
Strengthening of inter-agency coordination for adequate implementation of trade agreements

### 3.3 Transition to Free Trade

#### 3.3.1 Poverty and Rural Development

Capacity Building Issue
Business development and market access services, e.g. assistance with entrepreneurial and technical skills, including those related to applications of science and technology such as biotech, market information, export promotion, quality and consistency of supply, e-commerce, and other technological applications
Development of innovative financial services, e.g. venture capital, small and micro-scale rural finance, savings mobilization, and remittances
Fostering of educational activities
Development of competitive enhancement programs, specifically aimed the rural agricultural and non-agricultural sector
Development of programs to foster the development of linkages between foreign investment and local business
Strengthening inter-agency coordination for an adequate implementation of support programs aimed at fostering rural development

Realization of competitiveness activities such as cluster development, competitiveness councils, and workforce development strategies
Improvement of infrastructure, in particular the rural road network – including pragmatic solutions to ensure its sustainable maintenance— and increased access to basic information technology
Development of sustainable development programs, including assistance to foster the use of clean production techniques and technology, modern means to handle waste, and management skills to foster a rational and sustainable use of available resources
Development of social programs, including initiatives aimed at poverty alleviation
Development of programs designed to promote gender equality in rural households and culture

### 3.3.2 Improvement of Business Environment and Investment Climate: Promoting Systemic Competitiveness

Capacity Building Issue
Elaboration of an Action Plan to take advantage of CAFTA to position Costa Rica in the international investor community
Cluster development and strengthening
Improvement of infrastructure: <ul style="list-style-type: none"> <li>- Identification of necessary regulatory changes to improve public works concession laws</li> <li>- Development of a program aimed at attracting FDI in the public works sector</li> <li>- Identification of possible sources of capital to expand infrastructure projects</li> </ul>
Improvement of physical infrastructure
Qualitative improvement in the education of the Costa Rican labor force, specially in the fields of English proficiency and computer literacy
Identification of mechanisms to enable the system of adjudication of public contracts to operate efficiently

### 3.3.3 Maximization of Benefits for Small and Medium Enterprises (SMEs)

<b>Capacity Building Issue</b>
Implementation of effective mechanisms to enable Costa Rican SMEs' competitive participation in international markets
Strengthening SME participation in export capacity building programs
Strengthening of trade promotion services, including basic training, professional update activities, establishment of trade promotion offices, participation in trade missions and fairs, access to data bases and other support activities
Negotiation of trade and cooperation agreements aimed at fostering the establishment of new SMEs and horizontal links among diverse enterprises
Improvement of information systems and access to information resources in order to analyze external markets
Promotion and execution of programs specifically aimed at fostering the incorporation and use of information technology by SMEs
Improvement of linkages between foreign investors and local business, including promotion of SMEs as suppliers of bigger multinational exporting enterprises, fostering an integration of the productive sector as a whole
Specialized skills' enhancement in areas such as high tech and control of the English language
Improvement of technical capacity to match labor offer and demand through specialized databases
Generation of business development programs, e.g. assistance with entrepreneurial and technical skills, including those related to applications of science and technology such as biotech, market information, export promotion, quality and consistency of supply, e-commerce and other technological applications
Development of competitiveness activities, e.g. cluster development, competitiveness councils, and workforce development strategies
Generation of new and innovative financial services, e.g. venture capital and small and micro-scale finance

Promotion and execution of sustainable development programs, including assistance to foster the use of clean production techniques and technology and modern means to handle industrial waste
Promotion and execution of programs designed to incorporate the feminine sector into entrepreneurial activities, in particular the establishment of SMEs

### 3.3.4 Science and Technology as a tool for promoting a new dynamic entrepreneurial sector

Capacity Building Issue
Programs to upgrade electronic telecommunications infrastructure
Programs to promote universal access to Internet
Strengthening of e-government programs and digitalization of governmental agencies and services
Legal framework improvements
Development of joint programs between government agencies, universities, and financing institutions to foster the establishment of SMEs on knowledge-intensive and high-tech activities
Generation of new and innovative financial services, e.g. venture capital and small and micro-scale finance specifically geared to the needs of emerging high tech and knowledge intensive businesses
Development of professional internship programs with the private sector, aimed at allowing young entrepreneurs to learn, through hands on experience, best international management practices
Generation or expansion of scholarship funds
Promotion of student and professor exchange programs
Promotion and execution of programs aiming at fostering a higher participation of women in science and technology based-business

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## PART 4. CONCLUSION: NATIONAL STRATEGY FOR COOPERATION

There is no doubt that the negotiations of CAFTA will represent a watershed in Costa Rica's development process. The conclusion of this agreement will entail the culmination of a trade policy reform process that for almost twenty years has been fostering an optimal insertion of Costa Rica to the international economy. Bearing this consideration in mind, this document has purported to present a general overview of the Costa Rican context in which the CAFTA negotiations will take place, and use that information to explain the main challenges the country will need to face as a result of integrating with its main trade and investment partner –which also happens to be the bigger economy in the world. This concluding section summarizes the international cooperation strategy the government of Costa Rica proposes in the context of the CAFTA negotiations. Although this conceptual approach will be subject of further consultation with different segments of the Costa Rican civil society, in principle, the priorities of the National Action Plan in each stage of the CAFTA process would attempt to address the following aspects.

In the **first stage**, i.e. **preparation for negotiations**, the main priority of the Costa Rican government resides in promoting and deepening a broad and transparent dialogue with its **national civil society on the benefits of free trade in general and CAFTA in particular**.

In the **second stage**, i.e. **implementation of trade rules and disciplines**, the main challenge Costa Rica will need to address is the effective **institutional strengthening of some key agencies in charge of applying trade agreements at the borders**. In particular, Costa Rica's priority is to have a **world class customs office**, efficient, transparent and capable to respond to the needs posed by an expanding economy based on increasing flows of trade and export-oriented investment. To complement this effort, agencies in charge of applying **SPS** and **TBT** measures should also be strengthened. For this purpose, specific benchmarking studies comparing the performance of these agencies with their similar in other countries such as Chile, Canada, the United States and Mexico could be particularly useful to have a clear identification of the specific areas for improvement. Such benchmarking assessments would be used as a basis for a scheduled action plan to tackle the identified weaknesses.

The third stage, **transition to free trade, is the phase to which the Costa Rican government provides the greatest emphasis**. The need to enable all segments of the Costa Rican society to fully rip the benefits of the future CAFTA ranks at the top of the objectives list of Costa Rica in the Integral Cooperation Agenda. To reach that goal, **four broad areas** for action have been identified, i.e. rural development, improvement of the business environment and investment climate, maximization of benefits for small and medium enterprises (SMEs), and

science and technology as a tool for promoting a new dynamic entrepreneurial sector.

In the first area of action, i.e. **rural development**, the main priority of the government is to device specific, coherent and realistic set of projects aiming at bringing further farm and non-farm opportunities to the inhabitants of the Costa Rican rural areas. Market information, business development skills, quality assurance, innovative financial schemes, environmentally-friendly production techniques, better access to technology and reduced transactional constraints are some of the concrete objectives for which Costa Rica must strive for –and international cooperation would be welcomed— to foster development in its rural areas. These types of competitiveness enhancing measures need to be packaged together around needs of a particular commodity or across a secondary-city corridor where both poverty and economic opportunity co-exist. Further any cooperation effort should be linked with governance or education activities, e.g. information networks or municipal development. Further, these activities need to complement existing or future cooperation initiatives aimed at improving off-farm infrastructure, market town development or community economic development.

In the second area of action, i.e., **improvement of business environment and investment climate**, Among the areas requiring immediate attention are the improvement of the **country's physical infrastructure** and the **qualitative improvement in the education** of the Costa Rican labor force. Education is one of the main priorities of Costa Rica in this area. Despite having one of the highest literacy rates of the Western Hemisphere (95%) given its particular context Costa Rica must reassess its concept of literacy in order to include two urgently needed elements: English proficiency and computer literacy. For Costa Rica to fully be able to integrate its economy into the international market, its population must undertake a qualitative leap in their education and be able to speak English and be able to manipulate at least the basic information technology skills.

**Maximization of benefits for small and medium enterprises (SMEs)** is the third area of action for the phase of transition to free trade. The importance of SMEs in the Costa Rican domestic economy contrasts with their relative weight the external sector. The majority of SMEs in Costa Rica are geared towards the domestic market, and those SMEs that in fact export, only represent a modest share of total exports from Costa Rica. Thus, there is a need to implement effective mechanisms to internationalize Costa Rican SMEs, attempting to enable these enterprises to fully participate from the benefits of free trade and to compete in international markets. A strategy aimed at promoting this objective should contemplate numerous elements such as : generation of new and innovative financial services, e.g. venture capital and small and micro-scale finance, assistance with entrepreneurial and technical skills, including those related to applications of science and technology such as biotech, environmentally friendly production



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techniques, market information, export promotion, quality and consistency of supply, e-commerce and other technological applications.

Last but not least, the fourth priority action area is the use of **science and technology as a tool for promoting a new dynamic entrepreneurial sector**. The promotion of the entrepreneurial spirit, the development of new enterprises based on creativity and innovation and the incorporation of information technology in the diverse faces of governmental activity is fundamental for the present and future development of Costa Rica. Thus, a strategy aimed at promoting this objective should be implemented in the near future. Such strategy should contemplate, *inter alia*, the following elements: Generation of new and innovative financial services, e.g. venture capital and small and micro-scale finance specifically geared to the needs of emerging high tech and knowledge intensive businesses, promotion of specific cooperation programs among universities, professional internship programs with the private sector, aimed at allowing young entrepreneurs to learn, through hands on experience, best international management practices, expansion of scholarship funds, promotion of student and professor exchange programs and promotion and execution of programs aiming at fostering a higher participation of women in science and technology based-business.