

Trade Policy Review Body

TRADE POLICY REVIEW

COSTA RICA

Report by the Government

Pursuant to the Agreement Establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), the policy statement submitted by the Government of Costa Rica is attached.

Note: This report is subject to restricted circulation and press embargo until the end of the meeting of the Trade Policy Review Body on Costa Rica.

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I. INTRODUCTION

1. Since the previous Trade Policy Review, Costa Rica has continued to step up its process of trade opening and integration, above all because the national economy is not large enough to provide the growth opportunities that the country needs. Therefore, a trade policy has been followed on a sustained basis over these years designed to achieve the fullest integration of Costa Rica into the global economy.

2. The success of the policies followed can be seen essentially in the growth of exports, the diversification of products and markets, the increase in foreign direct investment and the generation of employment by the export sector.

3. To continue with this model, the country ascribes the greatest importance to the trade agenda for the coming years, high on which is an active and constructive role in the bilateral, regional and multilateral negotiations in which Costa Rica is engaged.

II. ECONOMIC AND TRADE POLICY ENVIRONMENT

4. In the second half of the 1990s, Costa Rica made a significant shift in its development strategy by devising a policy for attracting foreign investment that was more aggressive and geared towards high-technology industry.

5. As a result of these endeavours, 1998 saw the start of substantial inflows of foreign direct investment (FDI) into the country, amounting to 4.2 per cent of gross domestic product (GDP) in 1999 (US\$620 million). The establishment of enterprises with foreign capital on the national territory brought greater dynamism both to the domestic market and to the export sector by creating new sources of employment and processes of technology transfer, and generating an appreciable amount of foreign exchange. Thanks to the combination of both elements, Costa Rica has been able over the past six years to record average growth of 4.7 per cent, including rates above 8 per cent for two consecutive years (1998 and 1999) and FDI has financed a large part of the balance-of-payments current account deficit.

6. From 1995 to 2000, the external sector, another mainstay of Costa Rica's economic growth, expanded by an average of more than 13 per cent, four percentage points above the average growth of imports. The consolidation of the process of opening in the second half of the past decade, the removal of barriers to foreign trade and the forging of closer ties with major trading partners are factors that have helped to account for the pivotal role played by the external sector in Costa Rica. This greater opening up of the economy is more evident in terms of national production, for whilst in 1990 the goods and services trade represented 70.8 per cent of GDP, at the close of the decade the figure was 96.6 per cent.

7. Goods exports rose by an average of 13.4 per cent during the last five years of the 1990s, driven chiefly by the manufacturing industry (21.7 per cent on average), which now accounts for just over three quarters of the country's total exports. Most industrial exports come from the electronics, textile and drugs industries. In the agricultural sector for its part – the hardest hit by international market price fluctuations – bananas and coffee continue to be the leaders, whilst pineapples, melons and plants and shrubs are steadily gaining in importance.

8. Foreign trade in services also expanded over the past six years, albeit to a lesser extent than that in goods, from 15.6 per cent of GDP in 1995 to 19.1 per cent in 2000. In this connection, tourism generated appreciable revenue that enabled the country to post successive surpluses in the balance of payments services account over the past six years. This sector accounts for almost 62 per cent of

domestic output and is concentrated mainly in the spheres of trade, real estate, business and rentals, as well as in transport and storage, education, hotels and restaurants, construction and the health sector.

9. Yet despite the satisfactory results of the policies to attract investment and to integrate Costa Rica's economy into the international market, public finances continue to show a major imbalance. In terms of revenue, the enactment of the Code of Tax Standards and Procedures (*Código de Normas and Procedimientos Tributarios*), the expiry of the Tax Credit Certificates (*Certificados de Abonos Tributario*) and efforts to improve tax collection started to yield encouraging results in late 2000. These policies have been matched by a process of financial engineering whereby domestic debt was replaced with external debt so as to alleviate domestic interest payments. The public sector deficit for the 1995-2000 period has remained close to 3 per cent of GDP, whilst domestic debt absorbed a third of the country's output this past year.

10. Yet the state of public finances has not frustrated the effectiveness of endeavours to maintain stability. After a 22.6 per cent annual rise in consumer prices for 1995, inflation could be brought down to 10.3 per cent in 2000.

III. TRADE POLICY DEVELOPMENTS 1995-2001

11. The overarching objective of Costa Rica's trade policy is to promote, facilitate and consolidate the country's integration into the international economy. To that end, a package of core strategies was implemented between 1995 and 2001 to guide and lend consistency to the national policy in the quest for a larger presence on world markets.

12. They consisted of effecting the internal changes needed to develop a more efficient economy that fosters the growth of foreign trade; improving and ensuring access for Costa Rican products to foreign markets; safeguarding Costa Rica's commercial interests against protectionism by other countries; laying down rules and procedures for suitably managing trade relations; broadly linking all sectors in the country with export activity; promoting Costa Rica's exportable supply abroad and creating the conditions necessary to attract national and foreign investment.

13. In pursuit of these goals, the Government of Costa Rica is applying in tandem a package of instruments that include participation in the multilateral system, furthering regional integration, negotiating trade and investment agreements and revitalising the process of opening up the economy.

(i) Multilateral System

- Initiatives to strengthen the multilateral system

14. Costa Rica has always believed in the Multilateral Trading System and has supported all moves to buttress that system since the inception of the WTO. A strong multilateral system with clear and transparent rules is of enormous benefit to a small, international trade-dependent economy such as that of Costa Rica.

15. Costa Rica viewed the Singapore Ministerial Conference as a great opportunity to supplement multilateral trade rules with rules on investment and has accordingly worked towards the creation of a working group to study this topic. Costa Rica is still convinced that the lack of a framework for investments within the WTO is a crucial shortcoming of the multilateral trading system and hopes that negotiations can be launched on the matter in the near future. At the same Singapore Ministerial Conference, our country considered it indispensable to draw up trade facilitation rules and therefore enthusiastically supported the creation of this work programme under the responsibility of the Council on Goods.

16. In January 1997, Costa Rica became the first Latin American country to adopt liberalisation commitments under the Agreement on Information Technology Products (ITA). These commitments are consistent with the country's policy for the development of the information technology industry over the past ten years. Costa Rica's aim is to broaden the reach of this Agreement to encompass other products and to step up its liberalisation in the WTO framework, and we therefore hope that the signatories of the ITA will reach an agreement in this regard.

17. The Second WTO Ministerial Conference held in Geneva afforded all WTO Members an opportunity to initiate a work programme on electronic commerce and to commit themselves to maintaining the current practice of charging no customs duties on electronic transmissions. Costa Rica enthusiastically supported this initiative as an opportunity to make the benefits deriving from this type of trade affordable for the bulk of the population and as a means by which new enterprises may thrive and grow and make a greater contribution in terms of added value and skilled human resources.

18. The country also welcomed the start of agricultural negotiations in the WTO, as envisaged in the Agreement on Agriculture. The nation's objective in these negotiations is the elimination and total abolition of agricultural export subsidies, which constitute the most unfair and trade-distorting mechanism in international trade. Similarly, Costa Rica maintains that all forms of domestic aids that distort international agricultural trade should be eliminated. As a Member of the Cairns Group, Costa Rica has co-sponsored negotiation proposals in four areas: export competition, domestic aid, market access and export restrictions and duties. The working agenda must strive to make farm produce subject to the same rules and conditions as those applied to industrial goods. The aim is to eliminate this unfair discrimination that mainly affects exports from developing countries.

19. Costa Rica also welcomes the start of negotiations on services and recognizes the significance of this process. It is highly important to complete the elaboration of the GATS rules, in particular those pertaining to subsidies and safeguards. As regards bringing more services under the commitments on market access and national treatment, this must be done on the basis of graduation and taking into account the development policies of Members. The negotiations on services must lead to the elimination of the bulk of the exceptions to most-favoured-nation treatment, especially all those based on reciprocity, as not only do they run counter to the goal of multilateralism, which is to enable all countries to benefit from the liberalization of markets, but they also constitute a disincentive to participation in the multilateral trading system.

- **Trade disputes**

20. Through its own experience Costa Rica has confirmed that the dispute settlement mechanism can be a useful vehicle for upholding the law and making trade relations secure and predictable.

21. In 1996 Costa Rica became the first WTO Member to request that a panel be set up to review measures it considered to be in breach of the Agreement on Textiles and Clothing (ATC). The imposition under Article 6 of the ATC of safeguards by the United States on exports of cotton underwear from Costa Rica could not be resolved in the Textiles Surveillance Body, which led Costa Rica to turn to the dispute settlement system. In November 1996 the Panel concluded that the quotas imposed by the United States were in violation of its ATC obligations. In 1997 the Appellate Body also found in favour of Costa Rica by concluding that the restrictive measure could not be applied retroactively. At the time, the textiles sector was the leading export industry, having been overtaken since then only by information technology exports.

22. On that occasion the dispute settlement system demonstrated it could be the best guarantee for safeguarding the interests of a small developing country. This is why Costa Rica believes that the

rules and procedures governing this system must be clear, fair and equitable and free of loopholes or contradictions. This is why Costa Rica, together with a group of countries, has co-sponsored a proposal for the revision of some provisions of the Dispute Settlement Understanding regarding the determination of compliance with the recommendations of the Dispute Settlement Body. Costa Rica's longer-term objective is to ensure that attention is also paid to the concerns that have often been voiced over the rights of third parties in these procedures.

23. Furthermore, since 1995 to date, the EU regime for the importation, sale and distribution of bananas has been in force on the basis of Regulation 404-93. The first amendments to this system came with the signing of the Banana Framework Agreement between the EU and Costa Rica, the second largest supplier of that market, and three other Latin American countries, namely Colombia, Nicaragua and Venezuela. In September 1997, the Dispute Settlement Body adopted the report of the Panel and of the Appellate Body condemning various elements of this regime. Costa Rica took part in that dispute settlement process as an interested third party. Its Government has recognized the outcome of the report adopted in the WTO and has urged the EU to comply with its conclusions and recommendations. During the ensuing three years, no agreement could be reached between the EU and its concerned trading partners as to how the EU regime should be modified. In December 2001 the EU Council of Ministers approved a European Commission proposal on a new regime. Costa Rica has signalled its rejection of that alternative.

- **Compliance with commitments**

24. Costa Rica's observance of WTO rules and disciplines is demonstrated by our country's effective compliance with its assumed commitments. Over the past two years, our country has notified a range of measures aligning our trade policy and laws with the agreed rules. First, Costa Rica notified the dismantling of its measures that were inconsistent with the TRIMs Agreement, ahead of the expiry of the time-frame. The WTO was subsequently notified of the entry into force of the Customs Valuation Agreement. Around the end of last year, changes to the intellectual property law were notified, bringing the national legal system into line with the TRIPS Agreement.

(ii) **Regional fora**

- **Free Trade Area of the Americas**

25. Costa Rica has played an active and constructive role in the FTAA process since the launch of the initiative in December 1994. It has done so not only through its work throughout the process and its regular contribution of ideas in the negotiating groups, but also through its role in holding several important posts.

26. Between May 1997 and 1998, Costa Rica chaired the FTAA process and played host to the Fourth Ministerial Summit in San José. As an outcome of that meeting, the ministers recommended to the Heads of State and of Government that the FTAA negotiations should start at the II Summit of the Americas and agreed on the objectives, principles and structure of the process. In addition, the country has chaired the Working Group on Investment, as well as the Negotiating Groups on Investment and Dispute Settlement.

27. Each negotiating group has now prepared a draft chapter to be submitted to the ministers at the next ministerial meeting scheduled for Argentina in April next. At that meeting, Costa Rica will advocate the adoption of clear guidelines for expediting the negotiations.

- **Central America**

28. In 1998, the countries in the region adopted a “Ministerial Plan of Immediate Action” setting forth the core elements, principles and actions on which trade integration endeavours amongst the Central American countries will be focusing. This plan has made for concrete progress in two specific areas.

29. The first pertains to the work done to improve the disciplines regulating intra-Central American trade. Salient in this field are the negotiation and entry into force of rules on technical standards and sanitary measures and the start of negotiations on a Central American Treaty on Trade in Services and Investment. Moreover, Costa Rica has been advocating the signing of a Central American Treaty on Trade Dispute Settlement that would make for the expeditious and effective settlement of trade disputes arising amongst the countries.

30. The second major area in this sphere consists of the efforts made in trade facilitation and the removal of trade barriers, notably steps taken by the Ministry with a view to eliminating a series of unnecessary measures that were hampering trade in the region.

(iii) Negotiation of trade and investment agreements

• **The Free Trade Agreement between Costa Rica and Mexico (FTA)**

31. The Free Trade Agreement between Costa Rica and Mexico took effect on 1 January 1995, becoming the first instrument of its kind to be signed between two developing countries in Latin America. The negotiations to revitalise the Free Trade Agreement and improve market access conditions were concluded in 1999.

32. During this time, the FTA has had a positive impact by reducing and even beginning to reverse in Costa Rica’s favour the limitations that have typified the historical pattern of trade flows between Central American countries and Mexico over the past three decades.

33. Trade has been extremely buoyant, especially Costa Rican exports to Mexico, which have increased three times as fast as imports. As for foreign direct investment, there has been a substantial increase in Mexican investment in Costa Rica over the time the FTA has been in force, making Mexico the second major source of FDI in Costa Rica.

34. In addition, the FTA has had a significant impact in terms of improving the regulatory framework of Costa Rica’s trade and has furthermore represented an invaluable vehicle for enhancing Costa Rica’s external position.

- **Other free trade agreements**

35. In recent years, Costa Rica has participated in various negotiations for the signing of free trade agreements with countries in the hemisphere. The objectives of those negotiations have been to ameliorate the conditions of access for Costa Rican products to certain markets, to offer greater security for the entry of Costa Rican products in the region, to enhance the competitiveness of the nation’s production sector, to promote, protect and increase investments in Costa Rica, to prepare the country for the FTAA process and to offer wider choices to the country’s consumers.

36. In this connection, negotiations between Central America and the Dominican Republic for the signing of a free trade agreement were completed in November 1998. By means of Law No. 7882 of

9 June 1999, Costa Rica's Legislative Assembly approved this trade agreement, which has not yet entered into force as approval by the Congress of the Dominican Republic is still pending.

37. Similarly, in November 1999 the countries of Central America and Chile signed a free trade agreement, thus culminating a process started in August 1998. In February 2001 Law No. 8055 "Law Approving the Free Trade Agreement between Central America and Chile" (*Ley de Aprobación del Tratado de Libre Comercio entre Centroamérica y Chile*) was promulgated, with which Costa Rica completed the requisite legal procedures for the adoption of the treaty. The treaty is currently awaiting the completion of the relevant procedures by the Chilean Government in order to come into force.

38. Both new-generation trade agreements prescribe rules and disciplines applicable not only to trade in goods, but also to other areas such as trade in services, investment and government procurement.

39. Costa Rica is also currently engaged in negotiations for the signing of free trade agreements with Canada and Panama. In the first case, the talks began in June 2000 and are expected to end in late March 2001, making it the first agreement of this kind signed in the American continent between a developed country and a small economy. In the case of Panama, and considering that trade relations with that country are governed by a treaty signed in 1973, the Central American countries and Panama are deploying major efforts to forge ahead with the establishment of a modern and comprehensive regulatory framework to govern and foment trade among them as a prelude to bilateral market access negotiations expected to be concluded in the course of this year.

40. These initiatives are a priority for Costa Rica given the importance of trading relations with these countries and the potential for trade expansion and consolidation that could flow from the signing of these trade agreements.

- **Agreements on the Promotion and Reciprocal Protection of Investments**

41. Costa Rica has persevered with its policy of protection of foreign investment through Agreements on the Promotion and Reciprocal Protection of Investments, providing substantive and legal guarantees for investments. Since 1995, the Legislative Assembly has approved agreements of this kind with the United Kingdom, France, Germany, Chile, Spain, Canada and the Republic of China. Recently, in January 2001, the Legislature approved the agreements with the Czech Republic, Argentina, Paraguay, the Netherlands and Venezuela. Other agreements are now before the Legislature or are being negotiated.

(iv) Unilateral liberalization initiatives

42. A great deal has been done in the way of unilateral tariff rollback measures. Between 1995 and 2001, Costa Rica's average tariff decreased from 11.7 per cent to 6.1 per cent for the entire tariff universe, with reductions in all the chapters of the harmonized system. Over that same period, Costa Rica fully liberalized 48.2 per cent of its tariff. It is worth mentioning that by the year 2000 over three fifths of the 5,994 eight-digit tariff items still had an import duty of less than 5 per cent and only 0.4 per cent of items were subject to a tariff higher than 50 per cent.

43. In spite of this, farm produce is still subject to tariffs higher than for other products (13.72 per cent versus 4.96 per cent in the industrial sector). Nevertheless, for goods imported in this sector at tariff levels above the bound tariff, the Government of the Republic instituted a programme in 1999 to bring down its tariff peaks substantially, in particular for poultry and dairy farming.

44. In the industrial sector, which accounts for virtually 90 per cent of the country's total imports, over half the tariff items entered at a zero tariff rate for 2000, which put the average weighted tariff for industrial goods and materials at 3.6 per cent.

45. In January 2000, Costa Rica attained the goal agreed with the other Central American countries of maintaining a tariff floor of 0 per cent and a ceiling of 15 per cent, with few exceptions.

IV. FUTURE POLICY DIRECTIONS

46. Costa Rica has an open economy in which the external sector is of paramount importance. For this reason, the country will be pressing ahead with a foreign trade policy that promotes greater and more secure access for Costa Rican products to international markets as a way of generating the growth and development opportunities that the country needs.

47. At the multilateral level, Costa Rica will continue to support the launch of a broad round of negotiations that will serve the interests of all Members and thereby further advance the liberalization process. In Costa Rica's view, in addition to the ongoing negotiations on Agriculture and Services, this new round should also encompass negotiations pertaining to the creation of a multilateral framework for investments, rules on trade facilitation and commitments on electronic commerce.

48. Costa Rica is convinced that many of the issues arising under the so-called implementation process could be more effectively addressed in a negotiating round rather than through a case-by-case review of the issues, and therefore believes that the programme could find a place on the negotiating agenda.

49. Furthermore, as a complement to its multilateral endeavours, Costa Rica will continue to play a constructive part in the various regional fora so as to promote investment, facilitate trade and eliminate more barriers at all levels. To that end, the country supports the proposal to strive to complete the negotiations on the Free Trade Area of the Americas in the shortest possible time. In Central America, moves will continue to buttress this regional integration scheme and to implement as soon as possible a flexible and effective dispute settlement system capable of resolving the various trade problems arising in the area.

50. Finally, Costa Rica will do whatever is necessary to reap maximum benefits from the free trade agreements it has signed and will continue to favour initiatives for more trading links with other countries in the region.
