



OECD Investment Policy Reviews

# COSTA RICA





# **OECD Investment Policy Reviews: Costa Rica 2013**

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## Foreword

**O**n 30 September 2013 Costa Rica became the 45th adherent to the OECD Declaration on International Investment and Multinational Enterprises in recognition of the country's progress in fostering investment liberalisation, deepening its international integration and promoting responsible business conduct.

As an adherent to the Declaration, Costa Rica commits to providing national treatment to foreign investors and promoting responsible business conduct. In turn, it benefits from similar assurance from other adhering governments to treat Costa Rican investors abroad fairly and to encourage their multinational enterprises operating in Costa Rica to contribute to economic, social and environmental progress. In accordance with the OECD Guidelines for Multinational Enterprises, an integral part of the OECD Declaration, Costa Rica has committed to establish a National Contact Point charged with promoting principles and practices embodied in the Guidelines, handling related enquiries in the national context and supporting mediation and conciliation procedures. As an adherent, Costa Rica will participate in the work of the OECD Investment Committee related to the Declaration.

This Investment Policy Review is based on the report supporting the examination by the OECD Investment Committee in view of Costa Rica's adherence to the OECD Declaration. It includes a special chapter on Costa Rica's investment framework in support of green growth, focusing on the country's policies regulations and institutions to facilitate and promote green investment. Representatives of OECD countries joined the OECD mission in San José in April 2013 to finalise the report. The examination of Costa Rica's investment policies took place in June 2013 at the OECD headquarters in Paris in the presence of a Costa Rican delegation led by Foreign Trade Minister Anabel González.

The review was prepared in close cooperation with the Costa Rican authorities by Marie-Estelle Rey, Alexandre de Crombrughe, Fernando Mistura and Dambudzo Muzenda from the Investment Division, Nariné Nersesyan from the Centre for Tax Policy and Administration, and Cristina Tébar Less, External Consultant, under the supervision of Pierre Poret, Counsellor in the OECD Directorate for Financial and Enterprises Affairs. The review received financial support from the government of Costa Rica and the Inter-American Development Bank.



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## Acronyms and abbreviations

<b>AACUE</b>	Association Agreement Central America – European Union – <i>Acuerdo de Asociación entre Centroamérica y la Unión Europea</i>
<b>AED</b>	Association of Enterprises for Development – <i>Asociación Empresarial para el Desarrollo</i>
<b>AMCHAM</b>	Costa Rican American Chamber of Commerce
<b>ARESEP</b>	Regulatory Authority of Public Services – <i>Autoridad Reguladora de los Servicios Públicos</i>
<b>AyA</b>	Costa Rican Institute of Aqueducts and Sewage – <i>Instituto Costarricense de Acueductos y Alcantarillados</i>
<b>BCIE</b>	Central-American Bank of Economic Integration – <i>Banco Centroamericano de Integración Económica</i>
<b>BEPC</b>	Best Environmental Practices Code
<b>BIT</b>	Bilateral Investment Treaty
<b>BOT</b>	Build, Operate and Transfer
<b>CACM</b>	Central American Common Market
<b>CAF</b>	Development Bank of Latin America – <i>Banco de Desarrollo de América Latina</i>
<b>CAFTA-DR</b>	Dominican Republic – Central America – United States Free Trade Agreement
<b>CARICOM</b>	Caribbean Community
<b>CCNRS</b>	National Consultative Council on Social Responsibility – <i>Consejo Consultivo Nacional de Responsabilidad Social</i>
<b>CDM</b>	Clean Development Mechanism
<b>CINDE</b>	Costa Rican Investment Promotion Agency – <i>Coalición Costarricense de Iniciativas de Desarrollo</i>
<b>CNC</b>	National Concessions Council – <i>Consejo Nacional de Concesiones</i>
<b>CNFL</b>	National Power and Light Company – <i>Compañía Nacional de Fuerza y Luz</i>
<b>CO<sub>2</sub></b>	Carbon Dioxide
<b>COMEX</b>	Ministry of Foreign Trade – <i>Ministerio de Comercio Exterior</i>
<b>CONASSIF</b>	National Council of Supervision of the Financial System – <i>Consejo Nacional de Supervisión del Sistema Financiero</i>
<b>CONICIT</b>	National Council for Scientific and Technological Research – <i>Consejo Nacional para Investigaciones Científicas y Tecnológicas</i>

<b>COPROCOM</b>	Commission to Promote Competition – <i>Comisión para Promover la Competencia</i>
<b>CPCI</b>	Presidential Council for Competitiveness and Innovation – <i>Consejo Presidencial de Competitividad e Innovación</i>
<b>CST</b>	Certification for Sustainable Tourism – <i>Certificado para la Sostenibilidad Turística</i>
<b>EFTA</b>	European Free Trade Association
<b>EIA</b>	Environmental Impact Assessment
<b>EIU</b>	Economist Intelligence Unit
<b>ENCC</b>	National Strategy for Climate Change – <i>Estrategia Nacional de Cambio Climático</i>
<b>ESPH</b>	Public Services Company of Heredia – <i>Empresa de Servicios Públicos de Heredia</i>
<b>EU</b>	European Union
<b>FCPF</b>	Forest Carbon Partnership Facility
<b>FDI</b>	Foreign Direct Investment
<b>FIU</b>	Financial Intelligence Unit
<b>FONAFIFO</b>	National Fund of Forestry Financing – <i>Fondo Nacional de Financiamiento Forestal</i>
<b>FONATT</b>	National Fund against the Trafficking of Persons and Smuggling of Immigrants – <i>Fondo Nacional contra la Trata de Personas y el Tráfico Ilícito de Migrantes</i>
<b>FTA</b>	Free Trade Agreement
<b>FTZ</b>	Free Trade Zone
<b>FZR</b>	Free Zone Regime
<b>GAMA</b>	Expanded Great Metropolitan Area – <i>Gran Área Metropolitana Ampliada</i>
<b>GATS</b>	General Agreement on Trade in Services
<b>GATT</b>	General Agreement on Tariffs and Trade
<b>GDP</b>	Gross Domestic Product
<b>GHG</b>	Greenhouse Gas
<b>GVC</b>	Global Value Chain
<b>IADB</b>	Inter-American Development Bank
<b>ICE</b>	Costa Rican Electricity Institute – <i>Instituto Costarricense de Electricidad</i>
<b>ICSID</b>	International Centre for Settlement of Investment Disputes
<b>ICT</b>	Costa Rican Tourism Board – <i>Instituto Costarricense de Turismo</i>
<b>IDA</b>	Agrarian Development Institute – <i>Instituto de Desarrollo Agrario</i>
<b>IFC</b>	International Finance Corporation
<b>IFRS</b>	International Financial Reporting Standards
<b>IIED</b>	International Institute for Environment and Development
<b>ILO</b>	International Labour Organization

<b>IMF</b>	International Monetary Fund
<b>INA</b>	National Apprentice Institute – <i>Instituto Nacional de Aprendizaje</i>
<b>INAMU</b>	National Institute for Women – <i>Instituto Nacional de las Mujeres</i>
<b>INDER</b>	Rural Development Institute – <i>Instituto de Desarrollo Rural</i>
<b>INEC</b>	National Institute of Statistics and Censuses – <i>Instituto Nacional de Estadística y Censos</i>
<b>INS</b>	National Insurance Institute – <i>Instituto Nacional de Seguros</i>
<b>INTECO</b>	Costa Rican Institute for Technical Norms – <i>Instituto de Normas Técnicas de Costa Rica</i>
<b>INTEGRARSE</b>	Central American Network for Corporate Social Responsibility – <i>Integración Centroamericana por la Responsabilidad Social Empresarial</i>
<b>IOSCO</b>	International Organization of Securities Commissions
<b>IP</b>	Intellectual Property
<b>IPA</b>	Investment Promotion Agency
<b>ISDS</b>	Investor-State Dispute Settlement
<b>ISO</b>	International Standardization Organization
<b>ITUC</b>	International Trade Union Confederation
<b>JASEC</b>	<i>Junta Administradora del Servicio Eléctrico de Cartago</i>
<b>LAC</b>	Latin America and the Caribbean
<b>LEED</b>	Leadership and Energy Environmental Design
<b>LPCDEC</b>	Law for the Promotion of Competition and Effective Consumer Protection – <i>Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor</i>
<b>LPG</b>	Liquefied Petroleum Gas
<b>M&amp;A</b>	Merger and Acquisition
<b>MEIC</b>	Ministry of Economy, Industry and Commerce – <i>Ministerio de Economía, Industria y Comercio</i>
<b>MESICIC</b>	Mechanism for Follow-Up on the Implementation of the Inter-American Convention against Corruption – <i>Mecanismo de Seguimiento de la Implementación de la Convención Interamericana contra la Corrupción</i>
<b>MICITT</b>	Ministry of Science, Technology and Telecommunications – <i>Ministerio de Ciencia, Tecnología y Telecomunicaciones</i>
<b>MINAE</b>	Ministry of Environment and Energy – <i>Ministerio de Ambiente y Energía</i>
<b>MNE</b>	Multinational Enterprise
<b>MOPT</b>	Ministry of Public Works and Transportation – <i>Ministerio de Obras Públicas y Transportes</i>
<b>MTSS</b>	Ministry of Labour and Social Security – <i>Ministerio de Trabajo y Seguridad Social</i>
<b>MW</b>	Megawatt
<b>NAFTA</b>	North American Free Trade Agreement

<b>NCP</b>	National Contact Point
<b>NDP</b>	National Development Plan
<b>NEP</b>	National Energy Plan
<b>OAS</b>	Organization of American States
<b>OECD</b>	Organisation of Economic Co-operation and Development
<b>PES</b>	Payments for Environmental Services
<b>PFII</b>	Policy Framework for Investment
<b>PGR</b>	General Attorney's Office – <i>Procuraduría General de la República</i>
<b>PISA</b>	Programme for International Student Assessment
<b>PPP</b>	Public Private Partnership
<b>PROACEX</b>	Programme for International Accreditation of Exporting Companies – <i>Programa de Acompañamiento en Certificaciones para la Exportación</i>
<b>PROCOMER</b>	Costa Rica Export Promotion Agency – <i>Promotora del Comercio Exterior de Costa Rica</i>
<b>PROPYME</b>	SME Support Programme – <i>Programa de Apoyo a la Pequeña y Mediana Empresa</i>
<b>R&amp;D</b>	Research and Development
<b>RBC</b>	Responsible Business Conduct
<b>RECOPE</b>	Costa Rican Oil Refinery – <i>Refinadora Costarricense de Petróleo</i>
<b>REDD</b>	Reducing Emissions from Deforestation and Forest Degradation
<b>SETENA</b>	National Environmental Technical Secretariat – <i>Secretaría Técnica Nacional Ambiental</i>
<b>SIGEG</b>	Labour Certification System in Equality and Gender Equity – <i>Sistema de Gestión de Equidad de Género</i>
<b>SINAC</b>	Costa Rican National Parks Administrator – <i>Sistema Nacional de Áreas de Conservación</i>
<b>SME</b>	Small and Medium-sized Enterprise
<b>SOE</b>	State-Owned Enterprise
<b>STI</b>	Science, Technology and Innovation
<b>SUGEF</b>	General Superintendence of Financial Entities – <i>Superintendencia General de Entidades Financieras</i>
<b>SUGESE</b>	General Superintendence on Insurance – <i>Superintendencia General de Seguros</i>
<b>SUGEVAL</b>	General Superintendence on Securities – <i>Superintendencia General de Valores</i>
<b>SUPEN</b>	Superintendence of Pensions – <i>Superintendencia de Pensiones</i>
<b>SUTEL</b>	Superintendence on Telecommunications – <i>Superintendencia de Telecomunicaciones</i>
<b>TAA</b>	Environmental Administrative Tribunal – <i>Tribunal Ambiental Administrativo</i>

<b>TICA</b>	Information Technology for Customs Control – <i>Tecnología de la Información para el Control Aduanero</i>
<b>TRIPS</b>	Trade-Related Aspects of Intellectual Property Rights
<b>UNCAC</b>	United Nations Convention against Corruption
<b>UNCITRAL</b>	United Nations Commission on International Trade Law
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>UNDP</b>	United Nations Development Programme
<b>UNEP</b>	United Nations Environment Programme
<b>UNFCCC</b>	United Nations Framework Convention on Climate Change
<b>UPOV</b>	Union for the Protection of New Varieties of Plants
<b>US</b>	United States
<b>USAID</b>	United States Agency for International Development
<b>USD</b>	United States Dollar
<b>USTR</b>	United States Trade Representative
<b>VCC</b>	Climate Conscious Travellers programme – <i>Viajeros con Conciencia Climática</i>
<b>VUCE</b>	Single Window for Foreign Trade – <i>Ventanilla Única de Comercio Exterior</i>
<b>WAIPA</b>	World Association of Investment Promotions Agencies
<b>WAVES</b>	Wealth Accounting and Valuation of Ecosystem Services
<b>WEF</b>	World Economic Forum
<b>WIPO</b>	World Intellectual Property Organization
<b>WTO</b>	World Trade Organization



## Executive summary

Costa Rica has managed to attract significant inflows of foreign direct investment (FDI) which have been a major contributor to its economic development. While foreign investments were at first mainly geared towards simple manufacturing operations, they have become increasingly diversified and knowledge-intensive and have helped to transform the economy. Annual FDI inflows have increased at an impressive pace, growing on average 13% per year over the past ten years.

Costa Rica meets all the requirements of the OECD *Declaration on International Investment and Multinational Enterprises*, which it adhered to on 30 September 2013 following a full *Investment Policy Review* by the OECD Investment Committee. Costa Rica has an open and transparent legal regime for investment, mainly governed by the general 1964 Commercial Code while subject to specific legislation in some sectors and incentives regimes. The principle of non-discrimination between nationals and foreigners is a constitutional right. Protection against expropriation and fair compensation are also guaranteed by the Constitution and the Expropriation Law. There is no restriction on the free transfer of foreign capital and profits.

The exceptions to the *National Treatment* instrument notified by Costa Rica are limited. Costa Rica maintains exceptions to national treatment for established foreign-owned enterprises for access to land and in electricity (generation), mining or exploration of ores other than hydrocarbons, transport (road, water and air) and agricultural aviation. Overall, the country ranks rather well in the OECD *FDI Regulatory Restrictiveness Index* with a legal regime for FDI more open than the average for the 57 OECD and non-OECD countries covered by the *Index*. The *Review* recommends evaluating the impact of remaining restrictions on a regular basis and considering alternative, non-discriminatory means to meet legitimate public policy objectives.

As an adherent to the *Declaration*, Costa Rica commits to promote the OECD *Guidelines for Multinational Enterprises* and will establish a dedicated National Contact Point in the Ministry of Foreign Trade to this effect. The country has taken a series of initiatives to promote responsible business conduct in the areas covered by the *Guidelines*. In the area of protection of human rights, the government has developed a comprehensive legislative and institutional framework and has ratified the main conventions relating to human rights and

labour rights. Efforts are ongoing to implement a consultation process with indigenous populations for all public and private projects that may affect their rights. The *Review* recommends that Costa Rica continue its efforts to fight corruption in the public sector and foreign bribery as set out in the *Guidelines*.

Although laws governing land access and tenure are generally transparent and non-discriminatory, the regulatory framework for land use and management needs to be enhanced through improved titling and cadastre. The legal framework for intellectual property rights is in compliance with ratified international intellectual property rights treaties and trade-related commitments, but challenges remain in terms of implementation. The judicial system is significantly backlogged. Although contracts are generally enforced, the *Review* recommends that concerns relating to the length and costs of proceedings be addressed as a matter of priority.

Costa Rica has a coherent strategy and a solid institutional framework to promote FDI, with the investment promotion agency (CINDE) performing very well in attracting foreign investments in targeted sectors. A challenge lies in business linkages, one of the major expected benefits of FDI, where transfers of technology and know-how have been limited. While Costa Rica has significantly invested in education to support the growth of skills-intensive industries, the *Review* notes that reducing the gap between supply and demand of qualified workers is becoming an increasing challenge in the country's priority sectors.

Infrastructure is another area of concern in Costa Rica's investment climate, particularly the quality of transport and the cost of electricity. The government is giving increased priority to private sector participation in infrastructure projects, notably through concessions, but obstacles remain. The authorities recognise their lack of expertise in managing public-private partnerships (PPPs) and the lengthiness of processes, in particular in the transport sector (roads and ports). The *Review* recommends that Costa Rica make better use of PPPs, develop management expertise, and offer more opportunities for foreign investors to participate in PPP projects. In particular, private investment in electricity generation needs to increase in order to help modernise the sector, meet growing demand and ultimately reduce the cost of electricity. The *Review* recommends evaluating the impact of existing barriers to FDI in the related sector.

Costa Rica has long-standing experience in promoting economic growth while preserving environmental resources. The *Review* commends Costa Rica for the way in which it has managed its natural endowments in a sustainable way. In 2009, Costa Rica pledged to become carbon neutral by 2021. The *Review* points out that moving forward on this objective will require higher levels of private investment in sectors such as electricity generation, transport and sustainable tourism.

The government understands the challenges affecting its economic growth and FDI attractiveness and is determined to strengthen its engagement with the OECD as a way of helping to address these challenges. As an adherent to the *Declaration*, Costa Rica is well positioned to benefit from international good practice and expertise to move ahead with its investment climate reforms and intensify its international integration.



## Assessment and recommendations

Costa Rica made valuable efforts to implement investment policies that contributed to boosting growth and competitiveness while promoting openness and transparency. Trade and investment reforms allowed the country to integrate with the world economy and led to a shift of the production composition towards high-tech manufacturing and value-added services. In parallel, the country has taken initiatives to promote sustainable development and responsible investment, particularly in the area of environment.

### The role of FDI in Costa Rica's economic development

Costa Rica has a long-standing and well-functioning democracy, with no army. The absence of military spending has allowed it to devote higher investments to social services. Public spending on education, for instance, represents approximately 7% of GDP and the literacy rate is just above 96%, the fifth highest in Latin America. Costa Rica has also strongly emphasised a development model that preserves its well-endowed natural environment. Environmental policies have notably focused on the protection and conservation of natural resources, and on electricity generation based on renewable sources.

With a population of 4.7 million inhabitants, Costa Rica has a small economy, but has successfully attracted and utilised foreign direct investment (FDI) as a catalyst for economic development. Supported by appropriate economic and social policies, FDI growth continues to be a top priority of the government, as evidenced by the country's National Development Plan 2011-14. While foreign investments were at first mainly geared towards simple manufacturing operations, they have become increasingly diversified and have contributed to upgrading the country's production base and exports, thereby drastically transforming the economy. Over the past two decades, annual FDI inflows to Costa Rica have grown at an impressive pace, accelerating over the last ten years to reach an average annual growth rate of 13%. Although Costa Rica benefits from different sources of FDI, the United States has been by far the largest, accounting for 60% of cumulated FDI flows between 2000 and 2012. Industrial manufacturing activities, mainly operated by US companies and concentrated in free trade zones, constitute a

large component of FDI inflows. Meanwhile, the share of FDI flows into the services sector has considerably increased over recent years, boosted by the opening of the telecommunications market, from only 8% of total inflows in 2002 to 40% in 2012. World-class multinational enterprises (MNEs) have invested in Costa Rica, contributing to production upgrading and increased knowledge- and technology-intensive activities.

Costa Rica is nevertheless facing challenges that affect economic growth and FDI attractiveness. Deficient transport infrastructure and high cost of electricity are increasingly hindering the country's competitiveness and would benefit from enhanced expertise in managing public-private partnerships (PPPs) and increased private sector participation. The business environment needs operational improvements for facilitating investment such as streamlining procedures, strengthening the efficiency of the judicial system, improving land management, and addressing a potential shortage of qualified human capital in knowledge-intensive industries. FDI impact in terms of technological spillovers and productive business linkages with domestic companies, including small and medium enterprises (SMEs), are limited. Costa Rica should take full advantage of its integration in global value chains by attracting those investments that would upgrade its position in these processes and enhance its competitiveness.

### **Costa Rica's investment regime and the OECD National Treatment instrument**

Costa Rica has an open and transparent legal regime for foreign investment. It does not have a specific law on investment. The main legislation governing private investment, both domestic and foreign, is the 1964 Commercial Code, which details all necessary requirements to do business. Investment in Costa Rica is also regulated by specific sectoral legislation and incentives regimes.

The principle of non-discrimination between nationals and foreigners is a constitutional right. Protection against expropriation is also guaranteed by the Constitution and compensation processes are covered by the Expropriation Law. There is no restriction on the free transfer of capital and profits, which can be made without delay and in a convertible foreign currency. Costa Rica is currently considering temporary measures to temper surge in short-term capital inflows. They should not affect FDI in principle, but implementation details will need to be closely assessed. The Constitution guarantees access to all regulatory information and it is easy to access business-related legislation. Mechanisms for public information and consultation on proposed legislation are available.

The exceptions to the *National Treatment* instrument notified by Costa Rica are limited (Annex A). As a result, Costa Rica ranks rather well in the OECD *FDI Regulatory Restrictiveness Index* and is below both the OECD average and the average for non-OECD countries in terms of FDI restrictions.

The country maintains exceptions to national treatment for established foreign-owned enterprises for access to land and in the following sectors: electricity (generation), mining or exploration of ores other than hydrocarbons, transport (road, water and air) and agricultural aviation. In transport and mining, restrictions to FDI are higher than the average for OECD countries according to the OECD *FDI Regulatory Restrictiveness Index*. Costa Rica has no FDI restrictions in manufacturing sectors, which has contributed to the development of a competitive manufacturing industry that is becoming both more knowledge-intensive and increasingly integrated with the world economy.

Productivity in the manufacturing industry may nevertheless suffer in the near term as a result of bottlenecks in some sectors, notably transport and electricity. Private investment in electricity generation needs to increase in order to contribute to modernising the sector, improve use of renewable energy in electricity generation, meet growing demand and eventually reduce the relatively high cost of electricity. Foreign investment in electricity generation is currently discouraged by restrictions, although it has the potential to develop this sector. The authorities are therefore encouraged to evaluate the impact of these restrictions on a regular basis and consider alternative, non-discriminatory means to meet legitimate public policy objectives.

The OECD *Declaration's* instrument on *Conflicting Requirements* provides that adherents should co-operate with a view to avoiding or minimising the imposition of conflicting requirements on multinational enterprises. Costa Rica has not identified any conflicting requirements imposed on MNEs operating simultaneously in the country and in other countries' jurisdictions, and has not received any complaints from MNEs on conflicting requirements stemming from Costa Rican laws and regulations. The government, in undertaking to pursue its efforts to make its investment regime more transparent and uniform, is ready to fulfil commitments under the instrument on *Conflicting Requirements* and to co-operate with other adhering countries in this area.

Costa Rica accepts the commitments under the *Declaration's* instrument on *Incentives and Disincentives to Investment* and will pursue its efforts to make its incentives schemes more transparent and to evaluate their costs and continued benefits. To assist in meeting these commitments, Costa Rica has been invited to use the OECD *Checklist for Foreign Direct Investment Incentive*

Policies, which is based on good practices in adhering countries, as well as the OECD Principles to *enhance the transparency and governance of tax incentives for investment in developing countries*. The authorities are invited to strengthen their engagement with the Committee on Fiscal Affairs in order to conduct analyses of tax policy for investment. They could benefit from the experience of the OECD *Tax and Development Programme* in evaluating the cost-efficiency of their investment incentives system and further improving its effectiveness.

## Costa Rica's policy framework for investment

### **Investment policy**

Costa Rica's performance in international rankings assessing business climates is uneven. It is relatively well positioned in the World Economic Forum's *Global Competitiveness Index 2012-13* (57th out of 144 economies) but its ranking on the World Bank 2013 *Doing Business* report is rather poor (110th place out of 185), though it gained 12 places in 2013. Hence, despite an open and transparent investment regime as assessed in this study, there is still room for improvements in the business environment.

As regards property rights and access to land, Costa Rican laws governing land access and tenure are generally transparent, and there is no discrimination against foreigners – except in restricted maritime terrestrial zones and borders territories. Nevertheless, the regulatory framework for land use and management needs to be enhanced through improved titling and cadastre. Investors are therefore required to exercise due diligence over property acquisitions and maintenance. In addition, the process of obtaining construction permits is lengthy and cumbersome, but notable efforts are being made to streamline procedures.

Costa Rica has set up a legal framework for intellectual property (IP) rights in compliance with ratified international IP rights treaties and trade-related commitments (e.g. the Agreement on Trade Related Aspects of Intellectual Property Rights [TRIPS] and the Free Trade Agreement between Central America, United States and the Dominican Republic [CAFTA-DR]), but challenges remain in terms of implementation. Further efforts to enforce IP legislation and improve the efficiency of legal proceedings are still required. Training public officials and fostering the capacity of academic institutions to enhance IP rights protection have also been identified as priorities by the government.

The judicial system is significantly backlogged in Costa Rica. Although contract enforcement is generally ensured, concerns relate to the length and costs of proceedings. The authorities and the business community attribute these problems to the legalistic culture of the country and procedural guarantees. Costa Rica does not have specialised commercial courts and civil

courts handle disputes over commercial contracts. The government promotes alternative dispute resolution. Following a first law on arbitration, conciliation and mediation applicable to all conflicts, a specific law on international commercial arbitration based on the UNCITRAL model law was adopted in 2011 to better conform to international practices and further encourage the use of arbitration by investors. Though the new law is recognised as an improvement by the business community, it is not yet implemented, as related regulations are not enacted.

Protection against expropriation is guaranteed by the Constitution and conditions and procedures for expropriation are stipulated in the 1995 Expropriation Law. Most of Costa Rica's investment partners are also protected by provisions under international investment agreements (bilateral investment treaties and investment provisions of FTAs). These provisions cover both direct and indirect expropriation, unlike the Expropriation Law. However, disputes over expropriation have occurred and some have been reported to be burdensome, especially in relation to land acquisition rights and land appraisals.

In terms of international investment agreements, Costa Rica has signed 21 BITs (13 in force) and 14 bilateral and regional FTAs with investment provisions (10 in force) – either through a reference to the BITs previously negotiated or through a comprehensive investment chapter, thereby providing investment protection to all of its main partners. The country developed a model BIT in 2011 and is revising investment provisions in some FTAs. The Ministry of Foreign Trade (COMEX) is the entity in charge of negotiating and implementing these agreements.

In the area of international arbitration, Costa Rica ratified the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) in 1977 and the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID) in 1993. All signed BITs and FTAs with an investment chapter contain investor-state dispute settlement (ISDS) provisions. Costa Rica has been a respondent state to six investment claims at ICSID, including one which is pending. In 2009, an Inter-institutional Commission for the Settlement of International Disputes on Trade and Investment was established in order to co-ordinate and manage Costa Rica's response to ISDS claims, as well as to help prevent them from being made in the first place. The authorities assess that the Commission is an effective mechanism for the prevention of investor-state disputes.

## **Investment promotion and facilitation**

The FDI strategy of Costa Rica is strongly embedded in its foreign trade policy, as most foreign investments are export-oriented and have contributed to consolidating the country as an export platform and increasingly integrating it with the world economy. Although FDI promotion did not initially involve targeting specific sectors, subsequently Costa Rica has increasingly targeted knowledge-intensive activities and is currently focused on three main clusters: advanced manufacturing, life sciences and services.

CINDE (Costa Rican Investment Promotion Agency) is a relatively small but efficient investment promotion institution. While CINDE is a private association, it receives political support from the authorities and works closely with COMEX. It has achieved concrete results in attracting FDI into the country since its creation and has an aftercare department that responds well to investors' concerns and provides policy recommendations to improve the investment climate. CINDE is less active in investment facilitation, however, and plays a minor role in promoting linkages between foreign affiliates and domestic companies.

CPCI (the Presidential Council for Competitiveness and Innovation) has been created to respond *inter alia* to business facilitation concerns. Composed of 19 public ministries and institutions' representatives, it has five priority areas: human capital and innovation; foreign trade and FDI; finance and capital markets; infrastructure development (telecommunications, electricity and transport); and regulatory improvement and procedures streamlining. CPCI also intends to act as a public-private dialogue platform since the private sector was incorporated into it in 2012.

There are four main incentive regimes in place in Costa Rica: the Free Zone Regime (FZR), the Inward Processing Regime, the Drawback Regime, and the Tourism Development Incentives Regime. These incentive regimes apply equally to both nationals and foreigners. The FZR is internationally recognised as a successful tool to attract foreign investment. However, as incentive regimes represent revenue foregone, measures to streamline tax exemptions could be envisaged.

Business linkages between MNEs and domestic companies have been rather limited. MNEs still import most inputs and services and tend to buy unsophisticated products and services from local suppliers, such as packaging materials, office supplies, security, cleaning and food, areas that offer few avenues for technology and knowledge transfer. PROCOMER, the export promotion agency, is in charge of linkages programmes and facilitates interactions between MNEs and local suppliers. Several initiatives to strengthen local capabilities of companies exist and have begun to yield results.

## **Trade policy**

The Costa Rican trade policy is well articulated with investment policy and reflects the country's broader economic objective of integrating into global value chains. Its foreign trade platform has been progressively developed on the basis of multilateral, regional and bilateral trade negotiations, which include its active participation in the WTO and the signature of 14 FTAs, 10 of which are already in force. FTAs cover nearly 85% of Costa Rica's total trade. The FTA between the US, Central America and the Dominican Republic (CAFTA-DR), which entered into force in Costa Rica in 2009, is considered as the most important one. The signature of a high number of FTAs illustrates Costa Rica's intention to build a predictable environment with its trade and investment partners, although there are overlaps in terms of countries covered by FTAs.

PROCOMER is the export promotion agency, which conducts activities such as seeking markets and identifying potential customers for Costa Rican products, capacity-building programmes for the internationalisation of SMEs, fostering backward linkages between foreign and domestic companies and streamlining export and import regulatory procedures. Several initiatives to facilitate trading across borders have taken place in recent years, including the Information Technology for Customs Control and the Single Window for Foreign Trade, which are electronic tools simplifying customs and administrative trade-related procedures. The authorities recognise, however, that customs procedures should be further improved.

## **Competition policy**

Competition policy favours innovation and contributes to conditions conducive to new investment. Sound competition policy also helps to transmit the wider benefits of investment to society. The Costa Rican Law for the Promotion of Competition and Effective Consumer Protection was enacted in 1994 to protect and promote free and fair competition by preventing and prohibiting monopolies and anti-competitive practices. It draws on the United Nations' Guidelines for Consumer Protection. The Law created COPROCOM (the Competition Authority), under the Ministry of Economy, Industry and Commerce, which benefits from political support while being fully autonomous.

All state-owned enterprises operating in markets that have been opened to private sector are subject to the Competition Law. Attention should be given to their potential abuse of power in the newly opened sectors (insurance and telecommunications), where COPROCOM has an uneven role in relation to sectoral regulation bodies (SUGESE and SUTEL respectively).

### **Human resource development**

Human resource development is a prerequisite needed for identifying and seizing investment opportunities. Policies that develop and maintain a skilled, adaptable and healthy population, and ensure the full and productive deployment of human resources, support a favourable investment environment.

On the one hand, Costa Rica has adopted consistent and long-lasting social policies with high investments in education and health that have supported the growth of skills-intensive industries. Education and health services are of good quality and accessible to the vast majority. The literacy rate of more than 96% is the fifth highest in Latin America. On the other hand, reducing the gap between supply and demand of qualified workers in certain high-tech industries is becoming an increasing challenge in the country's priority sectors. Reinforcing partnerships between the government, universities, R&D centres and the private sector to develop appropriate skills for new generations is key for Costa Rica to continue its development path towards a knowledge-intensive economy. Moreover, while the labour market provides a good level of guarantee for workers, increased flexibility in labour regulations, notably on hiring workers and in working hours, could ease business activities in the country.

### **Infrastructure development**

Sound infrastructure development policies ensure that scarce resources are channelled to the most promising projects and address bottlenecks limiting private investment. In Costa Rica, infrastructure is an area of concern for the investment climate, with the quality of transport and the cost of electricity being the main challenges. The government is giving increased priority to private sector participation in infrastructure projects and in developing expertise in managing PPPs, but obstacles remain. The National Concessions Council (CNC) needs to build its capacity to better identify, evaluate and execute infrastructure projects, as well as increasing flexibility and resources. In addition, the government needs to more systematically consult and communicate with local communities to sensitise them on the advantages of concessions, so that private sector participation in infrastructure development becomes more widely accepted. To this end, the *OECD Principles for Private Sector Participation in Infrastructure* provide a coherent catalogue of policy directions that could be beneficial for Costa Rica.

In the case of electricity, increasing private sector participation, including foreign, in electricity generation should contribute to modernising the sector, and lead to increased production and eventually reduced costs. The opening of the telecommunication sector in 2008 has resulted in growing market penetration by private operators, including foreign investors, although the

public operator (ICE), remains the major supplier. The water and sanitation regulatory framework is sound but requires further improvements to promote a more effective and sustainable management of water resources and sewage systems. The *Private Sector Participation in Water Infrastructure: OECD Checklist for Public Action* can also provide guidance to Costa Rica in this sector.

The authorities recognise their lack of expertise in managing public-private partnerships and the lengthiness of processes, in particular in the transport sector (roads and ports). Costa Rica is therefore encouraged to make better use of PPPs, develop management expertise, and offer more opportunities for foreign investors to participate in PPP projects.

### **Financial sector development**

Developed and well-functioning financial markets give firms the ability to seize promising investment opportunities, while imposing discipline on firms to perform and facilitating new entry into product markets. Costa Rica has a relatively deep financial sector by regional standards, although financial intermediation remains largely bank-dominated. Reforms, over the past two decades, have liberalised the financial sector and strengthened the regulatory framework. In 1995, Costa Rica opened up the banking sector to private competition, including foreign investors, hereby eliminating the monopoly of state banks. In 1996, the creation of private complementary pension plans was allowed to private foreign and domestic investors. CAFTA-DR eliminated the public monopoly in insurance and opened the market to private sector participants, including foreign-controlled insurers. Since 2008, the number of registered insurance products has increased about three times.

However, moving forward will require additional efforts to bring financial sector regulations closer to international standards and to level the playing field between state-owned and private investors operating in the country. Enhancing the mobilisation of financial resources will also require regulatory reforms facilitating access to capital markets. The Costa Rican capital market is still at an early stage of development. The government is working on some initiatives addressing these challenges, which include bringing domestic regulations closer to international standards, improving capital market infrastructure, easing burdensome regulations for the issuance of securities and participation in the market, notably to sophisticated investors, and developing an alternative stock exchange to support the development of high-growth potential SMEs.

### **Public governance and anti-corruption**

Costa Rica is carrying out efforts to strengthen efficiency of public governance with a focus on regulatory improvements in the business environment. A notable reform underway is the digitalisation of procedures

for business facilitation (e.g. *CrearEmpresa*). However, bureaucracy is still perceived as an obstacle by investors. The authorities recognise that there is a need to pursue streamlining and modernisation of procedures for doing business and facilitating both domestic and foreign investment.

Costa Rica is committed to fighting corruption and improving integrity in its public governance. It is considered as a relatively low corruption country. It has ratified the UN and the Inter-American Conventions against Corruption. The Law against Corruption and Illicit Enrichment of Public Officials was enacted in 2004, which improved the anti-corruption system. However, the review mechanism of the Inter-American Convention against Corruption still identifies recommendations to be implemented, such as providing the oversight bodies with the necessary financial and human resources, improving information flows and training programmes, ensuring the effective enforcement of a public ethics system, strengthening mechanisms encouraging public servants to report acts of corruption, and adopting comprehensive legislation on the right of access to public information.

With a view to improve its anti-corruption legislation and mechanisms and to benefit from best practices, Costa Rica has requested to participate as an Invitee in the Working Group on Bribery in International Business Transactions. It has expressed interest in aligning itself with the standards of the *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*. In January 2013, the authorities officially considered undertaking an *Integrity Scan* under the CleanGovBiz Initiative, a self-assessment exercise supported by the OECD based on a tool covering all relevant OECD anti-corruption and other integrity instruments.

## **Costa Rica's adherence to the OECD Guidelines for Multinational Enterprises**

The *OECD Guidelines for Multinational Enterprises* are recommendations jointly addressed by governments to multinational enterprises. They aim to ensure that the operations of these enterprises are in harmony with government policies, to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to sustainable development made by multinational enterprises. The *Guidelines* are also supported by a unique implementation mechanism, the National Contact Points (NCP), designed to promote the effective use of the *Guidelines* and address issues that may arise from the non-observance of the *Guidelines*.

Upon adherence to the *OECD Declaration*, Costa Rica will establish its National Contact Point in the Ministry of Foreign Trade (COMEX). COMEX has led the process of Costa Rica's adherence to the *OECD Declaration on International*

*Investment and Multinational Enterprises* and is aware of the related commitments. The authorities have committed to take into account in establishing the NCP the recommendations and commentaries on the implementation procedures provided by the *Guidelines* so that it can operate efficiently and in accordance with the core criteria of visibility, accessibility, transparency and accountability. They indicated that the NCP will have a monopartite structure and may comprise an advisory board in the future. They have also committed to staff the NCP with one public official and provide the necessary budget to carry out promotional activities, handle inquiries, resolve issues, and perform all other functions necessary for an adequate implementation of the *Guidelines*.

Costa Rica has taken a series of initiatives to promote responsible business conduct (RBC) in the areas covered by the *Guidelines*. In the protection of the environment, the country is today considered a model of effective environmental policies and the ecotourism industry is adopting RBC standards in relation to environmental protection, responsible consumption and community development. However, although it has engaged into international initiatives (e.g. ratification of conventions covering RBC areas and FTAs with environmental and labour provisions), it has not yet developed a comprehensive national strategy on RBC and still has a fragmented approach. The OECD *Guidelines on Multinational Enterprises* could serve as a tool to further promote and structure RBC policies in Costa Rica.

Costa Rica has implemented reforms to establish disclosure requirements and mechanisms. The National Council of Supervision of the Financial System issued in 2009 a corporate governance code for the disclosure of non-financial information of listed companies, which was amended in April 2013. However, further measures are needed to enhance transparency and accountability, and strengthen minority shareholders' protection.

The government has set in place a comprehensive legislative and institutional framework for human rights protection and continues to improve it, based on international reports and recommendations. It has ratified all major related international conventions and seeks to improve monitoring, development and implementation of human rights instruments and policies. Efforts are ongoing in the implementation of a consultation process with indigenous people for all public and private projects that may affect their rights. The OECD *Guidelines* will encourage the government to enhance foreign enterprises' responsibility to respect human rights, to monitor infringements and remediate them.

In the area of employment and industrial relations, Costa Rica is endeavouring to improve its legislation, in particular on labour proceedings to strengthen enforcement of international conventions related to association

rights and collective bargaining. It has developed a specific system of employers-employee relations and has also developed innovative initiatives, such as the SIGEG certification (Labour Certification System in Equality and Gender Equity). Government efforts should continue to ensure that companies further apply the recommendations of the *Guidelines* on employment relations.

Regarding the *Guidelines* area on combating bribery, bribe solicitation and extortion, improvements could be pursued. Notable efforts are conducted in Costa Rica to fight corruption in the public sector. Nonetheless, the country still has to improve its legislation, strengthen prevention standards, foster enforcement of the laws and regulations, better address corruption in business, and encourage enterprise policies and measures to fight bribery.

Costa Rica has a law and an institution dedicated to consumer interests and protection. The government issued a manual for companies in the commercial sector to improve their conduct *vis-à-vis* consumers. Additional efforts should concentrate on consumer awareness, legislative improvements and on promoting sustainable consumption.

The government is aware of the importance of science, technology and innovation (STI) policies and how critical they are to advance towards becoming a knowledge-based economy. The country has a promising innovation potential and developed an ambitious national STI Plan. Identified challenges are mainly to strengthen and upgrade its national capacities to develop and absorb STI, to align skills with the market needs and to attract multinational enterprises conducting and diffusing R&D activities at the benefit of the country's competitiveness.

Other issues covered by the *Guidelines* (such as environment and competition) are analysed in Chapters 3 and 5.

## Costa Rica's policy framework for green investment

The OECD defines green growth as “fostering economic growth and development, while ensuring that natural assets continue to provide the resources and environmental services on which countries' well-being relies. To do this, it must catalyse investment and innovation which will underpin sustained growth and give rise to new economic opportunities”. Investment for green growth includes *inter alia* investments in infrastructure such as water sanitation and distribution, transport, and housing, renewable energies, energy efficiency, and natural resource conservation.

A good framework for green investment includes a strong government commitment to support green growth and promote private investment to achieve these goals; policies and regulations that guide investors towards greener investment, including policies promoting green business conduct,

adequate institutional capacity to design, implement and monitor green investment policies, and policies supporting private participation in green infrastructure projects; institutional capacity to design and implement investment policies in support of green growth objectives; and financial incentives for green investment.

Costa Rica has long-standing experience in promoting economic growth while preserving environmental resources. It has been recognised as a leader in sustainable policy and practice by the United Nations Environment Programme, and has been highly praised for the way in which it has managed its natural endowments for the purpose of sustainable development. Several initiatives have received worldwide recognition for the scale of their ambition and effectiveness, such as its system for payment of ecosystem services which has helped to significantly reverse the rate of deforestation in the country.

In 2009, Costa Rica made a pledge to become carbon neutral by 2021. Moving forward on this objective will require higher levels of private investment in sectors such as electricity generation, transport and sustainable tourism. Though Costa Rica has no formal green growth agenda in place, nor a specific strategy to promote green investment, it has developed a range of policies to increase private investment in support of the country's environmental objectives and its commitment to become a low carbon economy. For example, it seeks to enhance private participation in electricity generation to promote investment in renewable energy. It is also promoting private investment in sustainable tourism, through incentives for companies to obtain sustainable tourism and carbon neutrality certification. While Costa Rica provides a significant number of incentives for green investment, there is to date no mechanism in place to assess the effectiveness of these incentives. Access to finance for green investment, e.g. in clean energy, is considered weak, and experience within the financial sector needs to be further developed. The government is currently designing measures to improve access to finance. A range of programmes are in place to ensure green business conduct and to involve companies in the government's carbon neutrality objectives, such as through certification under the C-Neutral label.



## Chapter 1

### **The role of FDI in Costa Rica's economic development**

*This chapter provides an overview of the Costa Rican economy and the role of FDI in its development. Costa Rica stands as an undeniable economic and social success story in the developing world, and in particular within the Latin American and Caribbean region. With a population of only 4.7 million inhabitants, Costa Rica's economy is small, but has nonetheless achieved significant integration into the world economy. It successfully attracted and used FDI as a catalyst for economic development. While foreign investments were at first mainly geared towards simple manufacturing operations, they have become increasingly diversified and knowledge-intensive and have helped to transform the economy. Over the past two decades, annual FDI inflows have increased at an impressive pace, accelerating over the last ten years to reach an average growth rate of 13% per year.*

## Introduction

Costa Rica stands as an undeniable economic and social success story in the developing world, and in particular within the Latin American and Caribbean (LAC) region. Having considerably transformed the economy and reduced poverty over the past decades, Costa Rica is the second largest economy of Central America, after Guatemala.<sup>1</sup> It is ranked as an upper middle-income country according to the World Bank and as a high income developing economy according to the United Nations. With a Gross Domestic Product (GDP) per capita in purchasing power parity of USD 12 157 in 2011, it is the second wealthiest country in Central America, closely behind Panama, the eighth in Latin America and the 12th within the overall LAC region.<sup>2</sup> The country has had no army since 1949 and has enjoyed political stability since 1948 owing to a well-functioning democratic system.

With a population of 4.7 million inhabitants in 2012, Costa Rica has a small economy, which however achieved significant integration into the world economy on account of export-oriented foreign direct investment (FDI) and an increasingly diversified export base. FDI has played a crucial role in national development and continues to be a top priority of the government, as evidenced by the country's National Development Plan (NDP) 2011-14 (*Plan Nacional de Desarrollo 2011-14 "María Teresa Obregón Zamora"*).<sup>3</sup> As Costa Rica has managed to attract FDI in high value-added and technology-intensive sectors, multinational enterprises (MNEs) have been pivotal in diversifying the country's exports, boosting economic growth and generating employment. World-class MNEs have invested in the country, among which the major first-comer and most emblematic was Intel.

The country nevertheless faces some challenges, as acknowledged by the authorities in their NDP 2011-14, including increased inequalities and infrastructure deficiencies, which are weakening the country's strong regional competitive position. The need to increase participation in global value chains, to facilitate linkages between MNEs and domestic companies, to streamline administrative procedures and to further enhance the alignment of education with labour market needs, among others, are also recognised by the government.

## Overview of the Costa Rican economy

Up until the 1960s, Costa Rica was heavily dependent on its agricultural sector, which was vital both for employment and exports. The economy was based on exports of some agricultural commodities (mainly bananas, coffee, sugar and beef) and was consequently vulnerable to external shocks and was faced with limited growth prospects (OECD, 2012). As a result, and like many other developing countries, Costa Rica then embarked upon a state-led import substitution industrialisation strategy. Although this new economic model allowed the country to achieve significant economic growth over the course of two decades, it started showing its limitations in the beginning of the 1980s, notably with the debt crisis that affected most Latin American countries.

Subsequently, Costa Rica opened its economy and opted for an export-oriented development strategy to expand and diversify its export base. Major reforms occurred, including trade liberalisation and opening to FDI. Whereas the 1980s was considered as a lost decade in many Latin American countries, Costa Rica adopted a policy mix of trade liberalisation and the promotion of export-oriented FDI, combined with several restrictions to private investment in certain key sectors. It led to relatively good economic results in comparison to the region (World Bank, 2007). FDI increasingly took a key role in the country's economic development strategy. While foreign investments were mainly geared towards *maquila* facilities initially,<sup>4</sup> they increasingly diversified and contributed upgrading the country's production base and exports, thereby drastically transforming the economy and increasing the standard of living. The economy grew at an annual average of 5.5% during the 1990s and at 4.2% since the beginning of the 2000s, exceeding those of most countries in the LAC region and reflecting the country's stable macroeconomic environment.

As highlighted by Table 1.1, the structure of the economy has been evolving over the past two decades. First of all, the primary sector has been slightly declining, falling from 12.4% of GDP in 1991, to 8.8% in 2012. According to the National Institute of Statistics and Censuses (*Instituto Nacional de Estadística y Censos*), the sector employed around 12% of the labour force in 2009. The manufacturing sector has always been central to Costa Rica's economy. It has been the most important contributor to GDP over the past two decades, with a constant share of GDP of approximately 21%. It employed about 12% of the labour force in 2009. The second largest contributor to GDP is the transport, storage and telecommunications sector, which has experienced a significant increase over the past two decades, growing from 7.5% to 16.2% of GDP between 1991 and 2012. It has been the main driver of GDP growth during the 2000s. The third largest sector in 2012, with a contribution of 15% of GDP, is wholesale and retail commerce, restaurant and hotel sector, which

Table 1.1. **Percentage of real GDP per sector**

	1991	2001	2012 <sup>1</sup>
Agriculture, hunting, forestry and fishing	12.4	10.7	8.8
Mining and quarrying	0.1	0.1	0.1
Manufacturing	21.0	21.7	21.3
Construction	3.8	4.0	4.1
Electricity and water supply	2.8	2.9	2.6
Wholesale and retail commerce, restaurants and hotels	17.9	17.9	15.0
Transport, storage and telecommunications	7.5	10.5	16.2
Financial intermediation and insurance	3.7	4.0	5.4
Real estate	6.2	5.0	4.3
Other business services	2.5	3.2	6.0
Public administration and compulsory social security	3.6	2.5	1.8
Community, personal and social service activities	12.2	10.5	9.2
Less: financial intermediation services indirectly measured	1.7	2.5	3.7
GDP at basic prices	92.0	90.6	91.1
Plus: taxes (net of subsidies)	8.0	9.4	8.9
GDP at market prices	100.0	100.0	100.0

1. Preliminary data.

Source: Central Bank of Costa Rica

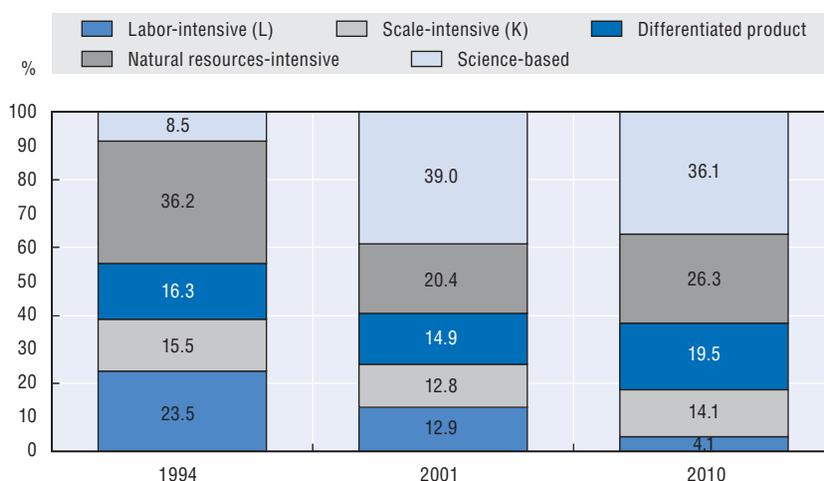
captures a significant fraction of the country's tourism activities. It is the largest employer, boasting more than a quarter of the labour force in 2009. While the community, personal and social services sector accounts for a smaller share of GDP (9.2% in 2012), it constitutes a sizeable employer nevertheless, having employed just less than 20% of the labour force in 2009. Lastly, construction, financial services and other business services have grown as a share of GDP over the past two decades, showing the growing importance of the services sector in the economy.

Over a few decades, Costa Rica has managed successfully to integrate into the world economy and benefit from trade by changing its export composition from primary products to high-tech manufacturing and value-added services. While the traditional agricultural exports of bananas, coffee, sugar and beef remain the backbone of commodity export trade, a variety of industrial and specialised agricultural products and high value-added goods and services have further bolstered exports. Whereas in 1995, agricultural exports were still higher than industrial exports, accounting respectively for 53.2% and 46.8%, this trend has since then reversed rapidly. In 2012, the Central Bank reported that 35.8% of total exports of goods were agricultural goods while 64.2% were industrial goods. In particular, microprocessors and controllers were the main export products, accounting for 19.7% of total exports of goods. Most exports are destined for the United States, accounting for 39.2% of total exports in 2012, followed by

the European Union (EU) (18.2%), Central America (14%) and Asia (13%). The vast majority of imports also originate from the United States (49.8% of total imports in 2012) and mainly consist of industrial goods, many of them being used as inputs for export production.

The structure of industrial exports measured by the intensity of the use of factors of production has considerably changed (Figure 1.1). Whereas in 1994, the greatest part relied upon natural resource and labour-intensive exports, with 36.2% and 23.5%, respectively, in 2010, technology-based exports took the lead (36.1%) while the share of labour intensive exports fell significantly to 4.1%.

Figure 1.1. **Structure of industrial exports by intensity in the use of factors of production**



Source: PROCOMER.

Exports of goods and services have grown 15-fold in the past 30 years and have diversified significantly, both in terms of products and markets.<sup>5</sup> Over the past decade, exports of goods have doubled, reaching USD 11.3 billion in 2012 and continue to grow rapidly, not only in value but also in diversity and sophistication. Today, Costa Rica exports over 4 500 different products to more than 150 countries, and exports of services represent 33% of total exports.

Economic integration was already among the country's priorities at its early stages of development, when it joined the Central American Common Market (CACM – made up of El Salvador, Guatemala, Honduras and Nicaragua) in 1963. From the end of the 1990s, it gradually liberalised trade and signed free trade agreements (FTAs) with a number of countries or regional groupings, such as the United States, Canada, the Caribbean Community

(CARICOM), Chile, Mexico, the Dominican Republic and, more recently, China, Peru, Singapore, Colombia and the European Free Trade Agreement (EFTA). Negotiations with the EU for an Association Agreement (which includes an FTA pillar) were successfully concluded in 2010 and signed in 2012. Costa Rica signed the Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR) in 2004, together with the US, the Dominican Republic and four other Central American states (El Salvador, Guatemala, Honduras and Nicaragua). The treaty, which was approved by the first referendum in the country's history, entered into force at the beginning of 2009. CAFTA-DR's objectives are to eliminate trade barriers, promote investment among members and to expand opportunities for their workers. The implications for Costa Rica are very important, as it involves strong commitments to economic liberalisation and openness.

As a consequence of these economic achievements, Costa Rica has managed significantly to raise living standards and reduce poverty to levels that figure among the lowest within LAC countries. In the past two decades, the percentage of the population living with less than USD 2 a day (in purchasing power parity terms) has dropped from 15% in 1990 to 6% in 2009, according to the World Bank. In 2012, the country was ranked 62nd out of 186 countries on the United Nations Development Programme (UNDP) Human Development Index.<sup>6</sup> This reflects the emphasis that Costa Rica has placed on education and health as long standing commitments, through a combination of free and mandatory basic education since the end of the 19th century and a highly developed tertiary education, as well as a quality public healthcare system.

Public spending on education represents approximately 7% of GDP, which is significantly higher than regional levels and comparable to those of many OECD countries. By constitutional mandate, this percentage will increase to 8% by 2014. As indicated by the UNDP Index, the literacy rate was 96.2% in 2012, which is the fifth highest rate in Latin America. In the World Economic Forum (WEF) Global Competitiveness Report 2012-13, Costa Rica is ranked 26th out of 144 economies for the quality of its primary education and 21st for the quality of its educational system overall, which makes it the highest ranked in Latin America for these two sub-categories. According to the UNDP Human Development Index, the country performs particularly well in terms of health, with a life expectancy of 79.4 years as well as public expenditure representing approximately 6% of GDP, these figures again being comparable to those of OECD countries.

Costa Rica has also placed strong emphasis on adopting a development model that preserves its very well-endowed natural environment. Environmental policies have focused on the protection and conservation of natural resources with special attention to protected areas (which represent more than 25% of the territory) and to electricity generation based on

renewable sources (Government of Costa Rica, 2010). As such, the country has successfully managed to find the right balance between economic development and environment protection. Simultaneously, Costa Rica has capitalised on its natural resources to promote and develop ecotourism activities, which have increasingly become central in its development process. The country is internationally recognised and cited as a best practice both for ecotourism and environmental conservation.

On the political front, Costa Rica is also a long-standing and well-functioning democracy, with successive democratically elected regimes since the late 1940s. It is hence one of the most politically stable countries in the LAC region, with relatively efficient and strong institutions. This factor has been fundamental in Costa Rica's economic boom and strong FDI attractiveness.

In spite of these impressive achievements, Costa Rica is facing a number of challenges that are affecting its economic performance and competitiveness. First of all, although Costa Rica has conducted inclusive social policies with almost 90% of the population covered by social security – a very high figure for a developing country – the emerging challenge of income inequalities has been intensifying. The Gini index shifted from 0.422 in 2006 to 0.515 in 2011, reaching its highest level in the past decades. The incomes of the wealthiest 20% of the population are more than 18 times higher than the poorest 20% (EIU, 2012). Increased inequalities are particularly prevalent in urban zones, where 60% of the population is concentrated and where poverty pockets have increased (Government of Costa Rica, 2010).

Being aware of the negative impact of insecurity both in the quality of life and the country's tourism and FDI attractiveness, the government ranks the fight against insecurity among its uppermost priorities. As acknowledged in the country's NDP 2011-14, Costa Rica has not only experienced amplified criminality and violence in the 2000s but is also simultaneously faced with organised crime, mainly related to drug trafficking. The government hence recognises that increased insecurity leads to a weakening of democratic institutions, governance and peaceful coexistence. Results have started to bear fruits, as criminality has been decreasing over the past two years (Government of Costa Rica, 2012).<sup>7</sup>

Infrastructure is becoming the main bottleneck for Costa Rica's competitiveness, in particular transport. Whereas Costa Rica is ranked 57th out of 144 economies in the overall WEF *Global Competitiveness Index 2012-13*, it is ranked 116th in its sub-index for transport infrastructure, which is perceived by the business community as the second most problematic factor for doing business. Similarly, the World Bank *Logistics Performance Index 2012* ranks Costa Rica 82nd out of 155 countries, a figure that has been continuously declining over the past years. Although these rankings only give a relative

picture, it is clear that transport infrastructure is slowly becoming inadequate and insufficiently maintained. For a country that is heavily reliant on trade and investment, this represents a particular bottleneck in terms of economic development. According to the World Bank (2009), this poor record is mainly due to the combination of three factors: an inadequate port model, limited private sector participation and institutional weaknesses. The NDP 2011-14 and the National Transport Plan 2011-35 recognise these shortcomings and include proposals to address them, including through FDI.

## **The role of FDI in Costa Rica's development**

Over the past six decades, Costa Rica has evolved as an investment destination. Whereas in the early 1960s some pioneer enterprises in the industrial sector established operations in the country, it was not until the 1980s – after the collapse of the import substitution model – that the country began to open up its economy while in parallel putting in place institutions to foster international trade and attract investment. From that period onwards, Costa Rica opted for an export-oriented development strategy, in which FDI played a central role.

Originally, Costa Rica attracted most of FDI in the areas of agro-industry, and textiles and apparel. A major breakthrough came in 1997, when the US multinational Intel decided to establish a microchip test and assembly plant in Costa Rica. Intel opened the door for others to follow and Costa Rica organised itself to take advantage of this, building upon its reputation as an investment destination and moving into new sectors in manufacturing, including medical devices and, to a lesser degree, aeronautics and automotive, while also becoming an important player in the area of services, particularly in the field of business process outsourcing. Contrary to many Latin American countries, high levels of FDI to Costa Rica cannot be explained by the exploitation of natural resources.

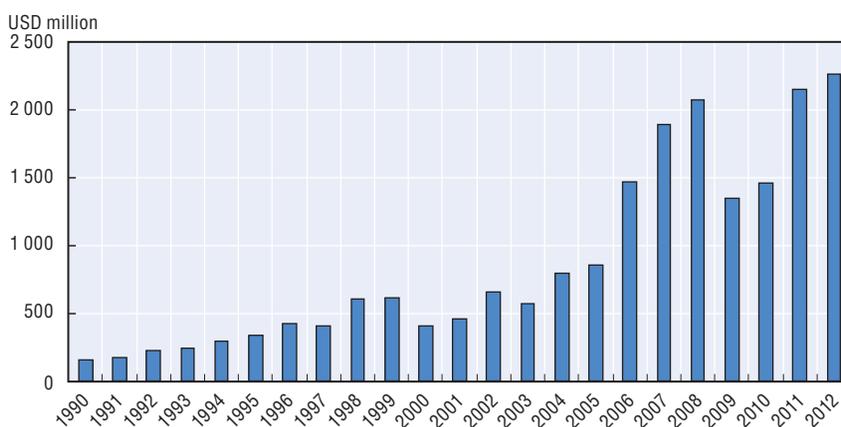
FDI stands high among the government's priorities and is well embedded in its current development strategy. The NDP 2011-14 has four main pillars of government actions: (1) social welfare; (2) public safety and social peace; (3) environment and land management; and (4) competitiveness and innovation. The latter pillar is divided into two strategic objectives: i) increasing production through investments in human capital and infrastructure and increased efficiency; and ii) promoting sustainable growth by expanding and diversifying markets. According to the NDP, FDI has a key role to play in both strategic objectives. Recognised benefits of FDI by the government include bringing capital, creating direct jobs and contributing to increased efficiency and know-how. Particular attention is given by the government to linkages in order to strengthen small and medium-sized enterprises (SMEs).

The Ministry of Foreign Trade (COMEX) is in charge of defining the country's FDI policy, overseeing special incentives regimes, and co-ordinating FDI-related strategies and plans. In 2005, COMEX introduced the Directorate for Investment, as the division responsible for advising on policy priorities and implementing investment promotion policy guidelines, as defined by the Minister. COMEX works with two implementing agencies, PROCOMER (*Promotora del Comercio Exterior de Costa Rica*), focusing on the promotion of exports, and CINDE (*Coalición Costarricense de Iniciativas de Desarrollo*), responsible for investment promotion. Further details on FDI governance are provided in the investment promotion and facilitation section of Chapter 3.

### Recent FDI trends

Over the past two decades, annual FDI inflows to Costa Rica have increased at an impressive pace (Figure 1.2), accelerating over the last ten years to reach an average growth rate of 13.1% per year. Whereas in 2002, FDI accounted for almost USD 660 million, in 2012, it reached USD 2 265 million, equivalent to 5% of GDP. FDI inflows nonetheless declined in both 2000 and 2009, when developed economies suffered from slowdowns. In 2009, FDI flows to Costa Rica declined by 35%, reflecting the direct consequences of the global economic crisis on foreign investment. Given that most FDI are export-oriented, inflows are particularly vulnerable to external fluctuations, especially those affecting the US; an economy particularly hit by the crisis and the major source country of FDI to Costa Rica (see below). Inflows peaked again from 2010, reaching their pre-crisis level in 2011 and their historical highest level in 2012.

Figure 1.2. **FDI inflows to Costa Rica, 1990-2012**



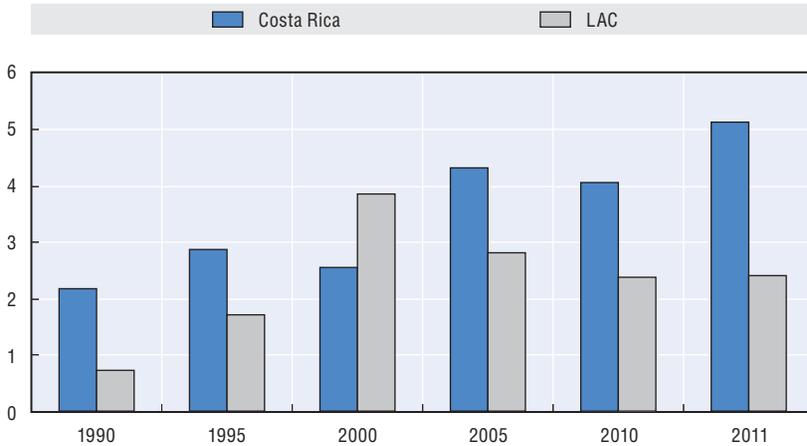
Notes: Figures for 2012 are preliminary.

Source: COMEX based on Central Bank.

Costa Rica is the second largest recipient of FDI within Central America, figuring closely after Panama. Inflows to Costa Rica have continuously represented approximately 25% of total inflows to Central America since the beginning of the 2000s. This figure is particularly remarkable when taking into account the size of the Costa Rican population, which only accounts for about 11% of the total Central American population. In 2012, FDI inflows per capita amounted to USD 485.

In relative terms, FDI flows to Costa Rica have performed well, accounting for more than 5% of GDP in 2011. FDI inflows as a share of GDP have been significantly higher in Costa Rica than in the LAC region overall over the past two decades (Figure 1.3). The only exception occurred in 2000, when Costa Rica experienced a significant drop in FDI inflows, as a consequence of the US economic slowdown, but by 2011, their proportion to GDP accounted for more than double of those in LAC.

Figure 1.3. **FDI inflows as a percentage of GDP in Costa Rica and LAC for selected years**



Source: World Bank Development Indicators

In addition, FDI inflows to Costa Rica have been mostly composed of Greenfield investments and reinvestments. Notwithstanding some exceptions, few mergers and acquisitions (M&As) have taken place, notably due to the absence of privatisation programmes (Box 1.1).

### Box 1.1. FDI and privatisations in Costa Rica

After the predominance of the import-substitution model, the 1990s in Latin America were characterised by far-reaching market-oriented reforms, which among other things led to high levels of FDI inflows. A significant proportion of inflows took the form of M&As, as a result of vast privatisation programmes in various key economic sectors, including utilities.

Costa Rica stands out as an exception in this regard, as the high levels of FDI into the country cannot be explained by the implementation of privatisation programmes. Unlike in most LAC countries, no privatisation strategy has been designed in Costa Rica and state-owned enterprises (SOEs) are thus still in place in a number of sectors, notably in infrastructure. In the past decade, attempts to open certain markets have been accompanied by waves of unpopularity and strikes. Although SOEs have not been privatised, the government is gradually introducing the possibility for private sector participation, including the opening of telecommunications in 2008 and insurance in 2009, which were still kept under the control of state-owned monopolies.

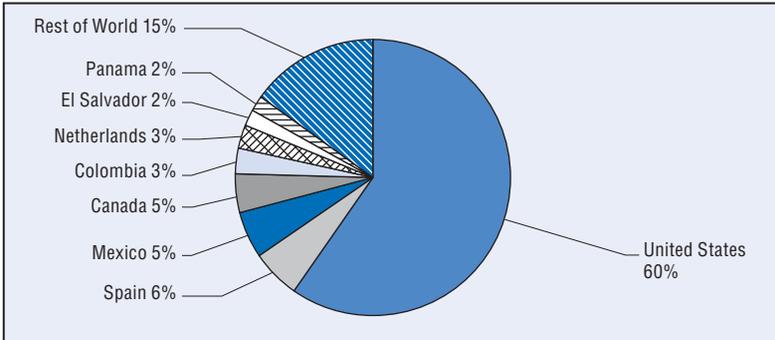
Foreign investor participation in privatisation of SOEs is hence limited in Costa Rica. Market-oriented reforms conducted from the 1980s aimed at attracting Greenfield export-oriented investments in productive sectors. The definition of a clear export promotion and diversification strategy was key to attract high levels of FDI.

### FDI by country of origin

The breakdown by nationality of foreign investors shows a very strong predominance of enterprises from OECD countries. Although Costa Rica benefits from different sources of FDI, the US has been by far the largest country of origin (Figure 1.4), accounting for 60% of total FDI inflows between 2000 and 2012. This figure demonstrates the extent to which Costa Rica has successfully positioned itself as an investment destination for US export-oriented MNEs, such as IBM, Intel, Hewlett Packard and Procter & Gamble. These companies have opted, through efficiency-seeking FDI, to service their domestic market by internationalising their production (OECD, 2004).

Although considerably lower than the US, Spain constitutes the second largest source of FDI with approximately 6% of total inflows during 2000-12, and is closely followed by Mexico and Canada, with approximately 5% each. Among Latin American countries, Mexico, Colombia, El Salvador and Panama are relatively well represented with a cumulated proportion of 12% of total FDI inflows during the same period.

Figure 1.4. **Cumulative FDI inflows (2000-12) by country of origin**

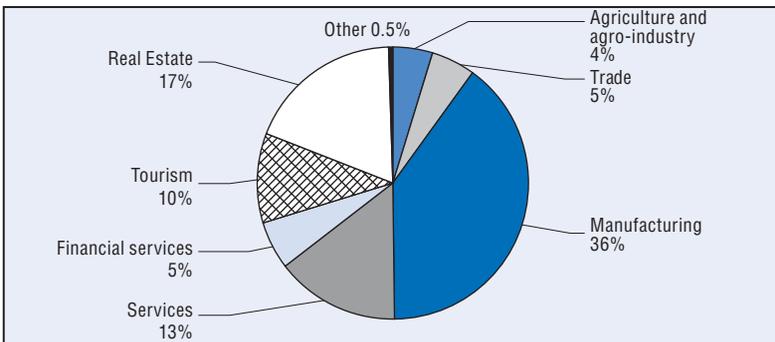


Source: COMEX, based on author's calculations.

### FDI in Costa Rica by sector

Costa Rica has managed to diverge away from agro-industry and textiles and towards more technology-intensive FDI starting from the 1990s. The country now enjoys a well-diversified FDI base (Figure 1.5). Industrial manufacturing activities, mainly operated by US companies and concentrated in free trade zones (FTZs), constitute a large component of FDI inflows to Costa Rica, accounting for approximately 24% in 2012. This share has declined slightly over the past decade, as it had accounted for a little more than half of total FDI inflows in 2001. The FTZs attracted USD 535 million FDI into the country, mostly in high-tech sectors. According to COMEX, foreign high-tech companies contributed to the creation of 8 225 direct jobs in 2012, representing 25% of all formal jobs generated by the private sector and 14% at national level. The high

Figure 1.5. **Cumulative FDI inflows (2000-12) by sector**



Source: Central Bank, CINDE, PROCOMER, COMEX and Costa Rica Tourism Board, based on author's calculations.

proportion of foreign investment in the manufacturing sector can be explained by Costa Rica's gradual integration into the international production systems of US MNEs (see above). Nonetheless, it is also the result of long-standing investments in education, which consequently provided the country with a highly qualified labour force and hence a strong competitive advantage in the region, in particular for high-tech manufacturing MNEs (OECD, 2004).

Meanwhile, the share of FDI flows into the services sector has considerably increased over the past years, from only 8% of total inflows in 2002 to more than 40% in 2012. A substantial increase was recorded in 2011 and 2012, following the liberalisation of telecommunications and subsequent foreign investments in this sub-sector, accounting for 16% of total FDI inflows in 2011 and 21% in 2012. They include investments in mobile telephony by Telefónica (Spain) and América Movil (Mexico), as well as smaller investments in Internet service providers, such as Metrowireless (Venezuela). While the respective shares of FDI in tourism and finance declined over the same period, those in real estate have risen.

Looking more in-depth, FDI increased significantly in areas such as services, life sciences and advanced manufacturing over the past decade. In the services sector, the number of companies grew from 5 in 2000 to 104 in 2011 and employment increased 35 times, from 1 061 to 37 049 workers. Many MNEs have selected Costa Rica to establish either their regional or global shared services centre, or to provide engineering or other services to their clients or affiliated companies abroad, including Hewlett Packard, IBM, Emerson, Intel and Procter & Gamble.

Companies operating in the life-sciences sector increased from 8 to 41 between 2000 and 2011, with employment rising significantly, from 1 500 to 13 561 workers. Moreover, whereas in the early stages most companies were dedicated to the manufacturing of low complexity devices, in recent years, they have evolved into more sophisticated activities and products, and a cluster encompassing a number of services for this industry has consolidated. Today, Costa Rica is home to companies such as Baxter, Hospira, Boston Scientific, Abbott Vascular and St. Jude Medical.

In the case of advanced manufacturing, companies grew from 30 to 47 and employment increased from 4 500 to 15 590 between 2000 and 2011. Some renowned companies operating in Costa Rica in this sector are Intel, L3 Communications, Panduit and Vitec.

The government's diversification strategy for FDI has in turn contributed to increase and diversify exports, reshape the country's productive structure and increase its participation in global value chains, particularly in the areas of electronics, medical devices, automotive, aerospace/aeronautics and film/broadcasting devices. As a result, about 37% of the country's total exports

are related to global value chains, with an average of 38% of such exported value being added domestically. Increased participation in these chains has enabled Costa Rica to become the country with the highest percentage of high tech exports out of total manufacturing exports in the Latin American region.

#### Box 1.2. **Measuring Foreign Direct Investment**

All OECD countries have made efforts over the past decade or so to align their national statistics with the recommendations of the OECD Benchmark Definition of Foreign Direct Investment (BMD) to provide more reliable, comprehensive and internationally comparable FDI statistics for policy making and for other purposes. OECD and IMF define FDI as a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The numerical threshold of ownership of 10% of the voting power determines the existence of a direct investment relationship between the direct investor and the direct investment enterprise. The population of enterprises to be included in the statistics is determined according to the Framework of Direct Investment Relationship (FDIR). The statistical unit is the enterprise (as opposed to local enterprise group) resident within an economic territory.

OECD recommends that FDI statistics be compiled and disseminated for inward/outward FDI positions (stocks of equity and intercompany debt) as well as for financial flows (of equity, reinvestment of earnings, and intercompany debt) and income flows (for dividends, reinvested earnings and interest on intercompany debt). Data should be based on the methodology referred to as the “directional principle” and be provided for subcomponents by partner country and by industry (according to International Standard Industry Classification (ISIC)). Market value should be applied by using recommended proxies for unlisted companies. For data dissemination, OECD recommends standard presentation distinguishing transactions and positions of resident Special Purpose Entities (SPEs) and proposes a list of supplemental presentations.

Data collection in OECD countries is based primarily on annual (and quarterly) enterprise surveys complemented by other sources such as the International Transactions System (ITRS), administrative sources, press, etc. Data collection is subject to special legislations in all OECD countries which is a necessary element for the safeguard of data confidentiality and to ensure the collection of reliable and complete information from reporting enterprises. The existence of legislation also enables to achieve a good response rate while sanctions are included for non-response.

The authorities of Costa Rica are encouraged to engage in a dialogue with the Working Group on International Investment Statistics (WGIIS), a subsidiary body of the Investment Committee and responsible for OECD's FDI statistics and the methodology, with a view to sharing experience, strengthening capacities and aligning data further with the OECD BMD4.

## ***The way forward***

Costa Rica has successfully attracted and utilised FDI as a catalyst for economic development. Appropriate economic and social policies have been conducted and enabled FDI to boost competitiveness. They allowed the country to integrate global value chains (GVCs) and consequently achieve sustained economic growth and increased living standards. Intel's establishment in 1997 opened the door for other MNEs to follow in similar sectors and sealed the beginning of a new FDI promotion era for Costa Rica, characterised by sector diversification, production upgrading and increased knowledge- and technology-intensive activities (OECD, 2012). In addition, out of the total FDI that Costa Rica intends to attract during the period 2011-14, about 40% is expected to be related to projects in sectors which will increase the country's competitiveness, such as telecommunications, clean energy and public works.

Costa Rica has been successful in integrating its economy in GVCs. According to the authorities, 38% of manufacturing exports are part of GVCs. It should pursue its efforts to take full advantage of its participation in GVCs to facilitate closer linkages between foreign direct investors and domestic companies, including SMEs, and thus raise its position in these processes and enhance its competitiveness. Given the dynamic and constantly evolving nature of GVCs, its policies for attracting and keeping international investment also need to evolve. Costa Rica is encouraged not only to implement specific measures to promote and facilitate targeted investments, but also to conduct broader policies for improving the investment environment. In that regard, Costa Rica could benefit from the work of the OECD on GVCs, in which it is already participating. The OECD has identified key policy implications of GVCs, including in the area of investment policy (Box 1.3).

Costa Rica should also overcome challenges that may affect economic growth, social welfare and FDI attractiveness. As previously highlighted, deficient infrastructure, in particular in transport, and high cost of electricity are increasingly hindering the country's competitiveness. In the infrastructure sector, the authorities recognise the insufficient private sector participation and the lack of expertise in managing public-private partnerships (PPPs). Relative insecurity and growing inequalities are also development concerns, directly affecting the country's attractiveness to foreign investment. Moreover, while FDI has contributed to fostering Costa Rican exports, generating domestic employment and stabilising the macroeconomic environment, its impact in terms of technological spillovers and linkages with domestic SMEs has been limited, while the latter also experience challenges in accessing finance. As analysed in this report, additional obstacles to FDI include the

**Box 1.3. GVCs and investment policy: key OECD messages**

- Given the important role of MNEs in GVCs, lowering investment barriers is an efficient way for a country to become integrated in GVCs. By inhibiting the efficient functioning of GVCs, impediments to cross-border investment can have negative welfare impacts beyond the home and host country.
- The current international investment regime built on thousands of bilateral and regional investment agreements does not adequately reflect the interconnected nature of economies in GVCs. Multilateral co-operation and co-ordination, such as the *OECD Policy Framework for Investment* and the *OECD Codes of Liberalisation*, are needed to maintain the open and predictable international investment climate that has supported international investment in GVCs.
- To realise the full benefits of international investment, investment promotion and facilitation policies need to focus more closely on the activities undertaken in GVCs rather than on industries. These policies must recognise that success in GVCs depends on both inward and outward investment. Governments should avoid incentive wars to attract high-value stages of a GVC and should work together to ensure that the multilateral investment system continues to support growth.
- Large MNEs, including in some cases state-owned enterprises (SOEs) are prominent players in GVCs. This has raised policy concerns, for example about the effects on competition and markets further downstream.
- GVCs can support the spread of ideas on responsible business conduct. The *OECD Guidelines for Multinational Enterprises* and implementation tools such as the *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas* are policy instruments for promoting responsible business in GVCs.

length of the judiciary processes, shortcomings in land registration management and titling, lack of streamlined administrative procedures, and a potential shortage of qualified human capital in knowledge-intensive industries in response to medium-term market needs. Costa Rica has carried out a number of initiatives to promote responsible business conduct, leading to positive impacts, notably on environment preservation, but further progress can be achieved in other areas.

## Notes

1. In this chapter, Central America refers to the region that includes Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.
2. World Bank Development Indicators.
3. The NDP is elaborated in conjunction with the planning units of the different Ministries, decentralised institutions and other local and regional entities of the State. It incorporates policies, objectives, actions and priority goals of the government for the period 2011-14.
4. *Maquila* refers to simple manufacturing operations – mainly assembly and basic processing – in free trade zones for export purposes. Over this period, *maquila* was associated with textiles.
5. Whereas in 1982, Costa Rica's total exports amounted to USD 1 121.0 million, in 2012, they reached USD 16 903.4 million.
6. The Human Development Index takes into account not only the standard of living but also social indicators, notably education and health.
7. Between 2010 and 2012, criminality indexes decreased from 12.5 to 9.5 for every 100 000 inhabitants.

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## Chapter 2

### **Costa Rica's investment regime and the OECD National Treatment instrument**

*The aim of this chapter is to analyse and assess the main features of the Costa Rican legislation relating to FDI and to present the exceptions to the OECD National Treatment instrument notified by Costa Rica. National treatment is the commitment by a country adhering to the Declaration on International Investment and Multinational Enterprises to treat enterprises operating on its territory, but controlled by the nationals of another country, no less favourably than domestic enterprises in like circumstances.*

*The exceptions to the National Treatment instrument notified by Costa Rica are limited. The country ranks rather well in the OECD FDI Regulatory Restrictiveness Index and is below both the OECD average and the average for non-OECD countries covered by the Index in terms of FDI restrictions. It maintains exceptions to national treatment for established foreign-owned enterprises for access to land and in electricity (generation), mining or exploration of ores other than hydrocarbons, transport (road, water and air) and agricultural aviation. Costa Rica has an open and transparent legal regime for investment, mainly governed by the 1964 Commercial Code, which details all necessary requirements to do business. Investment is also regulated by specific sectoral legislation and incentives regimes. The principle of non-discrimination between nationals and foreigners is a constitutional right.*

This chapter examines Costa Rica's investment regime in light of the *National Treatment* instrument, the first element of the *OECD Declaration on International Investment and Multinational Enterprises* (Box 2.1). Chapter 3 looks at various aspects of Costa Rica's broader investment policy framework using the *OECD Policy Framework for Investment*. Costa Rica's framework regarding responsible business conduct as covered by the *Guidelines for Multinational Enterprises*, an integral part of the *Declaration*, is analysed in Chapter 4.

National treatment is the commitment by a country adhering to the *Declaration on International Investment and Multinational Enterprises* to treat enterprises operating on its territory, but controlled by the nationals of another country, no less favourably than domestic enterprises in like circumstances. The *National Treatment* instrument consists of two elements: a declaration of principle, which forms part of the *Declaration*, and a procedural OECD Council Decision which obliges adhering countries to notify their exceptions to national treatment and establishes follow-up procedures in the OECD to deal with such exceptions. The Decision comprises an annex that lists exceptions to national treatment, as notified by each adhering country and accepted by the OECD Council. The Investment Committee periodically examines the exceptions. To ensure transparency, countries adhering to the *Declaration* also undertake to report any measures that, while not representing exceptions to national treatment, have an impact on it. The lists of these exceptions and measures are published and regularly updated.<sup>1</sup>

National treatment has become a well-established principle among adhering countries. Exceptions are typically limited to certain sectors, such as mining, transport, fisheries, broadcasting and telecommunications. Exceptions are reduced in scope or eliminated among adherents to the *Declaration* as a result of unilateral measures by the countries themselves, or as a result of peer reviews.

The aim of this chapter is to analyse and assess the main features of the Costa Rican legislation relating to foreign direct investment (FDI) and to present the exceptions to the *OECD National Treatment* instrument notified by Costa Rica.

### Box 2.1. **The Declaration on International Investment and Multinational Enterprises**

Adopted in 1976, the *Declaration* is a policy commitment by adhering governments to provide an open and transparent environment for international investment and to encourage the positive contribution multinational enterprises can make to economic and social progress.

The *Declaration* consists of four elements (each underpinned by a decision of the OECD Council on follow-up procedures):

- **National Treatment:** A voluntary undertaking by adhering countries to accord to foreign-controlled enterprises on their territories treatment no less favourable than that accorded in like situations to domestic enterprises.
- **The Guidelines for Multinational Enterprises:** Recommendations on responsible business conduct addressed by governments to multinational enterprises operating in or from adhering countries. The *Guidelines* were updated in 2011.
- **Conflicting requirements:** Adhering countries agree to co-operate so as to avoid or minimise the imposition of conflicting requirements on multinational enterprises.
- **International investment incentives and disincentives:** Adhering countries recognise the need to give due weight to the interest of other adhering countries affected by laws and practices in this field; they need to strengthen international co-operation in this area and endeavour to make measures as transparent as possible.

All 34 OECD member countries have adhered to the *Declaration*, as have ten non-member countries: Argentina (22 April 1997), Brazil (14 November 1997), Colombia (8 December 2011), Egypt (11 July 2007), Latvia (9 January 2004), Lithuania (20 September 2001), Morocco (23 November 2009), Peru (25 July 2008), Romania (20 April 2005), Tunisia (25 May 2012). Jordan's adherence is forthcoming.

## Main features of Costa Rica's investment regime

### Overview of investment-related legislation

Costa Rica has an open and transparent legal regime for foreign investment, although it does not have a specific law on foreign investment. The main legislation governing private investment, both domestic and foreign, is the Commercial Code (*Código de Comercio*, Law No. 3284 of 27 May 1964). A separate law on investment has not been considered to be useful by the authorities and the absence of such is not perceived as a concern by foreign investors. The investment regime is adequately regulated by the current legislation.

The Commercial Code details all necessary requirements to do business. It is divided into five sections: i) corporate formation and forms of enterprise; ii) commercial obligations and contracts; iii) negotiable instruments; iv) bankruptcy; and v) limitations for enforcement of commercial obligations. Both the Commercial and Civil Codes govern commercial transactions and litigation. In addition, Costa Rica developed specific sectoral legislations, which contain investment-related provisions (e.g. legislation on telecommunications, electricity, transport). Special incentives regimes have also been established to attract targeted investments. The country has four incentives regimes: i) the Free Zone Regime;<sup>2</sup> ii) the Inward Processing Regime;<sup>3</sup> iii) the Drawback Regime;<sup>4</sup> and iv) the Tourism Development Incentives Regime.<sup>5</sup> While access to these regimes is available to both foreign and domestic investors, they have proved to be effective policy tools to attract FDI into the country. The proportion of FDI inflows under these regimes has varied throughout the last decade and has been directed to various sectors. From 2006 to 2012, almost 30% of FDI operated under the Free Zone Regime (Chapter 3 Section on Investment promotion and facilitation).

The principle of non-discrimination between nationals and foreigners is embodied in Costa Rica's legal framework and is protected as a fundamental constitutional right. The Constitution also guarantees the right to private property and protects citizens from expropriation, stipulating that individuals cannot be deprived of their property unless there is a legally proven public interest and prior compensation (Article 45). The Expropriation Law (Law No. 7495 of 3 May 1995) provides additional details and provisions on the expropriation processes (Chapter 3 Section on Investment policy). There is no restriction on the free transfer of capital and profits, which can be made without delay and in a convertible foreign currency. Costa Rica is currently considering the introduction of temporary capital control measures to temper surge in short-term capital inflows. They should not affect FDI in principle, though implementation details would need to be further analysed and closely assessed.

Costa Rica does not differentiate between investors on account of the size of their enterprises or the origin of their capital. There are however sectoral exceptions to national treatment, though limited (see below and Annex A).

Costa Rica has 13 bilateral investment treaties (BITs) in force, as well as 10 free trade agreements (FTAs) with investment-related provisions with Canada, four CARICOM countries, Chile, China, Dominican Republic, Mexico, Panama, Peru, Singapore, and Central America-United States, as well as the Association Agreement between Central America and the European Union. The FTAs either have a chapter on investment (notably the FTA between Central America, the United States and the Dominican Republic, CAFTA-DR) or make a reference to a previously signed BIT. This network of treaties provides for

investor protection through a series of provisions covering investment standards and dispute resolution mechanisms (Chapter 3 Section on Investment policy).

Investment contracts are signed in the framework of the Free Zone Regime. When the investor decides to establish in Costa Rica under this regime, a contract is issued in the form of an executive agreement in which the benefits are granted and the conditions are listed. According to the authorities, these contracts do not contain stabilisation clauses.<sup>6</sup> In public procurement contracts, an adjustment clause is included as required by the law and seeks to maintain the economic equilibrium of the contract.

### **Transparency, accountability and predictability of Costa Rica's investment regime**

When laws and regulations are accessible to the public and to economic operators, it provides a guarantee of transparency for investors. Constraints on access to legislation, lack of clear and concise information and government discretion in disclosing or withholding information constitute obstacles to investors.

In Costa Rica, access to information is guaranteed by the Constitution (Article 30). It is generally easy to access business-related legislation. Consultation mechanisms for interested parties on the elaboration and implementation of legislation are available.

There are constitutional provisions to guarantee free access to administrative departments for purposes of information on matters of public interest, which are closely connected to other constitutional rights such as the right of request, response, truthful and objective information, and due process. The latter comprises due notification, right to be heard, right to prepare and file a written or oral submission, right to be represented and advised by attorneys or technicians, and right to appeal.

Several other laws ensure the right of free access to information on administrative documents and procedures. The National Archive System Law<sup>7</sup> guarantees free access to all documents produced or held by institutions of the three government branches, except for documents or files containing state secrets. The Constitutional Court has determined that the freely accessible files of public interest comprise those of the central and decentralised public administration and institutions, including municipalities, professional associations, fully or partly publicly-owned companies, productive and industrial corporations, pensions operators, publicly-owned companies of the National Banking System, companies registered in the stock market, as well as the National Insurance Institute (*Instituto Nacional de Seguros – INS*).<sup>8</sup> Information on legislative procedures is available on the Congress' webpage.<sup>9</sup>

The Constitution requires publishing every law in the Official Gazette (*La Gaceta*). It also determines that laws become effective solely upon publication. The Official Gazette is available on line.<sup>10</sup> Costa Rica has also implemented a user-friendly tool that grants access to all existing laws, administrative regulations and judicial rulings: SINALEVI,<sup>11</sup> the Costa Rican system of legal information. All legislation is therefore freely and easily accessible in Spanish.

However, the Organization of American States (OAS) Mechanism for Follow-up on the Implementation of the Inter-American Convention against Corruption (*Mecanismo de Seguimiento de la Implementación de la Convención Interamericana contra la Corrupción*, MESICIC) calls for strengthening the mechanisms that guarantee the right of access to public information. While progress is noted in strengthening the consultation mechanisms, the revision of the legislation – integrating all related provisions into a single regulatory text – and the implementation of measures to support access to public information are recommended (OAS, 2013) (Chapter 3 Section on Public governance and anti-corruption).

The procedures for the enactment of national legislation are established in the Constitution, the Congress' regulations and organic laws of various competent authorities. The initiative to start the process resides in: i) any member of Congress, ii) the Executive Branch (through the Ministers), and iii) a minimum of 5% of duly registered national citizens (the popular initiative).<sup>12</sup>

The legislative process entails participation mechanisms, through hearings organised by legislative commissions with the public and private sectors. The private sector is represented in these hearings by chambers, associations and other organisations. Lawmakers convene the stakeholders they believe may be affected by a particular bill of law. Without prejudice to the above, groups or individuals that have not been convened may still provide lawmakers their criteria in writing or through an oral hearing. When laws require implementation regulations, the Executive Branch may submit the draft regulations to public consultation prior to their final enactment. It grants a term of 10 working days to public entities, organisations that represent general or corporate interests and the general public, either to make statements regarding the proposed regulations or to oppose the draft text. The notice for consultations must be published in the Official Gazette and optionally in a newspaper of national circulation, in the convening entity's website or by means of a direct notice to the relevant entities.<sup>13</sup>

The General Law of Public Administration (*Ley General de la Administración Pública*, Law No. 6227 of 2 May 1978) establishes that parties and their representatives, and any attorney, shall be entitled to examine, read and copy any part of the administrative file and to request certification thereof in any state of the administrative procedure.<sup>14</sup> This right concerns only administrative

acts and is only open to the parties to the procedures, which can be natural or legal persons.

Authorities frequently hold seminars and training sessions with interested parties regarding the implementation of new investment-related legislation. This allows a closer interaction, discussion and feedback with various stakeholders and promotes compliance with existing laws and regulations. These seminars are frequently dedicated, though not exclusively, to businessmen operating in free zones and civil servants.

The government has also taken steps towards regulatory improvement and removal of unnecessary burdens to business development, recognising that bureaucracy continues to be burdensome for businesses. In particular, the Presidential Council for Competitiveness and Innovation along with the Ministry of Economy, Industry and Commerce, launched in 2010 a National Strategy on Regulatory Improvement (Chapter 3 Section on Public governance and anti-corruption).

### **Principle of non-discrimination**

The principle of non-discrimination is embodied in Costa Rica's legal framework and is protected as a fundamental constitutional right. Article 19 of the Political Constitution provides that foreigners are subject to the same individual and social rights and duties as nationals – with some exceptions<sup>15</sup> – and Article 33 establishes the principle of equality before the law. All other hierarchically inferior legislation and regulations, including those relevant to investment, are bound by the Constitution.

Costa Rica grants most-favoured-nation treatment and national treatment to foreign investors in light of its commitments under the WTO and other trade-related agreements. Exceptions to national treatment, as established by the law, have been listed in Costa Rica's non-conforming measures annexes included in FTAs containing investment or cross-border services chapters and in the General Agreement on Trade in Services (GATS) Schedule of Specific Commitments. The exceptions to national treatment are analysed below and summarised in Annex A.

There is no discrimination regarding administrative procedures. Foreigners should complete the administrative procedures required to perform business under the same conditions as those applicable to Costa Rican nationals, in particular, as regards to establishment of companies, ownership of shares, registration to operate in a municipal district, registration as an employer with the social security authorities, and registration as a taxpayer with the tax authorities.

### *Transfer of funds*

There is no restriction on the free transfer of capital and profits. The Central Bank no longer has the discretion to impose restrictions. Transfers should be allowed without delay and in a convertible foreign currency,<sup>16</sup> though exceptions exist in relation to the exchange regime as set out in the Organic Law of the Central Bank (Articles 77 to 84). These exceptions can be used only in exceptional economic instability circumstances, but, even under these exceptional circumstances, the free conversion of national currency into other currencies is guaranteed by the law (Article 82).

The principle is contained in BITs and investment chapters of FTAs ratified by Costa Rica. These treaties generally allow for the free transfer of capital and profits, in a freely usable currency at the market rate of exchange. As mentioned in the CAFTA-DR, these transfers usually include: i) contributions to capital; ii) profits, dividends, capital gains, and proceeds from the sale of all or any part of the covered investment or from the partial or complete liquidation of the covered investment; iii) interest, royalty payments, management fees, and technical assistance and other fees; iv) payments made under a contract, including a loan agreement; v) payments pursuant to the articles on treatment in case of strife and on expropriation and compensation; and vi) payments arising out of disputes (Article 10.8.1 of CAFTA-DR). Some treaties, mainly FTAs, contain exceptions. For example, the transfer may be restricted through the equitable, non-discriminatory and good faith application of the domestic legislation relating to: i) bankruptcy, insolvency, or the protection of creditors' rights; ii) issuing trading or dealing in securities, futures, options, or derivatives; iii) criminal or penal offenses; iv) financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities; or v) ensuring compliance with orders or judgments in judicial or administrative proceedings (Article 10.8.4 of CAFTA-DR). Transfer of capital can also be restricted through a general exception regarding the balance of payments. However, this provision is not provided for in some BITs and FTAs (including CAFTA-DR) and in the model BIT of Costa Rica. The exception allows the country to temporarily restrict transfers under certain conditions, including consistency with the Articles of Agreement of the International Monetary Fund (IMF).

Costa Rica is considering the introduction of temporary capital control measures to ease macroeconomic pressures arising from surges in capital inflows, like the one experienced during the period from November 2012 to January 2013. The authorities explained that, during this period, the country faced a strong increase in portfolio inflows due to the widening of interest rate differentials in relation to international markets. This has raised authorities' concerns over macroeconomic stability and has led them to submit a draft law

to Congress increasing authorities' ability to impose temporary measures, discouraging short-term capital inflows.

The proposed law would allow the competent authority (Executive Branch in the case of taxes and Central Bank in the case of reserve requirements) to increase the tax on interest paid to non-residents by up to 30 additional percentage points and/or to impose reserve requirements of up to 25% on foreign inflows, channelled to the purchase of bonds and other securities (excluding stocks) in the domestic market. The competent authority would be authorised to differentiate the incidence and the applicable rate levels of measures according to the currency, type of revenues, and maturity of investments. According to the authorities, the proposed law does not impact interest on intercompany loans or interest on loans to private firms by banks or financial entities recognised by the Central Bank as normally performing international financial transactions. Such measures are to be of a temporary nature and would be allowed for six-month renewable periods. Their implementation and renewal would require a qualified majority of the Central Bank Board of Directors to declare the existence of an external disequilibrium caused by capital inflows.

The proposed law would not affect investment in domestic instruments that have or will take place before such measures are implemented, or after their expiration. It would exclude, from its scope of application, international bonds placed in the international market in the past or in the future by the government or entities of the non-financial public sector of Costa Rica. Other significant channels for investment by non-residents would not be affected by the proposed law. For example, loans to domestic firms (financial and non-financial) by first order international banks and other financial entities, seen as regularly carrying out financial operations with Costa Rica, are exempt from income taxes both under the current law and in the bill of law (while domestic banks are subject to income taxes in Costa Rica under the current law). Similarly, non-resident's investment in free trade zones in Costa Rica by way of intercompany loans or direct participation in the company's capital are not impacted by the proposed bill. As companies in Costa Rican free trade zone are considered resident companies, their investments are not affected by the draft law either.

According to the Costa Rican authorities, the bill, once enacted by Congress, will not affect FDI. However, the extent to which measures might affect FDI can only be properly assessed once the law is passed and authorities decide on the implementation details of such measures. A few instruments targeted by the proposed law are included in the definition of FDI as stated on the *OECD 4th Benchmark Definition of FDI (2008)*, and on the *IMF 6th Balance of Payments and International Investment Position Manual (2008)*. The implementation details would allow an analysis of whether it would only

affect portfolio investors and not foreign direct investors. According to the Costa Rican authorities, based on the OECD and IMF FDI definition, the proposed law would only affect debt instruments issued by local firm and sold in the financial market to foreign capital (except to international financial entities recognised by the Central Bank as normally conducting international transactions). However, this FDI channel has been fairly limited until now in Costa Rica, where FDI through investment in equity or through inter-company loans has been much more common. As such, the extent to which FDI may be impacted by the proposed law is expected to be fairly limited.

Should Costa Rica wish to adhere to the OECD *Codes of Liberalisation of Capital Movements and of Current Invisible Operations*, these measures, if implemented, will be thoroughly analysed and assessed during the adherence process.

The government should act consistently with its commitment to consider and avoid unintended effects on FDI when applying any future measures. The proposed law, as currently drafted, does not appear to authorise measures that would discriminate between companies established in Costa Rica. Therefore, it is unlikely that it would have implications to the OECD *National Treatment* instrument.

## Exceptions to the National Treatment instrument notified by Costa Rica

Costa Rica's exceptions to national treatment notified under the *National Treatment* instrument of the OECD *Declaration* are based on the broad range of domestic laws and regulations documented by the Costa Rican authorities. The review also draws on other instruments, in particular Costa Rica's commitments under the CAFTA-DR and the Schedule of Specific Commitments on Services within the General Agreement on Trade in Services (GATS) of the World Trade Organization (WTO), as complementary sources of information for discussion with the authorities and validation of Costa Rica's list of exceptions to the OECD *National Treatment* instrument presented in Annex A. However, the OECD instrument follows a "negative-list approach" to notifying restrictions and discourages listing "precautionary" exceptions (i.e. not reflecting applied restrictions). Therefore lists of exceptions under these various instruments are not necessarily the same. Only measures concerning legal entities are reported for the purpose of the OECD *National Treatment* instrument, and thus any measure that may also apply to natural person is not reflected, neither in this Chapter nor in the list.

The country maintains exceptions to national treatment for established foreign-owned enterprises for access to land as well as in the following sectors: electricity (generation), mining or exploration of ores other than hydrocarbons, transport (road, water and air) and agricultural aviation.

### **Access to land**

Access to land in Costa Rica is allowed on a non-discriminatory basis between domestic and foreign investors established in the country. However, a discriminatory treatment applies to land lying in the restricted maritime terrestrial zone. The maritime terrestrial zone includes the public zone, which refers to land within 50 meters from the high tide line, and the restricted area, which refers to 150 metres of land starting from the public zone line. These two areas are defined by law as the 200-metre strip located along the entire length of the Atlantic and Pacific coast lines of Costa Rica, measured horizontally from the ordinary high tide line.<sup>17</sup> While no activity may be developed in the public zone by foreign and domestic investors, concessions may be granted in the restricted zone.

Concessions in the restricted zone shall not be granted to enterprises with bearer shares, enterprises domiciled abroad, enterprises incorporated in Costa Rica by foreigners nor to enterprises in which over 50% of the capital stock is owned by foreigners. In addition, the entities or their shareholders/stockholders entitled to those concessions are not permitted to transfer quotas or shares to foreign nationals.

### **Electricity (generation)**

Private companies are allowed to invest in power plants not exceeding 50 000 kW, provided that the Costa Rican Electricity Institute (*Instituto Costarricense de Electricidad*, ICE) purchases the electricity produced, and provided that the power generated by all such private plants in Costa Rica does not represent more than 30% of the total power produced by all public and private plants in the national electric system. Additionally, 35% of the capital stock of the company must be owned by Costa Rican nationals.<sup>18</sup> There is no restriction on foreign investment in electricity generation for own consumption.

Investment in the generation, distribution and commercialisation of electricity requires a concession, which is granted based on demand for the service, but concessionaires already supplying the service have priority.<sup>19</sup> ICE holds a *de facto* monopoly on the transmission of electricity, besides also operating in electricity generation, distribution and commercialisation. ICE also benefits from exclusive government incentives. For instance, ICE's bearer bonds in national or foreign currency are exempt from all present and future taxes.<sup>20</sup> ICE is also exempt from local taxes (imposed by municipalities), except when acting as operators or suppliers of services and products in competitive telecommunications or electricity markets.<sup>21</sup>

Private participation of capital stock in enterprises incorporated or acquired by ICE is limited to 49% of the capital stock. Participation of foreign capital in public or private legal persons entering into joint ventures with the

Public Services Company of Heredia (*Empresa de Servicios Públicos de Heredia*, ESPH) is limited to a maximum of 49% of the capital stock.

### **Mining and exploration of ores, other than hydrocarbons**

A concession from the government is required for undertaking mining activities. Foreign governments or their representatives cannot be granted concessions for mining or exploration of ores.<sup>22</sup> Open-pit metallic mining activities (including exploration and exploitation) are forbidden in Costa Rica regardless of the investor's nationality. Permits for exploration purposes are only allowed for scientific and investigation purposes.<sup>23</sup>

Foreign investors wishing to undertake mining activities in the country are required to set up an enterprise incorporated in Costa Rica with nominative stock. On a non-discriminatory basis, the state of Costa Rica may request participation as shareholder in the enterprise that was granted the concession. In this case, the enterprise must recognise the right of the state to participate, limited to a maximum of 33% of the capital.<sup>24</sup>

### **Land transportation**

Permits are required to supply international remunerated passenger road transportation services,<sup>25</sup> and they can only be granted to Costa Rican enterprises whose capital is at least 60% owned by Costa Rican nationals or to foreign enterprises whose capital is at least 60% owned by Central American nationals. The principle of reciprocity applies for the issuance of permits.

In the case of domestic freight road transport services, only Costa Rican nationals or enterprises whose capital stock is at least 51% owned and directed by Costa Rican nationals may supply such services. No motor vehicle, trailer, or tractor-trailer with foreign licence plates may transport goods within the national territory, except when registered in Central American countries.

The provision of domestic remunerated passenger road transportation services requires a concession from the Ministry of Public Works and Transportation (*Ministerio de Obras Públicas y Transportes*, MOPT). The government reserves the right to limit the number of concessions, including for special passenger transportation services (i.e. flexible itinerary services, such as door-to-door services)<sup>26</sup> and for taxi services.<sup>27</sup> Concessions are only opened for bidding if the Ministry has previously determined the need to supply the service based on proper technical studies. Companies established abroad are discriminated in the application for concessions. Where nationals and foreigners equally fulfil the parameters of selection set out in the rules of a public bid for a concession for domestic remunerated passenger land transportation services, the Costa Rican offer shall prevail.<sup>28</sup>

There are no restrictions to national treatment in the case of railroad transport services. There is however the requirement for companies wishing to provide both railroad passenger and freight transport services to be incorporated in Costa Rica. A concession for providing such services is required and is granted by the MOPT.

### **Water transportation**

A concession from the MOPT is required for the provision of maritime cabotage transport services. Concessions of water transportation services are limited, based on demand for those services, and priority is given to concessionaires already supplying the service.<sup>29</sup> Only Costa Rican enterprises of which at least 60% of the capital stock is owned by Costa Rican nationals can be granted a concession for providing such services.

In addition, tourist cabotage transport services must be conducted by vessels registered in Costa Rica. Foreign flag vessels, except for touristic cruises, using the services of a marina cannot supply water transport or fishing services, diving, or other sports or tourism-related activities. There is no discrimination towards established foreign investors in the registration of vessels. Costa Rican nationals, national public entities, enterprises incorporated in Costa Rica, or shipping company representatives can register vessels in Costa Rica.

### **Air transportation**

Previous restrictions to foreign investment in domestic air transportation, which limited foreign capital to 49% of the capital stock of the company and prohibited foreign nationals in the board of directors, were lifted in 2007.<sup>30</sup> Currently, the only remaining restriction is that only enterprises must be incorporated in Costa Rica to provide domestic air transport services.

In the case of international air transportation, certificates for the exploitation of such services are issued based on the principle of reciprocity when in the absence of agreements or conventions.

### **Agricultural aviation**

The issuance of certificates for the provision of agricultural aviation activities is restricted to companies with at least 51% Costa Rican capital stock.

### **Other measures reported by Costa Rica not covered by the OECD National Treatment instrument**

Costa Rica applies some measures which are not covered by the OECD *National Treatment* instrument as they do not constitute departures from national treatment under the terms of this instrument, but may impact FDI. Costa Rica lists these measures in the annexes on non-conforming measures

in its free trade agreements. Some of these measures may affect FDI, such as for example, incorporation requirements which limit foreign investments in the form of branches, or cross-border trade-related measures that may be more burdensome for a foreign-owned company established in Costa Rica.

Although the measures affecting FDI in the form of branching are not covered by the OECD *National Treatment* instrument, they are reported here because they are taken into account in the measuring of Costa Rica's restrictiveness to FDI under the OECD *FDI Regulatory Restrictiveness Index* (see below). These measures require investors to be incorporated under Costa Rican law in the following sectors: fishing, mining, transport, mass media and advertising services, and financial services.<sup>31</sup>

Among the measures notified by Costa Rica, one has been interpreted as not falling under the coverage of the *National Treatment* instrument, but is reported here for transparency purposes. The measure refers to the law that regulates mass media and advertising agencies, which establishes that all commercial breaks, spots and filmed commercials inserted during programmes sponsored by the state, its institutions or other entities supported by the state, shall be of national production. In addition, the state, its institutions or other entities supported by the state are required to dedicate their publicity and information on television and radio budgets to sponsor live, taped, filmed, artistic, cultural and informative programmes of national production.<sup>32</sup> In the absence of explicit legal stipulations on the interpretation of the term "national production" for the purpose of the law, the OECD Secretariat considered there is no basis to list this measure under the *National Treatment* instrument.

For transparency purposes, other measures affecting the mass media and advertising sector have also been notified by Costa Rica, but not listed under the *National Treatment* instrument. The law establishes that shares and quotas of a company owner of any broadcasting station or advertising agency cannot be encumbered in favour of foreign individuals or legal entities.<sup>33</sup> The law also grants national treatment subject to reciprocity to Central American radio, movie, or television commercials.<sup>34</sup> Established foreign-owned investments in media and advertising services are also particularly affected by a few trade-related measures. For instance, only 30% of the commercials aired on each domestic television station or projected in each cinema may originate from abroad. The number of radio programmes and radio soap operas recorded abroad may not exceed 50% of the total number aired per domestically transmitted radio stations per day. The number of programmes filmed or videotaped abroad may be limited to 60% of the total number of programmes aired on domestically transmitted television per day. Broadcasting in radio, television and cinema of foreign commercials and jingles are subject to limitations: if the commercials consist of jingles recorded

abroad, a lump sum must be paid every time the commercial is aired on domestically transmitted television. In addition, the person who hires or employs foreign artists shall hire the same number of national artists for the same show, except if the union representing most of the artists indicates a shortage of national artists to be hired.<sup>35</sup>

Costa Rica also has trade-related measures affecting other sectors, but these are not reported as they fall outside the scope of the *National Treatment* instrument.

### **Access to local finance**

Foreign-controlled established companies undertaking mining activities face restrictions in the access to local finance. Banks of the National Banking System,<sup>36</sup> which is formed only by State and public banks, are not permitted to finance foreign capital enterprises in an amount greater than 10% of the total amount invested, or enterprises in which less than 50% of capital shares are Costa Rican.

### **Government procurement**

Government procurement processes in Costa Rica are governed by the 1995 Law of Public Procurement (*Ley de Contratación Administrativa*, Law No. 7494 of 2 May 1995) and its regulations, which include several provisions aimed at upholding the principles of transparency and procedural fairness. Public interest, efficiency, equal opportunity and free competition are principles governing procurement proceedings expressly stated in the law. Three tendering procedures are allowed: open, selective and limited tendering. The law also establishes that the terms and conditions of public bidding for open tenders be announced and published in the official Gazette and in the case of the ICE, in its official website. Potential bidders and other interested parties are allowed to file objections against bidding terms and conditions before the Comptroller General for public tendering procedures or before the procuring entity in other cases. The right to appeal against final awards before the Comptroller General or the procuring entity is also guaranteed and final awards are subject to judicial review.

Costa Rica has committed to respect transparency, procedural fairness and reciprocity in several FTAs that include provisions on public procurement. It is also considering becoming an observer in the WTO Plurilateral Agreement on Government Procurement. In addition, the government has been increasing efforts to render electronic public bidding proceedings and make them accessible through the web, in order to increase efficiency and transparency. A web-based bidding system (*Mer-link*)<sup>37</sup> is in place for most purchases made by the central government, public banks and autonomous

institutions. It allows public institutions to publicise their demand for goods or services and suppliers to be aware of, participate in and follow up on public procurement procedures.

Public works concessions are governed by the General Law of Public Works Concession with Public Services (*Ley General de Concesión de Obras Públicas con Servicios Públicos*).<sup>38</sup> The purpose of this law is to regulate such contracts where, due to specific needs of the public administration, the construction or rehabilitation of physical infrastructure, plants, buildings, facilities, or other government-owned works is awarded to a supplier and, as consideration for a supplier's execution of the contract, the procuring entity grants for a specified period, the right to control and operate, and demand payment for the use of such works.

According to domestic legislation, national treatment regarding government procurement processes is granted on a reciprocity basis, but this provision is not usually applied since the government seeks to procure the best goods and services regardless of the nationality of the provider. The only clear discrimination is towards companies established abroad on concession of public works or of public works with public services. Where nationals and foreigners equally fulfil the parameters of selection set out in the rules of a public bid for a concession of public works or of public works with public services<sup>39</sup> the Costa Rican offer shall prevail.

## **Measures notified under the National Treatment instrument by Costa Rica for transparency**

### ***Investment by established foreign-controlled enterprises***

#### ***Land***

Non-discriminatory restrictions apply to territories within the two kilometre strip along the borders with Nicaragua and Panama, but residency requirements apply for foreign stockholders. These regulated frontier territories are considered national reserve and as such shall remain under state control. They are administered by the Rural Development Institute (*Instituto de Desarrollo Rural, INDER*),<sup>40</sup> and authorisations may be granted for farming, commercial, industrial, housing and public service purposes to legal entities, if foreigners own more than 50% of the capital stock and stockholders have permanent residency status in Costa Rica.

Access to land in specific zones identified as belonging to a public regime, namely indigenous territories<sup>41</sup> and wildlife protected areas,<sup>42</sup> is restricted on a non-discriminatory basis.

### **Corporate organisation and key personnel**

Costa Rica gives preferential treatment to national workers. Article 68 of the Political Constitution establishes that “no discrimination is allowed with respect to salary, advantages or work conditions between Costa Rican nationals and foreigners, or with respect to a group of workers. In equal conditions, the Costa Rican worker must be preferred.” Likewise, the Labour Code<sup>43</sup> establishes that employers have the obligation “to prefer, in equal circumstances, Costa Ricans over those who are not, and those who have performed well previously, with respect to those who have not” (Article 68 subparagraph b).

There are specific rules regarding both entry and sojourn of key personnel hired by foreign companies. The General Law of Migration and Foreigner Affairs (*Ley General de Migración y Extranjería*, Law No. 8674) establishes migratory categories for this type of personnel, among others including temporary workers, workers with a specific occupation, business visitors, intra-corporate personnel and personnel attached to after-sale services (Article 94). The Regulations on Foreigner Affairs (*Reglamento de Extranjería*, Executive Decree No. 37112) sets forth the conditions for the entry and sojourn of these categories. “Business visitor” is defined as the “foreign person who visits the country for a period that doubles the length of his/her visa as a tourist and who develops activities such as purchase and sale of goods or services, contract negotiations, discussions with colleagues or participation in business activities” (Article 2). Temporary residents can only carry out remunerated and lucrative activities on their own account or under contract if authorised by the General Directorate of Migration and Foreigner Affairs (Article 80 of Law No. 8674). For this authorisation, the Directorate takes into account the technical recommendations of the Ministry of Labour and Social Security.

Costa Rica has only a few restrictions that are more burdensome for foreign-owned firms established in the country in relation to the employment of key foreign personnel. In the road transport sector, enterprises supplying motorised freight transportation services must be effectively controlled and directed by Costa Rican nationals. In mining, 75% of the members of mining co-operatives must be Costa Rican nationals. In water transport services, at least 10% of the crew on Costa Rican registered vessels used for international traffic that call on Costa Rican ports shall be Costa Rican nationals, provided that such trained personnel are available domestically.

### **Sectors subject to public/private/mixed monopolies or concessions**

Monopolies and concessions must be notified under the OECD *National Treatment* instrument under transparency measures. Monopolies can take two forms: i) a public monopoly, run by the state or managed by local governments, and ii) a monopoly exercised under an exclusive licence granted to a private operator.

### **Public monopolies**

In Costa Rica, the following activities are subject to public monopolies:

- Exploration and exploitation of geothermal activities;
- Import, refinery and wholesale distribution of crude oil and its derivatives;
- Production and marketing of ethylic alcohol for the elaboration of alcoholic beverages;
- Water supply and public sewage services;
- Social service of postal communication of letter classified as letters and cards (LC) according to the Universal Postal Union;
- Lottery sale services;
- Electricity transmission; and
- Basic traditional telephony (fixed telecommunications).

### **Concessions**

Investments in the following sectors are subject to concessions:

- Railroad, road and maritime transport services;
- Marinas, docking facilities and airport services;
- Radio and television broadcasting services;
- Wireless services;
- Electricity generation, distribution and commercialisation;
- Mining and hydrocarbons exploration;
- Irrigation services;
- Maritime and air services in national ports; and
- Collection and treatment services of industrial and solid waste.

## **Rationale for the existing restrictions and plans for phasing them out**

According to the authorities, some restrictions are based on the need to ensure harmonisation and equilibrium of the needs and interests of consumers, users and suppliers of public services, the assurance of standards of quality, quantity, opportunity, stability and reliability in their provision, the enhancement of cost-oriented tariffs and prices, whilst promoting local investment projects. Other restrictions are designed to keep certain strategic sectors of economic, social or cultural interest within the scope of the state's control. Lastly, some restrictions seek to endorse the state's ownership, use and supervision of the national patrimony, including assets of public domain, as well as its right to demand liability from economic activities that have a bearing on matters of public interest.

Although no periodic reviews are in place to evaluate the cost of the discriminatory restrictions, some initiatives have been pursued to reduce the scope of the restrictions in certain sectors, in particular telecommunications, insurance and electricity.

Since 2008, Costa Rica has experienced substantial transformations in two sectors which were formerly state monopolies: telecommunications (provided by ICE, the Costa Rican Electricity Institute) and insurance (provided by INS, the National Insurance Institute). In the context of CAFTA-DR, Costa Rica adopted commitments to open up these sectors and enacted domestic legislation<sup>44</sup> to implement them. In both sectors, legislation entailed the adoption of a new regulatory framework and the establishment of two new regulatory institutions: the Superintendence on Telecommunications (*Superintendencia de Telecomunicaciones* – SUTEL) and the General Superintendence on Insurance (*Superintendencia General de Seguros* – SUGESE).

In telecommunications, the new legislation includes regulatory principles such as universal service, independence of the regulatory authority, transparency, interconnection, and fair competition. It provides for market opening in three areas: mobile services, internet services, and private networks. This allows telecommunications services providers, on a non-discriminatory basis, to effectively compete to directly supply services to customers. Over the last few years, SUTEL has granted 115 authorisations to private operators to supply telecommunications services (Chapter 3 Sections on Competition and Infrastructure).

In the insurance sector, the new legislation fully opens the sector to competition by national and foreign enterprises, subject to the fulfilment of legal requirements which are applicable on a non-discriminatory basis, i.e. compliance with prudential solvency and integrity requirements. Since 2008, the number of registered insurance products has increased about three times, and there are currently 12 private enterprises, including international companies, incorporated and authorised to provide insurance services (Chapter 3 Section on Financial sector development).

In electric energy generation, current legislation authorises private companies to invest in power plants not exceeding 50 000 kW, whilst obliging them to sell the electricity produced to ICE. With the objective of promoting reform in this sector, a special legislative commission<sup>45</sup> was established in September 2010 to discuss and bring together into one single bill, a series of initiatives<sup>46</sup> related to electric energy, formerly submitted to the legislative process. These initiatives aim at enhancing the private sector's participation in the electricity sector and further liberalising generation, transmission and distribution of electricity (Chapter 3 Section on Infrastructure). Indeed, the

authorities are encouraged to evaluate the impact of these restrictions and consider alternative, non-discriminatory means to meet legitimate public policy objectives.

At present, the authorities have indicated that they envisage no further measures liberalising foreign investment in specific sectors.

### **Costa Rica's position under the instrument of the OECD Declaration on Investment Incentives and Disincentives**

The instrument on *Incentives and Disincentives to Investment*, which is an integral part of the *Declaration on International Investment and Multinational Enterprises*, recognises that adherents may be affected by this type of measure and stresses the need to strengthen international co-operation in this area. It first encourages them to make such measures as transparent as possible so that their scale and purpose can be easily determined. Secondly, the instrument provides for consultations and review procedures to make co-operation between adherents more effective.

Costa Rica has declared that it is ready and able to fulfil its commitments under this instrument, in particular by pursuing its efforts to make its support system more transparent and to further improve evaluation of costs and benefits of existing investment incentive measures (Chapter 3 Section on Investment promotion and facilitation).

### **Costa Rica's position under the instrument of the OECD Declaration on Conflicting Requirements**

The instrument on *Conflicting Requirements*, which is also an integral part of the *OECD Declaration on International Investment and Multinational Enterprises*, provides that adherents should co-operate with a view to avoiding or minimising the imposition of conflicting requirements on multinational enterprises. By adopting an approach based on co-operation, adhering countries agree to hold consultations on potential problems and to give due consideration to the interests of other countries in the regulation of their economic affairs.

Costa Rica has not identified conflicting requirements imposed on multinational enterprises operating simultaneously in the country and in other countries jurisdictions, and has not received any complaints from multinational enterprises on conflicting requirements stemming from Costa Rican laws and regulations. The government is committed to address any conflicting requirements that may be brought to its attention.

In undertaking to pursue efforts to make its investment regime more transparent and uniform, Costa Rica considers itself able to fulfil commitments under the instrument on *Conflicting Requirements* and is ready to co-operate with other adhering countries in this area.

## FDI Regulatory Restrictiveness Index for Costa Rica

The OECD *FDI Regulatory Restrictiveness Index (FDI Index)* seeks to gauge the restrictiveness of a country's FDI rules (see Box 2.2). The Index is currently available for 34 OECD countries, 11 countries adhering to the *OECD Declaration on International Investment and Multinational Enterprises* and 13 other countries, including China, India, Indonesia and Russia. It is used on a stand-alone basis to assess the restrictiveness of FDI policies in reviews of candidates for OECD accession and in *OECD Investment Policy Reviews*, including reviews of new adherent countries to the *OECD Declaration*.

The *FDI Index* does not provide a full measure of a country's investment climate as it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework, such as the extent of state ownership, and other institutional and informal

### Box 2.2. Calculating the FDI Regulatory Restrictiveness Index

The OECD *FDI Regulatory Restrictiveness Index* covers 22 sectors, including agriculture, mining, electricity, manufacturing and main services (transport, construction, distribution, communications, real estate, as well as financial and professional services).

For each sector, the scoring is based on the following elements:

- the level of foreign equity ownership permitted,
- the screening and approval procedures applied to inward foreign direct investment;
- restrictions on key foreign personnel; and
- other restrictions such as on land ownership, corporate organisation (e.g. branching).

Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is a weighted average of individual sectoral scores.

The measures taken into account by the Index are limited to statutory regulatory restrictions on FDI as reflected in the countries' lists of exceptions to the *National Treatment* instrument and measures notified for transparency without assessing their actual enforcement. The discriminatory nature of measures, i.e. when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored. Incorporation requirements, as they restrict FDI in the form of branching, are also taken into account although they are not covered and, thereby, listed as an exception in the *National Treatment* instrument.

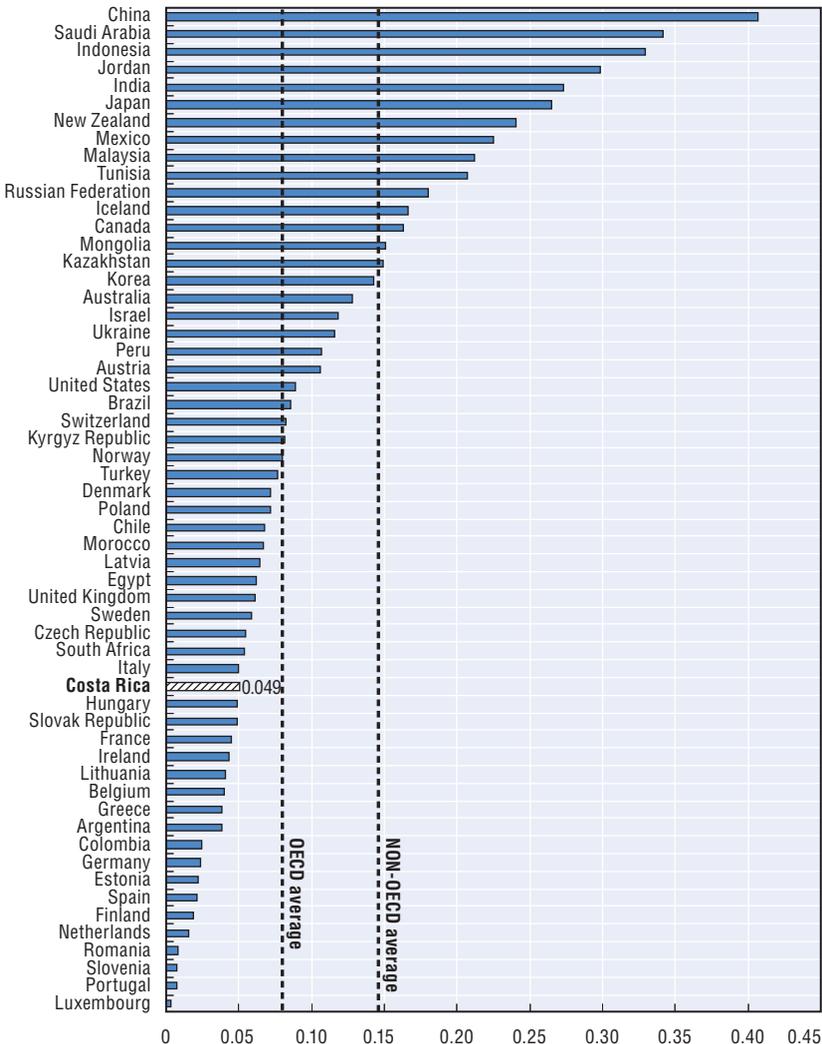
For the latest scores: [www.oecd.org/investment/index](http://www.oecd.org/investment/index) and for a discussion of the methodology: *OECD Working Paper on International Investment* No. 2010/3.

restrictions, which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of a country's attractiveness to foreign investors and the FDI Index, used in combination with other indicators measuring various aspects of the FDI climate, contributes to assessing countries' international investment policies and to explaining variations among countries in attracting FDI.

Costa Rica ranks rather well in the *FDI Index* compared to over 50 countries for which the *Index* is currently available (Figure 2.1). With a score of 0.049, the country stands below both the OECD average (0.079) and the average for

Figure 2.1. **OECD FDI Regulatory Restrictiveness Index, as of December 2012**

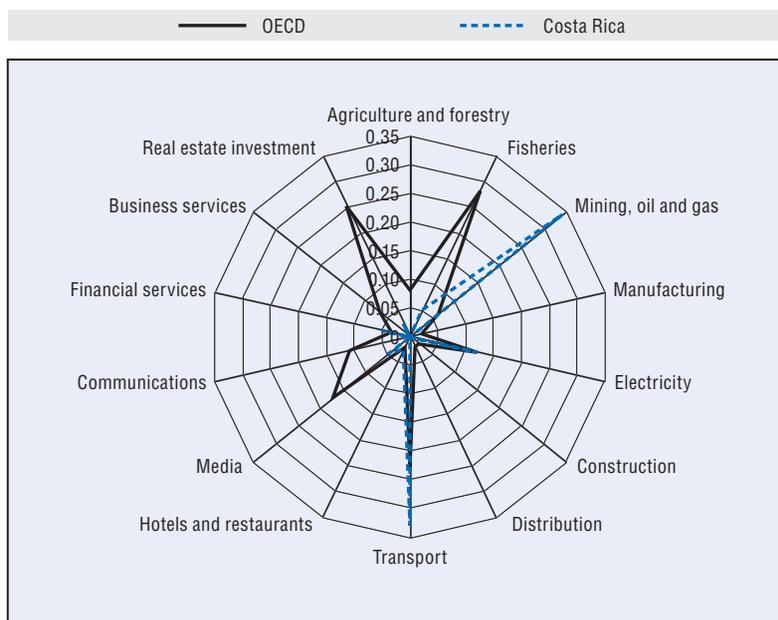
Closed = 1; Open = 0



non-OECD countries (0.145) in terms of FDI restrictions. In comparison to the 10 adherent countries to the *OECD Declaration on International Investment and Multinational Enterprises*,<sup>47</sup> Costa Rica stands significantly below the *FDI index* average of adherent countries (0.089). Costa Rica's position in the *FDI Index* reflects and confirms its regulatory openness towards foreign direct investors.

Restrictions to FDI in Costa Rica are mainly concentrated in a few service sectors and mining (Figure 2.2). In a number of sectors, restrictions to FDI refer mainly to incorporation requirements. Foreign equity limitations also exist in a few other sectors, notably transport, electricity and mining (see above). In two of these sectors, namely transport and mining, restrictions to FDI are higher than the average for OECD countries. Costa Rica has no FDI sector-specific restriction on manufacturing. This has contributed to the development of a competitive manufacturing industry in the country that is currently advancing towards more knowledge-intensive activities and is increasing its integration to the world economy.

Figure 2.2. **OECD FDI Regulatory Restrictiveness Index by sectors, 2012**



Productivity in the manufacturing industry may nevertheless suffer in the near term as a result of bottlenecks in some sectors, notably transport and electricity. Private investment in electricity generation needs to increase in order to modernise the sector, improve use of renewable energy and electricity generation, meet growing demand and eventually reduce the relatively high

cost of electricity. Foreign investment in the sector is currently discouraged by restrictions while it has the potential to develop these sectors (Chapter 3 Section on Infrastructure). An analysis of the impact of such restrictions should be undertaken in order to assess whether they continue to meet legitimate public policy objectives and the government may consider alternative, non-discriminatory means with a view to facilitate investment in the sector.

## Notes

1. The list of exceptions to national treatment and the list of measures reported for transparency by all adhering countries are available at [www.oecd.org/industry/inv/investment-policy/nti.htm](http://www.oecd.org/industry/inv/investment-policy/nti.htm).
2. Governed by the Free Zone Regime Law, No. 7210 from 1990, and the Executive Decree No. 34739-COMEX-H from 2008 and their amendments.
3. Governed by the General Customs Law (Law No. 7557 of 20 October 1995), the Regulations to the General Customs Law (Executive Decree No. 25270 of 14 June 1995) and the Regulations to the Inward Processing Regime (Executive Decree No. 34165-H-COMEX), and their amendments.
4. Governed by the General Customs Law.
5. Governed by the Law on Incentives for Tourism Development (Law No. 6990 of 5 July 1985) and its amendments (Law No. 7293 of 31 March 1992 and Law No. 8114 of 4 July 2001).
6. "The term 'stabilization clause' refers to the contractual clauses in private contracts between investors and host states that address the issue of changes in law in the host state during the life the project." Ruggie J. (2009), *Stabilization Clauses and Human Rights*, IFC and UNHCHR, New York and Geneva.
7. Approved by Law No. 7202 of 24 October 1990.
8. The Decision No. 2120 of 2013 defines the extent of the right of free access to public interest files according to Article 30 of the Constitution.
9. [www.asamblea.go.cr](http://www.asamblea.go.cr).
10. *La Gaceta digital*: [www.gaceta.go.cr](http://www.gaceta.go.cr).
11. [www.pgr.go.cr/scij/index\\_pgr.asp](http://www.pgr.go.cr/scij/index_pgr.asp).
12. Popular initiative for bills of law may be performed through a referendum. The referendum process can be initiated by: i) 5% of duly registered national citizens; ii) two third of the total membership of Congress, or iii) the Executive Branch, along with absolute majority of the total membership of Congress. Bills on budgetary, tax, fiscal, monetary, credit, pensions and security matters, loans and contracts, and administrative matters cannot be subject to a referendum process.
13. Articles 361 and 362 of the General Law on Public Administration (Law No. 6227).
14. Article 273 of Law No. 6227 stipulates the conditions under which information is not made available to the public: when State secrets or confidential information of the Parties may be compromised and when the access to that information may confer a Party an undue privilege, or an opportunity to damage the public administration, the counterpart or third parties.

15. Exceptions include intervening in the political affairs of the country (subject to the jurisdiction of the courts of justice and the authorities of the Republic) and resorting to diplomatic channels (except as provided for in international conventions).
16. The Organic Law of the Central Bank (Article 85) stipulates that the currency exchange regime must guarantee the freedom of conversion of domestic currency to foreign currency.
17. Law No. 6043 of 2 March 1977.
18. Articles 3, 5 and 20, Law No. 7200 of 28 September 1990.
19. *Ibid*, and Law No. 7593 of 9 August, 1996.
20. Article 9, Law No. 449 of 8 April 1949.
21. Article 18, Law No. 8660 of 8 August 2008.
22. Articles 7 and 9, Law No. 6797 of 4 October 1982.
23. Article 8bis, Law No. 6797 of 4 October 1982.
24. Article 54, Law No. 6797 of 4 October 1982.
25. Article 4, Executive Decree No. 26 of 10 November 1965.
26. Law No. 3503 of 10 May 1965, Executive Decree No. 28337-MOPT of 16 December 1999, and Executive Decree 15203-MOPT of 31 January 1984.
27. Law No. 7969 of 22 December 1999, Executive Decree No. 33526 of 7 December 2006, Executive Decree No. 5743-T of 12 February 1976, Executive Decree No. 28913-MOPT of 13 September 2000, Executive Decree No. 35847-MOPT of 11 February 2010, Executive Decree No. 35985 of 16 April 2010.
28. Article 6, Law No. 3503 of 10 May 1965.
29. Executive Decree No. 66 of 4 November 1960.
30. *Sala Constitucional* No. 11156-2007 of 1 of August 2007.
31. Similar to other countries, in the sectors in which foreign enterprises are allowed to establish branches to carry out operations in Costa Rica, they are required to establish and maintain a legal representative with full power of attorney (*apoderado generalísimo*) to execute any acts that are necessary for the businesses of the branch (Law No. 3284 of 30 April 1964).
32. Article 1, Law No. 4325 of 17 February 1969.
33. Article 4, Law No. 6220 of 20 April 1978.
34. Article 11, Law No. 1758 of 19 June 1954.
35. Article 3, Law No. 5812 of 10 October 1975.
36. Article 1, Law No. 1644 of 26 September 1953.
37. Currently, *Compra Red* (the former web-based bidding system) is still in place, while public entities are encouraged to use *Mer-Link* ([www.mer-link.cr](http://www.mer-link.cr)). A ruling has been issued in order to have *Mer-Link* as the only system to be used by all public entities in 2014.
38. Law No. 7762 of 14 April 1998.
39. Law No. 7762 of 14 April 1998.

40. Formerly known as Agrarian Development Institute (*Instituto de Desarrollo Agrario*, IDA), it was transformed into INDER by the Law No. 9036 of 11 May 2012.
41. Articles 3 and 5, Law No. 6172 of 29 November 1977.
42. Articles 32 and 37, Law No. 7554 of 4 October 1995. Articles 13 and 14, Law No. 7575 of 13 February 1996.
43. Law No. 2 of 2 August 1943.
44. Law No.8642 of 4 June 2008 and Law No.8653 of 22 July 2008.
45. Special Legislative Commission, File No.17820.
46. Bill No.18093, Bill No.17495, Bill No.17474, Bill No.17496, Bill No.17666, Bill No.17812, Bill No.17811.
47. Argentina, Brazil, Colombia, Egypt, Latvia, Lithuania, Morocco, Peru, Romania, Tunisia and Jordan (forthcoming).

## Chapter 3

### Costa Rica's policy framework for investment

*This chapter examines Costa Rica's investment policy in light of the OECD Policy Framework for Investment (PFI). The PFI was developed within the OECD by the representatives of nearly 60 countries, and poses a list of key questions that should be examined by governments seeking to create a favourable investment climate. The objective of the PFI is to mobilise private investment in support of stable economic growth and sustainable development, contributing in this way to the prosperity of countries and their citizens and to combating poverty. The PFI is not prescriptive. It is a flexible instrument that allows countries to evaluate their progress and identify priorities for action in various policy areas.*

*The chapter puts emphasis on the country's investment policy and investment promotion and facilitation, and addresses less extensively other aspects of the PFI (trade policy, competition policy, human resource development, infrastructure development, financial sector development, and public governance and anti-corruption). Some related areas are also discussed in Chapter 4 on Costa Rica's adherence to the Guidelines for Multinational Enterprises, in particular the policies promoting responsible business conduct.*

This chapter examines Costa Rica's investment policy in light of the OECD *Policy Framework for Investment* (PFI) (Box 3.1). It puts emphasis on the country's investment policy and investment promotion and facilitation, and addresses less extensively other aspects of the PFI (trade policy, competition policy, human resource development, infrastructure development, financial sector development, and public governance and anti-corruption). Some related areas are also discussed in Chapter 4 on the adherence to the *Guidelines for Multinational Enterprises*, in particular the policies promoting responsible business conduct.

#### Box 3.1. The OECD Policy Framework for Investment

The OECD Policy Framework for Investment (PFI) was developed within the OECD by the representatives of nearly 60 countries, and poses a list of key questions that should be examined by governments seeking to create a favourable investment climate. The objective of the PFI is to mobilise private investment in support of stable economic growth and sustainable development, contributing in this way to the prosperity of countries and their citizens and to combating poverty.

The PFI is not prescriptive. It is a flexible instrument that allows countries to evaluate their progress and identify priorities for action in ten policy areas: i) investment policy, ii) investment promotion and facilitation, iii) trade policy, iv) competition policy, v) tax policy, vi) corporate governance, vii) policies for promoting responsible business conduct, viii) human resource development, ix) infrastructure and financial sector development, and x) public governance. Three principles apply throughout the framework: policy coherence, transparency in policy formulation and implementation, and regular evaluation of the impact of existing and proposed policies.

By encouraging a structured process for formulating and implementing policies at all levels of government, the PFI can be used in various ways, including for self-evaluations, peer reviews, regional co-operation, and multilateral discussions.

A User's Toolkit has been developed offering practical guidance on how to implement the PFI. It highlights how the core principles of the PFI influence investment; how the various chapters of the PFI relate to one another and how the PFI can assist in an on-going and iterative process of reform and in fostering public-private dialogue.

Source: OECD, [www.oecd.org/daf/investment/pfi](http://www.oecd.org/daf/investment/pfi) and [www.oecd.org/investment/pfitoolkit](http://www.oecd.org/investment/pfitoolkit).

## Investment policy

The quality of investment policies directly influences the decisions of all investors, be they small or large, domestic or foreign. Transparency, property protection and non-discrimination are investment policy principles that underpin efforts to create a sound investment environment for all.

### **International assessment of Costa Rica's business environment**

Costa Rica has uneven results among international rankings that assess investment climates across countries worldwide. These assessments are using different methodologies, some based on factual data (e.g. number of procedures) and others on stakeholders' perception.

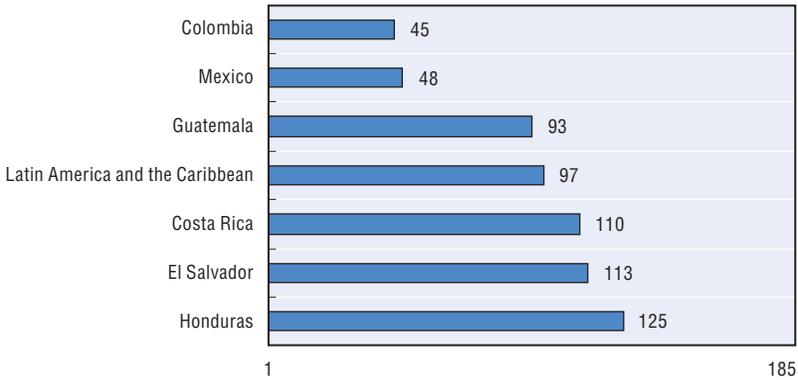
The country is relatively well positioned on the World Economic Forum (WEF) *Global Competitiveness Index*, which 2012-13 edition ranks it at the 57th position out of 144 assessed economies. It is very well ranked regionally, as the sixth most competitive among LAC countries, after Chile, Panama, Barbados, Brazil and Mexico. Costa Rica boasts a high quality education system (21st) and a good capacity to innovate (43rd) among its major strengths. Among its main weaknesses, the report highlights the poor quality of transport infrastructure (116th) and the excessive time needed for procedures to open a business (130th). Based on surveys among the business community, the WEF report also notes that the most problematic factors for doing business are inefficient government bureaucracy, an inadequate supply of infrastructure and difficult access to financing.

Costa Rica's ranking on the World Bank *Doing Business* is rather poor. It is ranked 110th out of 185 economies on the 2013 edition. However, it gained 12 places compared to 2012 and was ranked among the top 10 world reformers. At regional level, the country is below the LAC average, standing at 97th place (Figure 3.1). In terms of indicators, Costa Rica's main weaknesses are "protecting investors" (169th), "starting a business" (128th), "dealing with construction permits" (128th), "enforcing contracts" (128th) and "resolving insolvency" (128th), while its main strengths are "getting electricity" (45th), "registering property" (46th) and "trading across borders" (51st) (Figure 3.2). Similarly, the World Bank 2010 *Enterprise Survey* concluded that the top three business environment constraints (out of 10) are, respectively, access to finance, practices of the informal sector and inadequately educated workforce. Business licenses and permits hold fourth position.<sup>1</sup>

In light of the weaknesses identified in the *Doing Business* Report, the government instigated a project that is supported by the World Bank to improve its ranking on the most pressing issues. As a result, Costa Rica's position improved by 12 places between 2012 and 2013 and efforts to further improve the position are on-going.

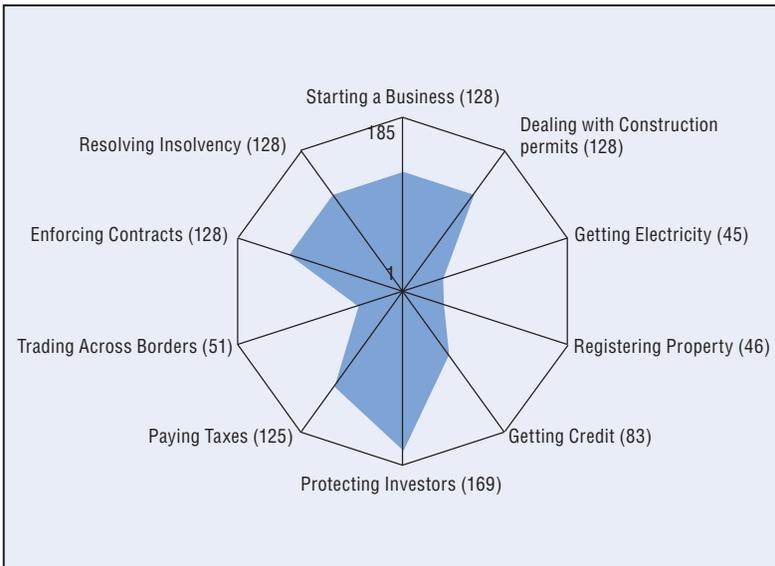
In conclusion, international assessments suggest that although Costa Rica is a competitive and open economy, there is room for improvement with regard to its investment environment and business climate. The aim of this section is to provide an analysis of several elements of the country's investment legal framework as a complement to the previous chapter.

Figure 3.1. **Ease of doing business: regional comparison**



Source: World Bank (2012a), Doing Business 2013.

Figure 3.2. **Costa Rica's ranking in Doing Business 2013**



Source: World Bank (2012a), Doing Business 2013.

### **Property rights and access to land**

Well-defined and secure land access and ownership, including effective registration, are important pre-requisites for a healthy investment environment. Reliable land titling and property registrars offer a form of collateral that investors can use to improve access to credit.

Article 45 of the Political Constitution encompasses the fundamental principle of inviolability of property, whereby no owner may be deprived of it unless there is a legally proven public interest and prior compensation. Other legislation and regulations, including the Civil Code, deal with the legal protection of private property. The Civil Code describes the rights covered by the ownership of property and the acquisition processes and rules. The Criminal Code imposes criminal sanctions to the violation of private property. The Expropriation Law states that in order to expropriate, a legally proven public interest and prior compensation is required (see below).

Except in restricted maritime terrestrial zones and in the territories within the 2 000 meters strip alongside the borders with Nicaragua and Panama, there is non-discriminatory access to land between domestic and foreign investors (Chapter 2).

Property protection is guaranteed by the state-administered registration system, which is carried out at the Public Registry (*Registro Nacional*), the centralised and competent entity to ensure legality of properties.<sup>2</sup> It comprises the country's registration systems for all types of property (i.e. land and concessions, movable assets, legal persons and intellectual property).<sup>3</sup> It is a subsidiary body of the Ministry of Justice and Peace and, as a public service entity, it performs the role of recording properties transactions, and offering publicity and legal certainty of the rights registered therein, before third parties. The National Cadastre is part of the Public Registry and records real estate.

Public access to the property registration system is guaranteed. Property reviews are possible through different search criteria (e.g. owner's ID, property registration number, cadastral plan number) from the databases available for public consultation. All information regarding properties and their registered owners can be obtained online without cost.<sup>4</sup> In addition, the Public Registry has several regional offices throughout the country. Certifications of property status can be requested online or physically at a low cost.

Security mechanisms required for the registration of real estate transactions seek to prevent the occurrence of fraud, protecting and granting legal certainty to proprietors, third parties and the public in general. All acts of land transfer must be endorsed by a Public Notary through a public deed, which is filed at the Public Registry in order to make it effective *vis-à-vis* third parties. Registry officials have a period of eight days to approve the deed and

publish the transfer or deny its filing. Registry entries may be challenged, and there are two paths to follow, depending on the nature of the complaint: extra-registry cases and intra-registry cases.<sup>5</sup> Property registration and transaction costs are correlated to the property's value. The same applies to applicable registration fees,<sup>6</sup> transfer taxes,<sup>7</sup> and public notary service fees.<sup>8</sup>

The country performs reasonably well on the *Doing Business* “registering property” indicator, for which it ranks 46th out of 185 economies in 2013. The number of procedures (five), the time required (20 days) and the cost induced (3.4% of property value) are all equal to or lower than the OECD average (respectively five procedures, 26 days and 4.5% of property value).

However, the government is still facing some challenges related to land ownership and management. According to the National Development Plan, one of the challenges to the country's competitiveness is the inadequate regulatory framework for land use and management. Related actions have been identified and include the regularisation of the cadastre with the objective of providing the country with an updated cadastre consistent with the information of the Real Estate Registry; and the development of regional plans to improve territorial management. The authorities also acknowledged the problem of consistency between properties' registered information and their cadastral surveys. The 2012 US Investment Climate Statement recognises that there are “continuing problems of overlapping title to real property”, as well as “fraudulent filings with the National Registry.” To overcome this problem, the Public Registry has established a programme aimed at integrating information in the Real Estate Registry and the National Cadastre. It is expected that once the programme will be completely executed, the geographical situations and borders of all properties will be attached to their records in the system.

There are two ways of protecting lands in Costa Rica: the protected areas where property rights are limited and the system under the Law of Lands and Colonisation (*Ley de Tierras y Colonización*, Law No. 2825 of 14 October 1961) which regulates the exceptional case of possession of unused land by farmers in state of necessity and under specific requirements (Article 92). The Law recognises the right to denounce the existence of lands where exploitation does not comply with the social function of property (Article 6). A mechanism allows farmers to occupy unused land and initiate procedures for rights' acquisition under certain circumstances. The Rural Development Institute (*Instituto de Desarrollo Rural*, INDER) is the entity in charge of dealing with the issue and should propose its mediation. If INDER declares the property in conflict, the land can be sold and handed over to the so-called *precaristas*. INDER is in charge of evaluating the price of the occupied lands and manages the expropriation process. If INDER does not declare the existence of a conflict within three months, or if the conflict has not been solved after one year, claimants can submit their case to a tribunal and request for expropriation (Chapter VI of the Law).

The issue of squatter's rights requires investors to exercise due diligence over property acquisition to ensure that no conflict ensues over the land, but also over the property itself if unoccupied.<sup>9</sup> The Costa Rican authorities recognised that this mechanism has been used in the 1980s and 1990s and led to some conflicts. However, in the past years, there have been very few cases of precarious occupation and none were registered in 2012-13. Given that the country has reached its agricultural limits for arable lands, there is less social pressure to occupy land, making precarious occupation less likely. This issue is not anymore identified as a major problem by investors. An ICSID case was brought in 2008 by a Canadian company which alleged that the government did not take appropriate measures to protect its properties against continuous invasion of squatters. However, the case was settled in favour of the Costa Rican state (see below).

Costa Rica still ranks 128th in the 2013 *Doing Business* for "dealing with construction permits", although it improved by 11 places compared to the previous edition and has recently implemented online approval systems streamlining the process for obtaining construction permits. One of the most significant challenges regarding construction permits relates to the length of the process, which used to take in many instances about 90 days. Moreover, procedures to obtain a construction permit had to be conducted before diverse agencies, including the Ministry of Health, the National Housing Institute, the Costa Rican Institute of Aqueducts and Sewage, the Fire Department and Municipalities, which made the process very cumbersome.

The government is currently addressing the issue by streamlining procedures in the area. Forty-one specific procedures for construction permits related to five public institutions<sup>10</sup> were identified as priorities for streamlining and a system for the Digital Review of Construction Plans was implemented in 2011.<sup>11</sup> The digital platform allows for the parallel and simultaneous review of construction plans by all institutions that should give their approval, instead of the previous process which required review by these institutions one after the other. This digital simultaneous review reduced the time for construction plan approval from 90 to 30 days. The system has been implemented in 27 municipalities, including the Municipality of San José (which has the largest volume of construction plans review processes).

In conclusion, laws governing land access and tenure are thus generally transparent and there is no discrimination between foreigners and Costa Ricans – except in restricted maritime terrestrial zones and borders territories. Nevertheless, there are challenges to overcome. The regulatory framework for land use and management needs to be enhanced through improved titling and cadastre. Investors are therefore required to exercise due diligence over property acquisitions and maintenance. In addition, the process of obtaining construction permits is lengthy and cumbersome, but notable efforts are being made to streamline procedures.

## Intellectual Property Rights

Intellectual property (IP) rights give businesses an incentive to invest in research and development (R&D), and ultimately lead to the creation of innovative products and processes. The effectiveness of IP instruments in terms of encouraging investment in innovation activity also depends on how well the rights are enforced. IP protection needs to strike a balance between society's interests in fostering innovation and in keeping markets competitive.

In Costa Rica, Article 47 of the Political Constitution provides that “every author, inventor, producer or merchant shall temporarily enjoy exclusive ownership of his work, invention, trademark or trade name, in accordance with the law”. This constitutional protection provides for the legal foundations of the Costa Rican intellectual property rights system. In addition, the country ratified many of the major international IP rights treaties (Table 3.1) and developed a national legislation for protection and enforcement that implements international commitments.

National legislation provides for protection of copyright and related rights, patents, industrial designs, trademarks, geographical indications, plant varieties, undisclosed information, including test data protection. All of these rights can be enforced through mechanisms available under the Law on

Table 3.1. **International intellectual property rights treaties ratified by Costa Rica**

Treaty	Year of Ratification
Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations	1971
Berne Convention for the Protection of Literary and Artistic Works	1978
World Intellectual Property Organization (WIPO) Convention	1981
Convention for the Protection of Producers of Phonograms Against Unauthorised Duplication of their Phonograms	1982
Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement – WTO)	1995
Paris Convention for the Protection of Industrial Property	1995
Lisbon Agreement for the Protection of Appellations of Origin and their International Registration	1997
Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite (Brussels 1974)	1999
Patent Co-operation Treaty	1999
WIPO Copyright Treaty	2000
WIPO Performances and Phonograms Treaty	2000
Budapest Treaty on the International Recognition of the Deposit of Micro-organisms for the Purposes of Patent Procedure	2008
International Union for the Protection of New Varieties of Plants (UPOV Convention)	2008
Trademark Law Treaty	2008

Source: WIPO.

Enforcement of Intellectual Property Rights (*Ley de Procedimientos de Observancia de los Derechos de Propiedad Intelectual*, Law No. 8039 of 12 October 2000). The main national laws are detailed below and include some provisions that go beyond the TRIPS Agreement:

- **Trademarks.** The Law on Trademarks and Other Distinctive Signs (*Ley de Marcas y Otros Signos Distintivos*, Law No. 7978 of 6 January 2000) includes the possibility to grant protection to collective trademarks and to incorporate sound and scent marks.
- **Geographic indications.** Costa Rica provides *sui generis* protection to all sorts of products through the Law on Trademarks and Other Distinctive Signs and the Regulation for the Protection of Geographical Indications and Appellations of Origin (*Reglamento de las Disposiciones Relativas a las Indicaciones Geográficas y Denominaciones de Origen*, Executive Decree No. 33743 of 14 March 2007). The protection of geographical indications has proven to be important for national agribusinesses (i.e. bananas and coffee) and small producers.
- **Patents.** Protection for any invention for all technology fields, and applicable legal exceptions may be found in the Law on Patents (*Ley de Patentes de Invención, Dibujos y Modelos Industriales y Modelos de Utilidad y sus reformas*, No. 6867 of 25 April 1983). Legal exceptions to patent protection are those contained in Article 27.3 of the TRIPS Agreement. In addition, Costa Rica is signatory of the Patent Co-operation Treaty, whereby registration procedures are equal to those available in the member countries to such agreement.
- **Test data protection.** The national legislation (*Ley de Información no Divulgada*, Law No. 7975 of 4 January 2000 and *Reglamento a la Ley de Información no Divulgada*, Executive Decree No. 34927 of 28 November 2008) grants five years of protection for pharmaceutical products and ten years of protection for agrochemical products. The test data protection covers new products only, which are those that do not contain a chemical component that has been previously approved in the country.
- **Copyrights and related rights.** According to national legislation (*Ley de Derechos de Autor y Derechos Conexos*, Law No. 6683 of 14 October 1982 and *Reglamento a la Ley de Derechos de Autor y Derechos Conexos*, Executive Decree No. 24611 of 4 September 1995), a minimum protection period of 70 years is granted after the death of the author, performer or producer. The same period is granted to broadcasting organisations. Additional provisions regarding effective technological measures and management information rights were established by law, as well as exceptions applicable to libraries and educational institutions. Furthermore, Costa Rica has regulations to limit the liability of Internet Service Providers in cases where third parties

infringe copyrights and related rights through their networks (*Reglamento Sobre la Limitación a la Responsabilidad de los Proveedores de Servicios por Infracciones a Derechos de Autor y Conexos de Acuerdo con el Artículo 15.11.27 del Tratado de Libre Comercio República Dominicana – Centroamérica – Estados Unidos*, Executive Decree No. 36880 of 18 October 2011).

Over the course of the last decade, Costa Rica has experienced two major modernisations of IP rights standards prompted by the implementation of the WTO TRIPS Agreement and the entry into force of the CAFTA-DR in 2009. As a result, the current national IP rights system was revised to ensure consistency with international obligations. The ratification of CAFTA-DR marked a new stage for IP rights in the country, upgrading the protection standards established in the TRIPS Agreement. For instance, through CAFTA-DR, the country instituted exclusive periods of protection for pharmaceutical and agrochemical test data; committed to establish mechanisms to limit the liability of Internet service providers in copyright infringement cases;<sup>12</sup> agreed to ratify the UPOV Convention, the Trademark Law Treaty and the Budapest Treaty; and set up new enforcement mechanisms.

As regards the institutional framework, the government created in 2002 the Inter-institutional Commission on Intellectual Property (*Comisión de Enlace Interinstitucional para la Protección de la Propiedad Intelectual*),<sup>13</sup> to promote co-ordination and co-operation between public institutions and between public and private ones, and to work towards the effective implementation of the norms that regulate intellectual property in Costa Rica. The Commission has taken a central role in the organisation of IP tasks and improved the inter-institutional co-ordination amongst various government agencies involved in IP rights protection. According to the authorities, this role has been acknowledged by WIPO, which considers replicating the model in other Latin American countries.

Registration processes are conducted by three different institutions. The Industrial Property Registry (*Registro de Propiedad Industrial*) is the entity in charge of the registration of patents, industrial designs, trademarks and other distinctive signs, and geographical indications. The Copyright and Related Rights Registry (*Registro de Derechos de Autor y Derechos Conexos*) provides for information and registers copyright and related rights. In 2003, this Registry opened an office for consultations regarding registration procedures, scope of protection, licenses, contracts to grant licenses and enforcement. The National Seeds Office (*Oficina Nacional de Semillas*) is responsible for registering plant varieties.

Registries are currently working without backlogs, except for the Patent Office, a subdivision of the Industrial Property Registry, which is working on reducing long delays. On average, trademark registration may take approximately

four months when no opposition is presented, while industrial designs registration may take six months. Patents registration usually takes five years. In general, registration costs are low and aligned with international standards.<sup>14</sup> As Costa Rica is party to various international registration agreements administered by WIPO, applicants can easily register their IP rights internationally. This also guarantees that registration procedures are in compliance with international standards. The Industrial Property Registry and the Copyright and Related Rights Registry received training from WIPO for the adequate implementation of standards and adjusted its internal procedures to comply with them, in particular through circulars (internal notices to staff to communicate orders from superiors).

In addition to the legal and institutional framework, the country has implemented policies to foster economic development through IP rights. The government recognised that defining a national IP policy is essential for enhancing the country's competitiveness, development and culture. It established its first National Strategy of Intellectual Property in 2011, which was launched by the President in April 2012. The strategy aims at strengthening the strategic use of intellectual property in research activities, business development and creative initiatives; raising awareness in the population on the importance of intellectual property; increasing the competitiveness of the productive sector; and promoting the social, economic and cultural development of the country. Developed on the basis of consultations with national and international industry, academia and civil society groups, the strategy established five strategic objectives and defined specific actions, deliverables, and terms for implementation to evaluate impact. The first implementation stage is scheduled in 2013.

Other relevant policies developed by the government in this field are the National Strategy on Entrepreneurship, designed by the Ministry of Economy, Industry and Commerce, and the National Plan for Science, Technology and Innovation, led by the Ministry of Science, Technology and Telecommunications. These policies aim at encouraging entrepreneurship and investment in innovation and technology. The government has also designed tools for SMEs to take advantage of the intellectual property rights system. For instance, given that high costs of patent registration may be an obstacle for SMEs, a reduction of 70% of the registration fees of patents and industrial designs is available for them. Additionally, funds are offered by the National Council for Scientific and Technological Research (*Consejo Nacional para Investigaciones Científicas y Tecnológicas*) to protect IP assets of SMEs and entrepreneurs.

Despite a developed legal framework, challenges regarding legal enforcement and control remain. The country has set up mechanisms to enforce IP rights including *ex-officio* border measures, deterrent imprisonment criminal sanctions for trademark counterfeiting and copyright piracy, and

pre-established damages in civil procedures for copyright infringement cases. The Law on IP enforcement<sup>15</sup> provides for mechanisms comprising civil and criminal procedures. Infringement of any IP right protected under international agreements or national legislation may be challenged through administrative and/or judicial actions. Civil procedures (including provisional measures, damages, payment of procedural and attorney fees, as well as the seizure and destruction of infringing goods) are available to any person affected by actions infringing IP rights. Criminal procedures initiate only upon request of the affected person. Remedies include imprisonment and monetary fines. Both in civil and criminal procedures, judicial authorities have the powers to order the seizure of suspected illegal goods, as well as any material used in their production.

Regarding challenges, the authorities recognised that procedures followed by customs authorities should be further developed and training is necessary to ensure better implementation of border measures. Another challenge lies in evaluating whether and how the Public Registry may establish administrative provisional measures, as to ensure a faster response to infringement. This evaluation is currently underway, in a joint effort between academia and competent institutions. Lastly, increased information and training about enforcement among public officials in charge of implementing IP legislation is also necessary to enhance on-going efforts.

In that regard, the Copyright Registry has undertaken efforts to provide training and information exchanges amongst schools and universities, in order to raise awareness on the importance of protecting rights related to artistic and literary works. The Intellectual Property Registry works with SMEs and the *Instituto Nacional de Aprendizaje* (technical education institution) providing advice on IP protection for their own inventions. The Ministry of Justice and Peace has proposed the creation of a National Academy of Intellectual Property and has reached out to WIPO as a key partner for this project. This Academy, which launched a preliminary stage of establishment early 2013, aims at promoting IP studies to improve the protection and recognition of these rights in the country and implement the National Strategy of Intellectual Property.

Nevertheless, some sources mention the lack of enforcement of the legislation. The US Investment Climate Statement points out that “while the legal framework governing intellectual property is basically in place, Costa Rica does not adequately enforce those rights. The United States Trade Representative (USTR) [...] noted that IPR enforcement with respect to copyright piracy and trademark counterfeiting required greater priority and resources. Significant delays in judicial proceedings and a lack of official investigators, public prosecutors, and criminal and civil judges specializing in intellectual property continue to hamper effective enforcement” (US

Department of State, 2012). In 2013, Costa Rica remains on the Watch List of the USTR annual Special 301 Report which states that the country “made initial progress in processing patent applications by adding examiners and achieving a reduction in the average time required to review patent applications. Nevertheless, significant concerns remain on IPR matters. Despite the need to implement a CAFTA-DR obligation to ensure that the software used by the government is legitimate, substantial progress on that front has not yet been realized. While the United States is aware of a recent measure intended to address this issue, it looks forward to confirming effective and timely implementation of the new measure later this year. Costa Rica should also take steps to grant *ex officio* powers to law enforcement and customs officials. An additional concern is the failure to create a specialized IPR crime unit, despite the government’s announced intention to do so in 2011. Costa Rica should take concrete steps to improve its overall IPR enforcement efforts by making IPR violations a higher priority, concluding prosecutions, and imposing deterrent penalties.” (USTR, 2013).

In conclusion, Costa Rica has set up a legal framework for intellectual property rights in compliance with international standards and recent trade-related commitments, but challenges remain in terms of implementation. Further efforts to enforce IP legislation and improve the efficiency of legal proceedings are still required. Training public officials and fostering the capacity of academic institutions to enhance IP rights protection have also been identified as priorities by the government.

### **Contract enforcement and dispute resolution**

A legal framework capable of ensuring the enforcement of contracts, the protection of property rights and the resolution of disputes is important for any investment. Recourse to the judiciary system should not be slow, burdensome and expensive, to avoid discouraging potential investors. The availability of alternative dispute settlement procedures is beneficial so as to solve disagreements, at least at a first instance level, between transacting parties at a reasonable cost.

The Costa Rican judicial branch is governed by the Political Constitution (Articles 9-10 and 152-167) and the Organic Law of the Judiciary (Law No. 7333 of 5 May 1993). The legal system is based on the Roman civil law. The Constitution guarantees the independence of the justice, the power of which is exercised by the Supreme Court of Justice and by other courts established by law. The Supreme Court of Justice is the highest court of the judiciary and the final instance in most cases. The judicial system is divided into administrative, civil and criminal matters. Disputes over commercial contracts are handled by civil courts, while disputes over public sector contracts are handled by administrative courts. There are no specialised

commercial courts in Costa Rica and commercial litigations are governed by both the Civil and the Commercial Codes. Decisions of civil courts on commercial matters might be subject to legal and factual scrutiny of two superior instances: the Civil Tribunal and the Second Chamber of the Supreme Court.<sup>16</sup>

Various international sources point out that, although courts are independent and contracts generally enforced in Costa Rica, there are concerns regarding the duration and costs of legal proceedings.<sup>17</sup> The country indeed ranks 128th position out of 185 economies on the World Bank 2013 *Doing Business* for “contract enforcement”. The report notes that, on average, 852 days and 40 procedures are required to enforce a contract, for a total cost of 24% of the claim. The difference with OECD countries is significant, where, on average, it takes 510 days, requires 31 procedures and costs 20% of the claim. The length of enforcing contracts is also higher than the regional average (727 days on average in LAC). According to the US Department of State (2011 and 2012), the unpredictability of outcomes is a “source of rising judicial insecurity”. This issue is also raised by business representatives in the country. The judicial system is significantly backlogged and civil suits may take more than five years. “Some US firms and citizens have satisfactorily resolved their cases through the courts, while others have seen proceedings drawn out over a decade without a final ruling. Cases related to squatters and the linked expropriation can be particularly cumbersome” (US Department of State, 2012).

Bankruptcy proceedings, addressed in the Commercial Code, are also recognised as slow in Costa Rica. This explains the poor ranking (128th) on the 2013 *Doing Business* for “resolving insolvency”. The World Bank report notes that it takes 3.5 years on average to close a business in Costa Rica, while it requires 3.1 years in LAC and 1.7 years in OECD countries on average.

Neither the authorities, nor private sector representatives mentioned that the absence of specialised commercial courts could be a reason for the lengthiness of the proceedings on commercial matters. It is more a systemic issue which can be attributed to the legalistic culture of the country, procedural guarantees and the deficient number of judges due to budgetary constraints. The government is conducting efforts to speed procedural issues through enhanced technology and to improve the quality of the judges.

Various initiatives have been implemented in order to reduce the length of litigations, including the use of computerised systems in most court offices, web access to court files and wider use of oral hearings. Courts handling disputes over government contracts began to rely on oral hearings in January 2008, when the Code for Administrative Procedures came into force. Then, in May 2008, civil and commercial proceedings started to rely mainly on

oral hearings with the enactment of the Law No. 8624 on Judicial Recovery. According to the authorities, this has improved efficiency and shortened the duration of cases. Judicial statistics show that upon the entry into force of the Code for Administrative Procedures, reductions in the duration of cases have been achieved.<sup>18</sup>

Costa Rica provides for alternative mechanisms to resolve disputes. In 1997, it enacted the Law on alternative settlement of conflicts and the promotion of social peace (*Ley sobre Resolución Alternativa de Conflictos y Promoción de la Paz Social*, Law No. 7727 of 9 December 1997) which contains a chapter on conciliation and mediation and one on arbitration. It applies to patrimonial conflicts (Articles 2 and 18) though it is open to private economic actors. However, official statistics show that only a minimum proportion of commercial conflicts are settled by Centres for alternative dispute resolution (10 cases out of 413 in 2012, most of the cases concerning labour issues).<sup>19</sup> In addition, the Law may not be suited for international investors as arbitrators are required to be lawyers incorporated in the Costa Rican bar (*Colegio de Abogados*) for at least five years and the language of arbitration should be Spanish.

To overcome the shortcomings of the 1997 Law, the Law on International Commercial Arbitration (*Ley sobre Arbitraje Comercial Internacional*, Law No. 8937 of 27 April 2011) was enacted in 2011. The law is based on the model law of the United Nations Commission on International Trade Law (UNCITRAL). It defines international arbitration, covers all stages of the arbitral process from the arbitration agreement, the composition and jurisdiction of the arbitral tribunal, the conditions for interim measures and preliminary orders, and the extent of court intervention through to the recognition and enforcement of the arbitral award. This new law is recognised as an important improvement by the business community and could help to reduce the backlog of the judiciary system. However, it is not yet widely used.

The country has also ratified the Inter-American Convention on International Trade Arbitration which refers to the rules of procedure of the Inter-American Commercial Arbitration Commission in the absence of an express agreement between the parties. However, there is no record that investors in Costa Rica have used this Convention to settle their disputes.

Costa Rica has several arbitration centres.<sup>20</sup> The two major ones are the Centre for Conciliation and Arbitration of the Chamber of Commerce of Costa Rica and the International Centre for Conciliation and Arbitration of the American Chamber of Commerce of Costa Rica. Their arbitration rules are based on the UNCITRAL Rules and include a phase of conciliation within the arbitration process. In 2012, these two centres have conducted respectively 31 and 12 arbitration processes.<sup>21</sup>

According to the US Department of State (2012), “the judicial system generally upholds contracts, but caution should be exercised when making investments in sectors reserved or protected by the constitution or by laws for public operation. Investments in state-protected sectors under concession mechanisms can be especially complex due to frequent challenges in the constitutional court of contracts permitting private participation in state enterprise activities. Furthermore, independent government agencies can issue permits or requirements that may contradict the decisions of other independent agencies, causing significant project delays.” It further mentions the persistent contradictory decisions between or within government institutions, as well as “a governmental reluctance to act and a tendency to draw procedures out to the degree permitted by law.” Before the enactment of the 2011 Arbitration Law, investors reported that they have experienced mixed results with arbitration and faced with insufficiently skilled lawyers (US Department of State, 2011).

In conclusion, the judicial system is significantly backlogged in Costa Rica. Though contracts are generally enforced, concerns relate to the length and costs of proceedings. The authorities and the business community attribute these problems to the legalistic culture of the country and procedural guarantees. Costa Rica does not have specialised commercial courts and civil courts handle disputes over commercial contracts. The government promotes alternative dispute resolution. Following a first law on arbitration, conciliation and mediation applicable to all conflicts, a specific law on international commercial arbitration based on the UNCITRAL model law was adopted in 2011 to better conform to international practices and further encourage the use of arbitration by investors. Though the new law is recognised as an improvement by the business community, it is not yet widely used.

### **Expropriation**

Whenever a government exercises its legitimate right of expropriation, there is an uncontested need for compensation. The compensation must be fair and adequate and paid promptly. In addition, the government decision to expropriate land or other property ought to be motivated by a public purpose, observe due process of law, and be non-discriminatory and guided by transparent rules. As expropriation is perceived as a major political risk for an investor, clear and complete provisions regulating expropriation are needed and constitute an investment guarantee.

Article 45 of the Costa Rican Political Constitution guarantees private property rights and stipulates that no one can be deprived of his/her private property, except in cases where public interest has been demonstrated and with prior compensation in accordance with the law. The Constitutional Chamber has further stated that a due process must be exercised to determine

whether or not there is a public interest basis justifying an expropriation.<sup>22</sup> According to the Expropriation Law (*Ley de Expropiaciones*, Law No. 7495 of 3 May 1995), prior to the expropriation, it is necessary to declare the public interest of the property and justify it. Then the Administration makes a valuation of the property and communicates it to the owner. If the owner does not agree with the amount of compensation stated by the Administration, an expert can review the valuation while the Administration begins the judicial process of expropriation. Both the judge's expert designation and the judge's final decision can be appealed by the parties.<sup>23</sup> Article 45 of the Constitution further mentions that in case of war or internal disorders,<sup>24</sup> compensation can be paid *a posteriori*, but no later than two years after the situation of emergency has ended. There are cases where property rights might be limited or restricted in order to comply with the essential objectives of the state. Article 45 also states that for reasons of public necessity, the Congress, by a vote of two-thirds of its full membership, may impose limitations of social interest on property.

There is no discrimination between foreign and national investors as regard to expropriation, as the principle is embodied in Article 19 of the Constitution. Moreover, in constitutional consultations regarding FTAs and BITs signed by Costa Rica, the Constitutional Chamber has ruled that expropriation rules should not be applied in a discriminatory manner against foreigners.<sup>25</sup> The right to recourse to administrative and judicial action regarding an expropriation is granted to both nationals and foreigners. If throughout the administrative procedure of expropriation, a constitutional provision is breached, the affected party is allowed to submit a complaint before the Constitutional Chamber. Foreigners have the right to submit complaints against the state in administrative, judicial and international courts, whereas nationals are only allowed to use domestic jurisdiction for the review of expropriation administrative acts.

The 1995 Expropriation Law stipulates the procedures, rules, rights and obligations to be fulfilled within the due process, as well as the state's limitations to deprive from ownership of private property. The legal provisions include requirements to be fulfilled by the state, fair price fixing mechanisms, modalities of compensation and rules for appeals and non-conformities. Expropriations can take place only after full and prior payment is made. Provisions include: i) return of the property to the original owner if it is not used for the intended purpose within ten years or, if the owner was compensated, right of first refusal to repurchase the property back at its current value; ii) a requirement that the expropriating institution complete registration of the property within six months; iii) a one-month period during which the tax office must appraise the affected property; iv) a requirement that the tax office itemise crops, buildings, rental income, commercial rights,

mineral exploitation rights, and other goods and rights, separately and in addition to the value of the land itself; and v) provisions providing for both local and international arbitration in the event of a dispute. The expropriations law was amended in 1998 and 2006 to clarify and expedite some procedures (US Department of State, 2012).

While the Expropriation Law does not contain provisions on indirect expropriation, all the BITs – including the model BIT – and investment chapters of FTAs signed by Costa Rica cover both direct and indirect expropriation. The CAFTA-DR even clarifies the scope of the concept and defines criteria determining what constitutes an indirect expropriation (Annex 10-C).

According to the US Department of State (2012), cases of expropriation of private land by the government have occurred without timely or adequate compensation, notably for purposes of national parks, indigenous reserves or agricultural projects. The main expropriating state bodies over the past years have been the Ministry of Public Works and Transportation, the Ministry of Environment and Energy (MINAE),<sup>26</sup> and the Costa Rican Electricity Institute (ICE). There are some cases of conflict over the evaluation of the expropriated land value between landowners and the government and the judicial processes associated with these cases are lengthy. Concerns *vis-à-vis* acquisition rights under the Law of Lands and Colonisation leading to dispossession of property remain. Though the mechanism is no longer identified as a major concern by investors, the latter are however advised to exercise due diligence over property acquisition (see above).

In conclusion, protection against expropriation is guaranteed by the Constitution. Conditions and procedures for expropriation are stipulated in the 1995 Expropriation Law. Most of Costa Rica's investment partners are also protected by provisions under international investment agreements (BITs and investment provisions of FTAs). These provisions cover both direct and indirect expropriation, unlike the Expropriation Law. Disputes over expropriation have occurred and some have been reported to be burdensome, especially in relation to land acquisition rights and appraisal of land value.

### **International investment agreements**

Costa Rica has signed 21 bilateral investment treaties (BITs), out of which one is pending ratification by the other party, two have not been brought into force, and five have been archived.<sup>27</sup> Therefore 13 BITs are in force (Table 3.2). Most of them have been negotiated between the end of the 1990s and the beginning of the 2000s. Nine of the BITs were ratified with OECD members. Costa Rica is currently negotiating a BIT with Kuwait and has proposed to negotiate a BIT with India. It can be noted that the length of time between the

signature and the entry into force of BITs is relatively long (average of 4.5 years and 15 years for the BIT with France). Costa Rica developed a model BIT in 2011, but the model has not yet been used.

Table 3.2. **BITs signed and ratified by Costa Rica**

	Date of signature	Ratification	Date of entry into force
Germany	13 September 1994	Law No. 7695 3 October 1997	24 April 1998
France	8 March 1984	Law No. 7691 3 October 1997	18 June 1999
Spain	8 July 1997	Law No. 7869 5 May 1999	17 July 1999
Canada	18 March 1998	Law No. 7870 5 May 1999	29 September 1999
Chile	11 July 1996	Law No. 7748 23 February 1998	23 June 2000
Czech Republic	21 October 1998	Law No. 8076 14 February 2001	5 March 2001
Argentina	21 May 1997	Law No. 8068 14 February 2001	1 May 2001
Venezuela	17 March 1997	Law No. 8067 14 February 2001	2 May 2001
Paraguay	29 January 1998	Law No. 8069 14 February 2001	25 May 2001
Netherlands	21 May 1999	Law No. 8081 14 February 2001	1 July 2001
Korea	11 August 2000	Law No. 8217 8 March 2002	26 August 2002
Switzerland	1 August 2000	Law No. 8218 8 March 2002	19 November 2002
Chinese Taipei	25 March 1999	Law No. 7994 7 March 2000	8 October 2004
United Kingdom	7 September 1982	Ratified by Costa Rica but not by United Kingdom	Not entered into force
El Salvador	21 November 2001	Archived	Not entered into force
Finland	28 November 2001	Archived	Not entered into force
Ecuador	6 December 2001	Archived	Not entered into force
Belgium and Luxemburg	26 April 2002	Archived	Not entered into force
Bolivia	7 October 2002	Archived	Not entered into force
China	24 October 2007	Pending ratification	Not entered into force
Qatar	25 December 2010	Law No. 9099 17 January 2013	Not entered into force – pending exchange of notes between the Parties confirming the conclusion of internal procedures

Source: COMEX and UNCTAD

In recent years, the country has actively negotiated free trade agreements, most containing investment components (Table 3.3). Some are negotiated as a regional grouping (Central America) and others by the country on a bilateral level. The vast majority of FTAs were signed with countries of the Americas, thereby extending the scope of investment protection to a relatively large number of countries of the continent, including the United States.

FTAs with investment components either make a reference to a BIT or incorporate a chapter on investment. When a BIT was already signed between parties, the FTA referred to the former agreement, as is the case in the FTA

Table 3.3. **FTAs with investment provisions ratified, signed and under negotiation by Costa Rica**

FTAs ratified	Entry into force	Investment provisions
Mexico <i>No longer in force</i> <i>(substituted by Mexico modernisation)</i>	1 January 1995	Chapter XIII on investment
Chile – Central America	15 February 2002	Chapter 10. BITs signed between Chile and the 5 CA countries form integral part of the treaty
Dominican Republic – Central America	7 March 2002	Chapter IX on investment
Canada	7 November 2002	Article VIII.2 notes the existence of the 1998 BIT between the parties
CARICOM (entered into force with 4 out of 15 CARICOM members)	From 15 November 2005 to 10 March 2011	Chapter X on investment
Panama – Central America	24 November 2008	Chapter 10 on investment
CAFTA-DR	1 January 2009	Chapter Ten on investment
China	1 August 2011	In Article 89, the Parties reaffirm the commitments under the 2007 BIT. Chapter 9 covers commercial presence in services (mode 3)
Costa Rica – Peru	Entered into force on 1 June 2013.	Chapter 12 on investment
Costa Rica – Singapore	Entered into force on 1 July 2013.	Chapter 11 on investment
Central America – Mexico (modernisation)	Entered into force on 1 July 2013	Chapter XI on investment
FTAs signed	Signature	Investment provisions
Central American Treaty on Trade in Services and Investment	24 March 2002 and amended on 22 February 2007 (pending ratification)	Chapter 3 on investment
Central America – European Union	29 June 2012 (pending ratification)	No chapter on investment but Chapter 6, Title III, on establishment
Colombia	22 May 2013 (pending ratification)	Specific chapter on investment
EFTA (European Free Trade Association)	24 June 2013 (pending ratification)	Specific chapter on investment for non-services activities and a trade in services chapter covering commercial presence in services (mode 3)
FTAs under negotiation		
Canada (modernisation)	This negotiation process was suspended	Specific chapter on investment

Source: COMEX.

between Chile and Central America, and in FTAs with Canada and China. Regarding the FTA with China which entered into force in 2011, though it recognises the commitments under the 2007 BIT, its provisions cannot apply as the BIT has not yet been ratified. It is in the final stage of the process of legislative approval (as of April 2013). In other FTAs, a full dedicated chapter on investment was negotiated.

Intentions and effects of incorporating an existing BIT into an FTA should be clear between the parties. BITs usually contain investment protection provisions and grant rights to investors at the post-establishment phase, while FTAs also provide for liberalisation commitments and are usually based on pre-establishment. According to the Costa Rican authorities, there is no contradictory provision between signed BITs and FTAs, or between FTAs covering the same countries. The issue of the incorporation or recognition of BITs in FTAs was discussed during the negotiations and no provision to govern potential interactions of treaties exists in the FTAs with Chile, Canada and China. In the FTA with Chile, the BITs signed between Chile and the five Central American countries form an integral part of the Agreement. The 2002 FTA with Canada notes the existence of the 1998 BIT. The FTA with China reaffirms the commitment of the 2007 BIT. While the first two FTAs do not contain market access commitments, the FTA with China has commitments for market access on services for all modes of supply, including mode 3 (commercial presence). When analysing the wording, there is no clear and consistent mention on the incorporation of BITs and it is recommendable not to use different wording should the circumstances of the negotiations allow.

In terms of country coverage, some overlaps are noted (e.g. the FTAs with investment chapters between Central America countries and the Dominican Republic and CAFTA-DR which also includes the United States). This is not considered as an issue by the authorities, which affirm that the investor can choose the protection of either treaty. However, in case of disputes, the situation may lead to more legal complexity and potential higher legal costs.

COMEX is in charge of negotiating, signing and administering international trade and investment agreements. The review and monitoring of the fulfilment of Costa Rica's international commitments under these agreements (FTAs and BITs) is one of COMEX's responsibilities.<sup>28</sup> In this respect, two treaties have been recently reviewed:

- FTA between Costa Rica and Mexico: authorities from both parties agreed to modernise provisions on the promotion and protection of investments. That modernisation took place within the negotiation of a consolidated FTA between Central American countries and Mexico, which was signed in November 2011, was ratified by Congress in February 2013 and entered into force on 1 July 2013.
- FTA between Costa Rica and Canada: authorities from both parties agreed on the need to substitute their former BIT with an investment chapter. This negotiation should form part of the modernisation process of the FTA.

In summary, Costa Rica has signed 21 BITs (13 entered into force) and 14 bilateral and regional FTAs (10 entered into force) with investment provisions – either through a reference to the BITs previously negotiated or through a

comprehensive investment chapter, thereby providing investment protection to all of its main partners. The country developed a model BIT in 2011. COMEX is the entity in charge of negotiating and implementing these agreements.

### **International arbitration**

Costa Rica ratified the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) in 1977<sup>29</sup> and the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID) in 1993.<sup>30</sup>

The country adopted in 2011 the model proposed by the UNCITRAL, including the 2006 amendments, in the law on international commercial arbitration. The Law is discussed under the previous sub-section on dispute resolution.

To date, Costa Rica has been a respondent state to six investment claims at ICSID, including one which is pending (Box 3.2).

#### **Box 3.2. Investor-State dispute settlement cases involving Costa Rica**

##### **Compañía de Desarrollo Santa Elena v. Republic of Costa Rica (ICSID Case No. ARB/96/1)**

**Investor:** Compañía de Desarrollo Santa Elena.

**Home country:** United States.

**Year initiated:** 1996.

**Grounds:** Compañía de Desarrollo Santa Elena (CDSE) instituted arbitration proceedings against Costa Rica regarding a dispute related to the expropriation by the government of Costa Rica of property owned by CDSE.

**Settlement:** Award issued on 17 February 2000. The Tribunal ordered the government of Costa Rica to pay compensation amounting to USD 16 million.

**Sector:** Tourism.

##### **Alasdair Ross Anderson and others v. Republic of Costa Rica (ICSID Case No. ARB (AF)/07/3)**

**Investor:** Alasdair Ross Anderson and others.

**Home country:** Canada.

**Year initiated:** 2007.

**Grounds:** Claimants alleged that the government of Costa Rica, by failing to provide proper vigilance and supervision over the national financial system, had injured their investments in violation of the BIT provisions regarding full protection and security, fair and equitable treatment, due process of law, and protection against expropriation.

**Settlement:** Award issued on 19 May 2010 in favour of Costa Rica and dismissing in its entirety the claimants' request for arbitration.

**Sector:** Financial sector.

**BIT provisions:** Articles II, VIII and XIV of the Canada-Costa Rica BIT.

Box 3.2. **Investor-State dispute settlement cases involving Costa Rica** (cont.)

**Marion and Reinhard Unglaube v. Republic of Costa Rica (ICSID Cases No. ARB/08/1 and ARB/09/20) – 2 cases**

**Investor:** Marion and Reinhard Unglaube.

**Home country:** Germany.

**Year initiated:** 2008.

**Grounds:** Claimants alleged that the government of Costa Rica made a de facto expropriation of their properties located within and around the Las Baulas National Park.

**Settlement:** Award issued on 16 May 2012 declaring that the government of Costa Rica breached Article 4(2) of the BIT by taking one of the properties of the claimants by measures tantamount to expropriation.

**Sector:** Tourism.

**BIT provisions:** Articles 2, 3, 4 and 7 of the Costa Rica-Germany BIT.

**Quadrant Pacific Growth Fund L.P and Canasco Holdings Inc. v. Republic of Costa Rica (ICSID Case No. ARB(AF)/08/1)**

**Investor:** Quadrant Pacific Growth Fund L.P and Canasco Holdings Inc.

**Home country:** Canada.

**Year initiated:** 2008.

**Grounds:** Claimants alleged that the government of Costa Rica did not take adequate measures to protect their properties against repeated invasions by squatters.

**Settlement:** The Tribunal issued an order terminating the proceedings and condemning claimants to pay USD 730 000 in favour of the government of Costa Rica for legal fees and other expenses incurred.

**Sector:** Agriculture.

**BIT provisions:** Articles II (2) (a) and II (2) (b) of the Canada-Costa Rica BIT.

**Supervision y Control, S.A v. Republic of Costa Rica (ICSID Case No. ARB 12/4)**

**Investor:** Supervisión y Control, S.A.

**Home country:** Spain.

**Year initiated:** 2012.

**Grounds:** Claimants alleged that the government of Costa Rica breached a contract signed with them to provide public vehicular inspection by maintaining the rates charged to provide the service without updating.

**Settlement:** Pending.

**Sector:** Public procurement.

**BIT provisions:** Articles II, IV and V of the Costa Rica-Spain BIT.

Source: ICSID.

All BITs signed by Costa Rica contain investor-state dispute settlement (ISDS) provisions. The FTAs with investment chapters have similar provisions. The most detailed provisions are found in the FTA between Central America and Panama, CAFTA-DR and the recently signed FTAs between Central America and Mexico and between Costa Rica and Peru. While these treaties contain comprehensive ISDS provisions, the others, in particular BITs, have less sophisticated mechanisms. Most of the Costa Rica's international investment agreements provide for amicable settlement of disputes. If the disputes cannot be settled within an indicated period, the disputes can be submitted to national courts or to international arbitration through ICSID or under the UNCITRAL rules. Most contain a fork-in-the-road provision, meaning that the choice of an investor to submit disputes either to a local court or international arbitration is deemed to be final to the exclusion of the other. Awards are definitive and legally binding.

COMEX, as the governmental entity in charge of administering the international investment agreements, handles the defence of the country in investor-state dispute settlement cases, in co-operation with other public entities. COMEX is responsible for safeguarding the national interest in the cases and co-ordinating the implementation of awards. In 2009, an Inter-institutional Commission for the Settlement of International Disputes on Trade and Investment<sup>31</sup> was established in order to co-ordinate and manage Costa Rica's response to ISDS claims, as well as to help prevent them from being made in the first place. Thus, the Commission not only deals with the existing disputes, but also plays a preventive role when conflicts arise between investors and the state.

The Commission is co-ordinated by the Ministry of the Presidency, and composed of COMEX, which acts as the Technical Secretariat, and the Ministries of Foreign Affairs, Finance and Justice. The Decree establishing the Commission expressly requires all government agencies involved in an investment dispute or its prevention to co-operate and provide all relevant information, thereby creating accountability at all levels of government for inconsistent measures or policies affecting investors.

The Commission and its Secretariat should bring attention to possible and existing cases, co-ordinate with other entities, in particular in the provision of information and documents, manage cases proceedings and prevention measures, and engage external advisors and legal counsellors. The Commission meets every three months when there are pending cases, otherwise, at least once a year. The Technical Secretariat provides technical support to the Commission. It prepares the documentation for the sessions, follows up on any matters that may arise in relation to the disputes, informs the Commission about the procedural status of active disputes, etc.

In terms of process, investors are supposed to use COMEX as the focal point and the Technical Secretariat of the Commission in order to explain their claims before activating the investor-state dispute settlement mechanism. Subject to the arguments provided by the parties and the evidence to support their claims, COMEX calls the dispute to the attention of the Commission and organises a meeting to discuss it in detail. Any other public entities involved in the dispute are invited to participate in the discussion to provide their views and share information. The Commission evaluates each claim and all relevant information, and then recommends appropriate measures to prevent the case from being raised to an investor-state dispute process. According to the authorities, the Commission is an effective mechanism for the prevention of investor-state disputes, thus avoiding lengthy and costly arbitral procedures.

## Investment promotion and facilitation

Investment promotion and facilitation measures, including incentives, can be effective instruments to attract investment, provided they aim at correcting market failures and are developed in a way that can leverage the strong points of a country's investment environment.

### **Investment promotion strategy**

The role of private investment, both domestic and foreign, is recognised as being central in Costa Rica's development, as stated in the 2010-14 National Development Plan (Chapter 1). COMEX – the Costa Rican Ministry of Foreign Trade – was established in 1986 with a mandate to define and co-ordinate foreign trade and foreign investment policies. Its mission is to promote the integration of the country into the global economy by supporting the expansion, diversification and sophistication of national exports and by attracting foreign investment. Foreign trade and FDI policies are strongly inter-related, as most foreign investments are export-oriented and have contributed to consolidating Costa Rica as an export platform. Therefore, the investment promotion strategy forms part of the country's broader trade policy, which is based on three pillars (Section on Trade policy).

The third pillar of the trade policy – maximising the export platform's benefits and potential – is oriented to support both export and investment promotion activities. The government seeks to identify market opportunities for Costa Rican products and to showcase the country as an investment destination. Over the past two decades, the authorities have maintained a coherent vision on the articulation between investment and trade promotion that has helped to obtain sizeable results in FDI attraction and export performance.

COMEX works with two implementing agencies: PROCOMER (*Promotora del Comercio Exterior de Costa Rica*), created in 1996 as a non-state public agency to promote Costa Rica's exports, and CINDE (*Coalición Costarricense de Iniciativas de Desarrollo*), the Costa Rican Investment Promotion Agency (IPA) created in 1982 as a private institution to promote the country as an investment destination.

Although FDI promotion did not initially involve targeting specific sectors, subsequently Costa Rica has increasingly targeted knowledge-intensive activities and is currently focused on three main clusters: i) advanced manufacturing, ii) life sciences and iii) services.<sup>32</sup> In addition, the country is currently positioning itself as a destination for investments in sectors such as electronics, clean technology, biotechnology, value-added services and tourism. The prospects for greater and better FDI will depend on an effective strategy to strengthen science-industry linkages, foster linkages with domestic companies, close the gap between supply and demand of human resources, develop industrial clusters in priority areas, and enhance the attractiveness of the business environment (see below).

According to the government, the strategy used to attract FDI has relied upon six pillars: i) proven track record of several multinational companies that are currently operating in the country, ii) qualified human resources, iii) strategic geographical location, iv) favourable business climate, v) quality infrastructure, and vi) good quality of life. The FDI promotion strategy will continue to focus on consolidating these six elements of competitiveness that still need further improvements.

### **Investment promotion agency**

#### ***Institutional framework***

Costa Rica started strengthening its institutional framework governing FDI in the mid-1980s. COMEX was created in 1986 by a budgetary law and formally constituted in 1996. Its responsibilities include the formulation of foreign trade and investment policy.<sup>33</sup> Since then, COMEX has been in charge of defining the country's FDI policy, overseeing special incentive regimes,<sup>34</sup> and co-ordinating FDI related strategies and plans. In addition, COMEX has increasingly participated in investment related international initiatives, which have contributed to promote the country as an advantageous business destination. Some examples of these international initiatives are the OECD Development Centre, the OECD LAC Initiative and the United Nations Conference on Trade and Development (UNCTAD) Investment Policy Framework for Sustainable Development, among others.

At operational level, while PROCOMER is responsible for promoting Costa Rica's exports and administering the free zone regime (FZR), CINDE is in charge of all foreign investment promotion related activities. CINDE is a private,

non-profit organisation, founded in 1982, declared of public interest in 1984, and the first IPA established in Latin America. As a private association, CINDE operates autonomously and reports to a board of businesspeople and professionals, which in turn reports to a general assembly. It employs 35 employees and acts as the country's sole agency for attraction of FDI in Costa Rica. While CINDE is a private association, it has always received political support from the authorities in promoting investment in priority sectors and enhanced its collaboration with the government through a recent co-operation agreement COMEX-PROCOMER-CINDE (see below).

### **CINDE's main functions**

CINDE performs the following roles: i) image building and strengthening the reputation of the country as an investment destination; ii) investment facilitation and aftercare to help solve problems faced by potential or existing investors; iii) investment targeting, by actively seeking out investment projects in the targeted sectors (advanced manufacturing, life sciences and services); and iv) advocacy to the government to promote improvement of the investment climate. CINDE thus performs the five functions that are generally recognised as essential constituents of investment promotion (image building, investment generation, investment facilitation, aftercare and policy advocacy). However, CINDE proactively performs these functions only in targeted sectors. It is not in its mandate to attract FDI in tourism, agriculture or infrastructure for example.

Considering that about 50% of FDI to Costa Rica in targeted sectors are reinvestments, CINDE created an Aftercare Department which is in charge of: i) facilitating the set-up process of new companies; ii) exploring ways to address companies' difficulties in their daily operations; and iii) identifying relevant topics to promote an improvement in the investment climate. The Aftercare Department thus has a broader mandate than aftercare *per se*, as it also assists companies in their pre-establishment phase. Although it does not act as a one-stop shop, it guides companies through the different procedures to set up a business and helps them to obtain a clearer understanding of the requirements that are to be fulfilled. In addition, the Aftercare Department aims at playing an important advocacy role in the relationship between investors and the government, both in the establishment and post-establishment phases. As such, it collects relevant information about investment dynamics, recurrent problems faced by investors and necessary improvements in the investment environment, and serves as a channel for voicing private sector needs to policymakers. While CINDE undertakes systematic aftercare with companies operating in targeted sectors (facilitation during the establishment phase; regular feedback request from investors; and proactive policy advocacy), it adopts a more reactive approach with investors active in other sectors (responding to their concerns when they raise them to CINDE's attention and refer them to other relevant institutions).

CINDE has generally been considered as a good performer within the field of investment promotion. According to the Investment Climate Advisory Service of the World Bank Group, CINDE ranked as the 10th best IPA in the world in 2009 out of 181 national IPAs assessed (World Bank, 2009). The same group cited CINDE's website as a best practice for the valuable use of interactive tools to enhance the promotional message in a cost effective manner (World Bank, 2012c). Similarly, UNCTAD (2007) cited CINDE as a best practice for its aftercare activities, which include networking support with other institutions in the country, the organisation of informative seminars and regular consultations with the business community, which serve to feed into its advocacy function.

#### ***Co-ordination and collaboration***

CINDE co-ordinates closely with COMEX, on both investment promotion activities and on enhancing the business climate. A co-operation agreement COMEX-PROCOMER-CINDE was signed in 2010 and brought into force in January 2011 to unify investment promotion efforts and increase collaboration. Within this framework, CINDE reports to the government on the status of the investment climate on a yearly basis, providing a general overview of the current situation, and pointing out specific areas that require special attention. During the first year of implementation of this agreement, the report submitted by CINDE focused particularly on the need to strengthen Costa Rica's human capital as a key factor to continue attracting FDI to the country (CINDE, 2012a; 2012b).

Recently, COMEX has been strengthening ties with other agencies in key priority areas, particularly with the Ministry of Science, Technology and Telecommunications, in order to promote a better alignment between FDI policy and innovation policy, to enhance skills development in priority sectors, and to further promote linkages between domestic companies and MNEs (see below).

#### ***Funding***

From 1983 to 1996, CINDE was funded by the United States Agency for International Development (USAID). When USAID withdrew, it left CINDE with an endowment significant enough to sustain its operations for the following years. From 1997 to 2006, CINDE's sources of finance were mainly funds from the Costa Rican United States Foundation along with its own endowment.

Since 2007, CINDE's budget has been financed from its own endowment, fundraising from private strategic partners, and since 2010, from the co-operation agreement with COMEX and PROCOMER. This agreement, in addition to enhancing collaboration in investment promotion efforts, intends

to improve the co-ordination and efficiency in the utilisation of available resources and also entails accountability for the use of resources and the activities performed. Moreover, in recent years, CINDE has developed new initiatives, such as the organisation of events and specialised fairs to create new sources of financing, which have contributed to the sustainability of CINDE's fundraising model.

### **Performance**

Every year, CINDE reports the results of its performance to a general assembly and publishes a report encompassing a detailed analysis on diverse variables. The report highlights the development of each targeted sector and summarises CINDE's participation in diverse fairs and events, providing a description of the main fora held and attended throughout the year in diverse locations. It also offers a sample of the most relevant media coverage achieved both in international and domestic communication channels.

The report also includes a section on companies' post-establishment support and the main changes introduced to the investment climate. It also highlights the most relevant challenges envisioned for the following year, which in the latest report include strengthening human resources, streamlining administrative procedures and improving transport infrastructure. Finally, the report provides transparent information on the budgetary execution and the return of investment, in terms of levels of employment generated and the number of projects attracted. For instance, in 2011 and 2012, CINDE's performance indicators reflected a good performance in comparison to the goals that were previously set. While the goals set were aimed at attracting 35 new foreign projects for a total investment of USD 500 million for each year, CINDE managed to attract 34 realised projects for a total of USD 470 million in 2011 and 40 realised projects for a total of USD 575 million in 2012 (CINDE, 2013). In terms of employment generation, it over performed, as jobs created by these companies totalled 7 728 in 2011 and 8 236 in 2012, while the target was set at 7 500.

### **International investment promotion initiatives**

In order to help build investment promotion expertise, Costa Rica has been an active participant in diverse fora where investment issues are examined, including UNCTAD, the WEF and the World Bank. Every year, the country is examined and ranked by the aforementioned in addition to other organisms, on diverse fields related to its investment performance and business climate, i.e. *Doing Business*, *Global Competitiveness Index* and the *Logistics Performance Index*. CINDE has established strong relationships with organisations such as USAID, the World Bank, the Inter-American Development Bank (IADB) and UNCTAD. It has also joined the World Association of

Investment Promotions Agencies (WAIPA), where it had previously taken part in the steering committee. CINDE is also participating in a regional network that brings together the IPAs from Central America.

In conclusion, CINDE is a relatively small but strong institution in the investment promotion framework of Costa Rica, which has achieved attracting significant inflows of FDI in targeted sectors into the country since its creation. It also has a strong aftercare department that performs well in responding to investors' concerns and in providing policy recommendations to improve the investment climate. In turn, although CINDE is meant to assist investors to start a business in Costa Rica, it is a less important function. It also plays a minor role in promoting business linkages between foreign affiliates and domestic companies (see below) and does not adopt a proactive approach for investment promotion in non-targeted sectors.

#### **Rationalising administrative procedures**

Although Costa Rica attracts significant inflows of FDI and is endowed with strong trade and investment institutions, there are significant challenges to overcome in order to offer a sound business environment. As an illustration, the country's current performance in the World Bank *Doing Business* rankings is relatively weak, ranked 110th out of 185 economies in the 2013 edition. Whereas the country's overall ranking improved by 12 places compared to the 2012 edition, the "starting a business" sub-ranking remains poor (128th position) and has slightly deteriorated by three places since the previous edition. According to the *Doing Business* report, it takes 12 procedures and 60 days to open a business in Costa Rica, both higher than LAC and OECD averages, accounting for respectively 9 procedures and 50 days, and 5 procedures and 12 days.

Similarly, Costa Rica's position on the WEF *Global Competitiveness Index 2012-13* is weak both in terms of number of procedures to start a business (121st position out of 144 countries) and number of days to start a business (130th). More alarming is that the rankings for these two sub-categories have also kept deteriorating over the past years, notably by 14 and 16 places respectively compared to the 2009-10 edition. Finally, the report highlights that "inefficient government bureaucracy" is perceived by the business community as the most problematic factor for doing business in Costa Rica (out of 16 factors).

As a response and in order to facilitate private investment in Costa Rica, the government has been implementing a national strategy for regulatory improvement and for streamlining procedures, since mid-2011, with the support of the World Bank (Section on Public governance and anti-corruption). This strategy seeks to reform the regulatory framework to enhance the

attractiveness of the business climate, provide greater legal certainty and transparency, and enhance the country's performance in international competitiveness indexes.

The institutions in charge of co-ordinating and ensuring the adequate implementation of the national strategy for regulatory improvement are the Ministry of Economy, Industry and Commerce and the Presidential Council for Competitiveness and Innovation (*Consejo Presidencial de Competitividad e Innovación*, CPCI). The latter, led by the President of the Republic, was established in 2010 with the purpose of aligning the different policies influencing the country's competitiveness, including those affecting the business climate. It is made up of 19 members who meet every month. They include the President, the Vice-President, 14 Ministers,<sup>35</sup> the Executive Chairpersons of the National Apprentice Institute (*Instituto Nacional de Aprendizaje*, INA), the Costa Rican Electricity Institute (*Instituto Costarricense de Electricidad*, ICE) and the Costa Rican Institute of Aqueducts and Sewage (*Instituto Costarricense de Acueductos y Alcantarillados*, AyA). Since 2012, three representatives from the private sector have also been participating in CPCI meetings. CPCI therefore generates a space for policy dialogue amongst different stakeholders, both from private and public sectors, to enable proper co-ordination amongst them and identify elements of improvement in the business environment. It is administered by an executive secretary who reports directly to the President.

The main priority areas of CPCI consist of:

1. Human capital and innovation;
2. Foreign trade and FDI;
3. Finance and capital markets;
4. Infrastructure development (telecommunications, electricity and transport);  
and
5. Regulatory improvement and streamlining procedures.

As per the fifth priority area mentioned above, progress has been achieved in obtaining construction permits, obtaining sanitary registration for products, fulfilling environmental requirements, obtaining credit and facilitating cross-border trading. These improvements are reflected in the *Doing Business 2013* edition, where the "dealing with construction permits", "getting credit" and "trading across border" sub-indicators have improved by 11, 14 and 11 places respectively compared to the previous edition.

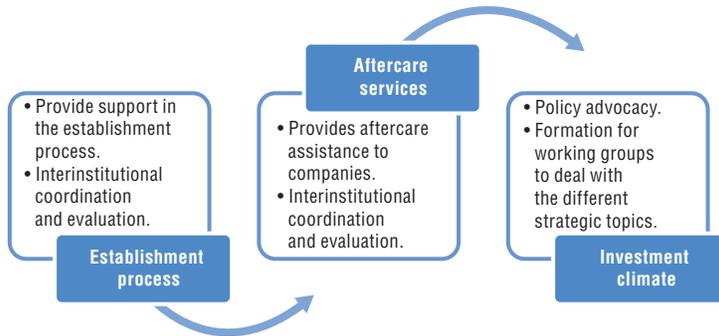
The implementation of *CrearEmpresa* in early 2012, a digital system for the registration of legal entities, marked the turning of an important milestone in regards to simplifying procedures for starting a business. It contributes to facilitate and streamline burdensome procedures required to initiate

operations. *Crear Empresa* acts as a one-stop single window interconnecting all government agencies involved in business registration. The procedures under this system include among others: registering commercial companies; legalising property at the Public Registry; obtaining health permits, environmental feasibility certificates, veterinary certificates, and soil use certificates; obtaining business licenses; registering as employers at the social security institute; and registering as taxpayers at the tax office. The government reports that since *Crear Empresa* was implemented, several administrative simplifications have already become palpable. For instance, the registration of a company only takes one hour (compared to several days that it would take before) and four steps have been grouped into a single one (Notary Public, Public Registry, Official Gazette and Tax Administration) for the legalisation of corporate books (MEIC, 2012). According to the Economist Intelligence Unit (2012), the establishment of this system has reduced the total time required to open a business from 90 to 20 days.

**Consultation mechanisms**

CINDE plays an important role in establishing and maintaining a dialogue with investors in view of enhancing the investment climate, particularly through its Aftercare Department. By being responsible for following up on companies’ post-establishment needs (see above), it monitors companies’ requirements and strategies through surveys, interviews and roundtables in order to perform its policy advocacy function. Information obtained serves as input to nurture discussions with public and private stakeholders, and to promote improvements to the business climate (Figure 3.3). Hence, CINDE co-ordinates closely with COMEX to approach diverse government agencies in order to prompt their adequate attention.

Figure 3.3. Policy dialogue within CINDE’s operational functions



Source: CINDE.

Furthermore, COMEX and CINDE have put in place other instances of dialogue to gather input from companies on key areas where improvement is required in order to increase competitiveness, and to inform them about government plans and of progress achieved in diverse areas of interest. In particular, there is a forum with MNEs in which the Minister of Foreign Trade, along with the Director of Investment of COMEX and the General Director of CINDE, interact with General Managers of companies on diverse issues. This forum takes place quarterly.

In parallel, CPCI also allows for consultations between the government and the business community, as representatives from the private sector have been participating in CPCI meetings since 2012, namely through the Costa Rican Union of Chambers and Associations of the Private Business Sector (*Unión Costarricense de Cámaras y Asociaciones del Sector Empresarial Privado*) and the Private Council on Competitiveness Promotion (*Consejo Privado de Promoción de la Competitividad*). These participants are invited to provide monthly feedback on the work of public institutions that form part of CPCI.

### **Investment incentives and special economic zones**

The instrument on *International Investment Incentives and Disincentives* is an integral part of the *OECD Declaration on International Investment*. It encourages adhering states to ensure that incentives as well as disincentives are as transparent as possible, so that their scope and objectives may be easily determined. Costa Rica has declared that it is ready and able to fulfil its commitments under this Instrument. The *OECD Policy Framework for Investment* encourages states to evaluate the costs and benefits of incentives, in particular the use of tax incentives together with the level of tax burden they impose on businesses with a view of meeting its investment promotion objectives.<sup>36</sup> The *OECD Checklist for Foreign Direct Investment Incentive Policies* also helps raise awareness of decision makers in assessing the usefulness and relevance of investment incentives.<sup>37</sup> In addition, the *OECD Tax and Development Programme* developed the *Principles to enhance the transparency and governance of tax incentives for investment in developing countries* to promote the management and administration of tax incentives for investment in a transparent, consistent manner, limit discretion and increase accountability.<sup>38</sup>

### **Inventory of incentive regimes**

There are four main incentive regimes currently active in Costa Rica. COMEX grants permissions for the Free Zone Regime (*Régimen de Zonas Francas*, FZR) and the Inward Processing Regime (*Régimen de Perfeccionamiento Activo*), which are administered by PROCOMER. Permissions to operate under the Drawback Regime (*Régimen Devolutivo de Derechos*) are granted by the General Customs Authority, and both COMEX and PROCOMER issue a recommendation

to the General Customs Authority for the reimbursement of duties and other taxes effectively paid or deposited by an importer of goods that are subsequently exported. Finally, the Costa Rican Tourism Board (*Instituto Costarricense de Turismo*) is responsible for the Tourism Development Incentives Regime (*Régimen de Incentivos para el Desarrollo Turístico*). These incentive regimes apply equally to both nationals and foreigners.

**The Free Zone Regime.** One of the most successful policy tools that Costa Rica has enacted to attract FDI is the FZR (PROCOMER, 2011). It is a system of incentives and benefits, which the state grants to companies that meet certain investment requirements and comply with certain requisites and obligations established in the law. It is ruled by the Free Zone Regime Law (Law No. 7210 of 23 November 1990) and its amendments, as well as by Executive Decree No. 34739-COMEX-H from 2008 and its amendments.

To qualify under the FZR, companies must be classified under at least one of the following categories: (Category A) export-processing industries; (Category B) trading companies; (Category C) service industries; (Category Ch) free zone park-managing companies; (Category D) companies or organisations engaged in scientific research; (Category E) companies operating floating docks for the construction, repair and maintenance of ships<sup>39</sup>; and (Category F) processing companies, whether they export or not. Furthermore, applicant companies must meet a number of conditions (Box 3.3).

The FZR grants foreign and domestic companies tax breaks for their investments in the country, including full or partial exemption from corporate income tax; full exemption from customs duties on import/exports tariffs (intermediate capital goods, raw materials and other inputs); full exemption from local taxes (sales, excise, fees, dividends and royalties); and full exemption on withholding taxes for remittances abroad (Table 3.4). Beneficiaries of the FZR can receive additional exemptions in case of significant re-investment or for investment in a new project.

Processing companies (Category F) can claim credit against taxable income for expenses incurred in training employees and domestic suppliers classified as SMEs that do not operate under the FZR, as well as against earnings reinvested in Costa Rica.<sup>40</sup> This tax credit is limited to 10% of the company's taxable income.

**The Inward Processing Regime.** The Inward Processing Regime is ruled by the General Customs Law (*Ley General de Aduanas*, Law No. 7557 of 20 October 1995), the Regulations to the General Customs Law (*Reglamento a la Ley General de Aduanas*, Executive Decree No. 25270 of 14 June 1995) and the Regulations to the Inward Processing Regime (*Reglamento del Régimen de Perfeccionamiento Activo*, Executive Decree No. 34165-H-COMEX), and their

### Box 3.3. Conditions to qualify under the FZR

*Investment requirements:* they vary depending on whether the company operates i) within or outside an industrial park; and ii) within or outside the Expanded Great Metropolitan Area (*Gran Área Metropolitana Ampliada*, GAMA). Applicant companies must meet, respectively, the following thresholds:

- *Within GAMA:* companies operating in industrial parks must invest a minimum of USD 150 000 in new fixed assets while companies operating outside an industrial park must invest USD 2 000 000.
- *Outside GAMA:* companies operating in industrial parks must invest a minimum of USD 100 000 in new fixed assets while companies operating outside an industrial park must invest USD 500 000.
- *Large scale projects:* companies investing a minimum of USD 10 million may also qualify for FZR benefits regardless of their location.
- *Minimum export level:* companies are required to export at least 75% of their sales, except for services companies under category C, which must export 50% and companies under category F, which are not subject to any export requirement. Nonetheless, based on Costa Rica's commitments under the WTO, the 75% export requirement will be eliminated by 31 December 2015.
- *Strategic sector requirement:* manufacturing companies seeking to operate within GAMA under category F must perform activities classified under a strategic sector. They must comply with at least one of the following:
  - *Size:* The project employs at least 200 people, reported in its payroll.
  - *Industry:* The project relates to any of the following industries: advanced electronics, advanced manufacturing, advanced electrical components; devices, equipment, implants and medical supplies and its highly specialised packaging or containers; automotive (devices and supplies); high precision machined parts and components; aerospace and aeronautics; pharmaceutical and biotechnology; renewable energy manufacturing; automation and flexible manufacturing systems; and advanced materials.
  - *R&D:* The project demands an allocation of at least 0.5% of the company sales to research and development expenses in its local operation.
  - *Certification:* Projects in which the company uses in its operation at least one of the following certifications: ISO 14001 (14004) or its equivalent; LEED or its equivalent.

*Domestic suppliers:* they must be engaged in manufacturing and sell at least 40% of their production to companies operating under the FZR.

Source: COMEX.

Table 3.4. **Incentives under the FZR**

Costa Rica taxes/other	Free Zone Regime
Corporate income tax	Free Zone holiday for full/partial income tax exemption for 8 <sup>1</sup> /4 years <sup>2</sup> with the possibility of renewing this exemption period upon significant reinvestment or investment in a new project.
Custom duties on imports/exports	100% exemption
Withholding tax on remittances abroad	100% exemption
Sales tax	100% exemption on local purchase of goods & services
Excise tax	100% exemption
Stamp duty	100% exemption
Property taxes	100% exemption for a 10 year term <sup>3</sup>
Property transfer tax	100% exemption for a 10 year term
Municipal patent license	100% exemption for a 10 year term <sup>4</sup>
Withholding tax on royalties, fees, dividends	100% exemption

1. If the company operates under category F (processing companies) of the FZR within GAMA, it is subject to 6% corporate income tax throughout the first eight years of operation, and 15% over the following four years (for a total of 12 years). Outside GAMA, the company is fully exempted over the first six years, subject to 5% corporate income tax over the next six years, and to 15% over the following 6 years (for a total of 18 years).
2. If the company establishes its operation outside GAMA, the full/partial income tax exemption period increases to 12/6 years with the possibility of renewing this exemption period upon significant reinvestment or investment in a new project.
3. This incentive is being evaluated by the General Attorney's office.
4. This incentive applies depending on the date of enactment of municipal legislation governing patent licensing.

Source: COMEX.

amendments. The Inward Processing Regime enables goods to enter the national customs territory and benefit from the full suspension of taxes, including customs duties, subject to the posting of a guarantee bond. The main objectives of this regime are to promote output, employment, foreign and domestic investment, exports and local consumption.

Companies that assemble, reassemble and/or transform their production may apply to the Inward Processing Regime to the extent that their products are exported or re-exported abroad within the time limits determined by legislation or, in some cases, consumed locally (prior payment of applicable domestic taxes). To be eligible under this regime, it is not necessary to fulfil any requirement of value-added. There are two modalities: i) 100% re-export: whereby companies re-export the totality of their production to other countries; or ii) re-export (direct and indirect) and local sale: whereby companies re-export part of their production and sell the other part in Costa Rica (and therefore pay applicable domestic taxes).

Companies operating under the Inward Processing Regime can import raw materials, machinery and equipment, with full suspension of customs duties and import taxes such as tariffs, VAT, excise taxes and an *ad valorem* tax assessed at a 1% tax rate (when applicable). However, all imported raw

materials and products must be later re-exported within a limited time frame that may vary depending on the type of product being imported. Nonetheless, prior to re-exportation, all imported products must be subject to a transformation, reconstruction, assembling or reparation process, or must be incorporated into the machinery or equipment being used as part of the on-going business of the company.

**The Drawback Regime.** The Drawback Regime, regulated by the General Customs Law (Articles 190 and 191) and its amendments, as well as by the Regulations to the Drawback Regime, is a customs regime that allows the rebates of duties or other taxes paid or deposited by an importer for goods that are subsequently exported within 12 months from the date of import.

**The Tourism Development Incentives Regime.** The Tourism Development Incentives Regime is ruled by the Law on Incentives for Tourism Development (Law No. 6990 of 5 July 1985) and its amendments (Law No. 7293 of 31 March 1992 and Law No. 8114 of 4 July 2001). Under this regime, the tourism industry is declared of public interest. It is administered by the Costa Rican Tourism Board and has the purpose of establishing an accelerated and rational development process of the following tourism activities: accommodation, international and national air transport of tourists, aquatic transport of tourists, receptive tourism of travel agencies exclusively dedicated to this activity, and rental of vehicles to foreign and national tourists.

Tourism operators must sign a tourism agreement with the Costa Rican Tourism Board to benefit from incentives (either totally or partially); depending on the nature of the tourism activity they perform (Box 3.4).

#### Box 3.4. Incentives under the Tourism Development Incentives Regime

##### Accommodation services

- Exemption from customs duties and taxes applicable on the importation or domestic purchase of products required for activities such as the setting up of new undertakings and building or remodelling facilities. This exemption does not apply to vehicles or fuels.<sup>1</sup>
- Granting of municipal patents required from companies for their operations. Municipalities shall grant these patents within a maximum term of 30 calendar days following the filing of the application, and shall charge the corresponding municipal tax.
- Authorisation from the Central Bank of Costa Rica for domestic hotels to act as auxiliary collectors of international currencies.
- Exemption from real estate tax, up to a six year period following the signature of the tourism agreement, to businesses set up outside the metropolitan region as defined by the Ministry of Planning.

**Box 3.4. Incentives under the Tourism Development Incentives Regime (cont.)****International and national air transport of tourists<sup>2</sup>**

- Provision of fuel at a competitive price that is not greater than the average in the international market.
- Exemption from all taxes and surcharges on the importation or domestic purchase of spare parts that are necessary for the proper functioning of aircrafts.

**Transport of tourists by water**

- Exemption from all taxes and surcharges applying primarily to the importation or domestic purchase of products required for the construction, expansion or remodelling of docks and other sites destined to the boarding or disembarking of tourists, as well as for the construction or maintenance of marinas, bathing sites or aquariums destined to the attention of tourism.<sup>3</sup>
- Exemption from all taxes and surcharges, except for customs duties (fixed tariff is 20%), on the import or domestic purchase of aquatic ships destined exclusively for the transport of tourists. For these purposes, it must possess adequate facilities for docking, embarking and disembarking of passengers.

**Receptive tourism of travel agencies exclusively dedicated to this activity**

- Exemption from all taxes and surcharges, except customs duties, applicable to the importation of vehicles for collective transport, with a minimum capacity of fifteen people. If the ad valorem tax exceeds 5%, the tariff excess will be exempt.

**Rental of vehicles to foreign and national tourists**

- Exemption of 50% of the total amount of current taxes affecting the importation of vehicles destined exclusively to tourist rental.

1. This exemption does not apply to the importation of like goods that are produced in the territory of countries that are signatories to the Convention on the Central American Tariff and Customs Regime, as regards quality, quantity and prices, as determined by the Ministry of Economy, Industry and Commerce.
2. This applies solely to companies transporting tourists on international routes and in scheduled flights, within the national territory.
3. This exemption does not apply to the import of like goods that are produced in the territory of signatory countries to the Convention on the Central American Tariff and Customs Regime, as regards quality, quantity and prices.

Source: COMEX.

**Assessment of the tax incentive regimes**

Costa Rica is frequently cited as a success story in attracting FDI by providing effective incentives schemes in addition to the underlying framework conditions and market characteristics – namely, stable macroeconomic and political conditions, a well-educated and relatively inexpensive labour force, dependable rule of law, and effective investment promotion systems.<sup>41</sup> The FDI attracted to Costa Rica by the FZR and the investment incentives have been fundamental to the transformation of the

country's economy to high technology manufacturing and services. Within the FZR, high technology companies lead growth in FDI and exports, positioning the country as the fourth exporter of high technology products in the world (the first in Latin America), measured as the share of these exports in the total exports volume of the manufacturing industry. Between 2006 and 2012, 28.9% of FDI inflows to Costa Rica originated from companies operating under the FZR.

Over the last six years, PROCOMER has been evaluating the impact of the FZR on the national economy by assessing several variables, such as the number of companies operating under the regime each year, main sectors of investment, annual export growth, export diversification, FDI, employment, wages, local linkages, etc. (PROCOMER, 2011).<sup>42</sup> As of January 2013, the number of companies operating under the FZR reached 315. Among them, 47% operate in services and 44% in the manufacturing industry. Exports of goods from the FZR have represented more than half of total country exports between 2006 and 2010. The electrical and electronics sector claims the largest share of exports, with 45% of the total export volume from companies established under the FZR in 2010. Exports from the FZR grew in sophistication and their technological profile flourished. Exports of services from the FZR have also been expanding, with an average annual growth of 19.4% between 2006 and 2010. Additionally, in 2012, the IADB sponsored an independent cost-benefit analysis that shows that the FZR companies generated at least 8.3% of the country's GDP.

PROCOMER's evaluation reports note that the employment level generated by companies in the FZR has experienced an average annual growth of 6.5% since 2000, reaching a total of 58 000 direct jobs by 2010. The services sector creates a large proportion of jobs, 48% of total in 2010. Similarly, the average salary paid per employee in the FZR showed a steady growth between 2006 and 2010, reaching an average of USD 1 028 per month per worker. The average salary in the services sector is USD 1 300. This figure represents 1.6 times the national average salary paid by the Costa Rican private sector.

The greater variety and sophistication of Costa Rican exports seen in recent years is related to FDI link to global value chains. The FZR claims credit in this area as well, since 80% of companies related to the global value chains operate under this regime. FZR companies currently participate in at least four important global value chains in the manufacturing sector: electronics, medical devices, automotive and aviation/aerospace. In total, by 2011, exports related to these global value chains accounted for 36.8% of total exports of goods from Costa Rica.

**Evaluation of the cost of investment incentives – tax expenditures.** Tax expenditures – the revenue loss attributable to investment incentives and special exemptions – is translating into less money available to the government of Costa Rica for other public expenditures. The Ministry of Finance issues tax expenditure reports annually. The latest analysis conducted by the Ministry estimates the total tax expenditures for 2011 at 5.79% of GDP, with 3.69% attributable to the general sales tax exemptions, 1.8% to the income tax, including 0.5% attributable to investment incentives (FZR), and 0.30% to other taxes. The overall size of tax expenditures – 5.79% of GDP – is of concern, but it is particularly important considering the remarkably low tax revenue collection figures, with the tax revenue to GDP ratio recorded at low 13.4% in 2011. Preserving Costa Rica's macroeconomic stability is of great importance to ensure that the investor-friendly framework conditions continue to be in place. To that end, the health of public finances, including stabilisation of the country's public sector debt and fiscal consolidation should be high on the agenda of Costa Rican policy makers. Measures to broaden the current tax base through elimination of the most wasteful tax exemptions must be carefully designed in order to increase the tax revenue collection yet without jeopardising the country's growth prospects.

### **Administration**

PROCOMER, as the entity in charge of the administration of the FZR, regularly monitors and controls companies operating under this regime. FZR companies must file an annual operations report with PROCOMER, which provides relevant information on the level of investment and employment, and in particular, on the company's compliance with the Executive Agreement and its Operations Contract under the FZR and with other applicable legislation.

The General Tax Administration performs periodical tax audits of all companies whether or not they have beneficiary status of the FZR. However, as acknowledged by Costa Rican authorities under the International Monetary Fund's Article IV consultations, "there is significant room to improve tax administration" and to reduce tax evasion (IMF, 2011). The adoption of a new information system to enhance crosschecks and tax compliance controls will enhance tax administration's ability to effectively monitor fraudulent activities including various transfer price schemes.<sup>43</sup>

### **The legal and regulatory changes of the investment incentives regime**

In light of the commitments under the WTO Agreement on Subsidies and Countervailing Measures, Costa Rica amended its FZR to bring it into compliance with the international norms. The amendment entered into force in January 2010 (Law No. 8794 of 12 January 2010). Changes introduced to the

FZR eliminated the link between exports and incentives by including a new category of beneficiary companies (Category F: processing company). These companies are not required to export a minimum percentage of their production to be eligible for the incentives granted under the FZR regime. The amendment also established that export-processing companies under category A<sup>44</sup> will benefit from all the FZR exemptions only until 31 December 2015, which is the deadline established to comply with the WTO commitments.

Costa Rica must still adjust the legislation for the Inward Processing Regime. To bring this legislation into compliance with the international norms will entail the modification of Article 179 of the General Customs Law to eliminate tax and duties exemptions on imported machinery and equipment. It will also require modifications to eliminate tax incentives for all imported merchandise that is not built into exportable products. These amendments are currently being drafted and discussed jointly between COMEX, PROCOMER, and the General Customs Authority. The government expects that the impact on companies currently operating under this regime will be limited.

### ***Business linkages and measures in favour of SMEs***

Business linkages between MNEs and domestic companies – one of the major expected benefits of FDI to boost the economy – have been rather limited in Costa Rica (OECD, 2004; OECD, 2012; Cordero and Paus, 2008; IADB, 2012). MNEs still import most inputs and services and tend to buy unsophisticated products and services from local suppliers, such as packaging materials, office supplies, security, cleaning and food; areas that offer few avenues for technology and knowledge transfer. In these areas, however, the quality of domestic suppliers is high and improving, as suggested by the country's shift from 44th to 28th position between 2001 and 2010 in the WEF *Global Competitiveness Index* for the quality of local suppliers. Costa Rica nevertheless reverted back to 38th position in the 2012 edition. Nonetheless, the high quality of domestic suppliers does not mean that business linkages are numerous and impact a high proportion of the domestic economy.

Opportunities for productive business linkages in Costa Rica are by definition limited due to the type of foreign investments attracted to the country, which are increasingly knowledge-intensive. For instance, in the life sciences sector, PROCOMER analysed that backward linkages with domestic suppliers are only possible in about one third of the production chain, as the rest is covered by raw materials, corporate contracts and intra-company trade. However, within the share of possible linkages with the domestic economy, linkage opportunities can be expanded. On the one hand, there is still a lack of local capabilities, as domestic companies have difficulties to overcome the

technological gap. On the other hand, MNEs have not been sufficiently willing to actively build networks of domestic suppliers, for reasons of economies of scale or lack of international certifications (OECD, 2012). A result is that, although SMEs play an important role in the Costa Rican economy, many of them have still been geared towards the domestic market and have had relatively little opportunity to be integrated in global value chains (OECD, 2004).

In this context, the government has increasingly undertaken initiatives to foster productive linkages between MNEs' affiliates and domestic enterprises. In late 1999, with the objective of increasing the local content of products manufactured by MNEs and raising the competitiveness of SMEs, the government launched, with the support of the IADB, a Project for the Development of Suppliers for High Technology Multinational Corporations (*Proyecto de Desarrollo de Proveedores para Empresas Multinacionales de Alta Tecnología*) to develop suppliers of high-tech MNEs. This project encompassed three main components: a sourcing pilot programme, an information-sharing system, and a national office for the development of suppliers (*Costa Rica Provee*).

*Costa Rica Provee* focused on determining the needs of MNEs, identifying potential suppliers and matchmaking between corporations and qualified suppliers. From 2000 to 2010, the programme established 331 linkages for local SMEs.<sup>45</sup> The packing, packaging, metal works, plastics and technology services sectors had the most transactions and the highest amounts negotiated. In 2010, an Inter-American Development Bank (IADB) study found that the volume of transactions over the preceding decade reached USD 840 million (IADB, 2010). Furthermore, in a representative subsample, the purchasing companies reduced costs by 16%, decreased quality problems by 2.5%, and improved delivery by 32%. This programme has now become PROCOMER's Export Linkages Department, which is focusing on the sectors that have been targeted for FDI promotion (advanced manufacturing, life sciences and services).

In 2010, the Commission for Export Linkages (*Comisión de Encadenamientos para la Exportación*) was established to streamline interagency policy co-ordination to broaden and deepen the establishment of productive linkages. The commission is headed by PROCOMER, and is composed of the following organisations: COMEX; the Ministry of Economy, Industry and Commerce; the Ministry of Science, Technology and Telecommunications; the National Council for Scientific and Technological Research; CINDE; the Costa Rican Chamber of Exporters; the Costa Rican Chamber of Industry; the Costa Rican Chamber of Information and Communication Technology; the Association of Free Zones; and the Costa Rican Institute of Technology.

The government is also increasingly devoting efforts towards building productive capacities of domestic companies, particularly SMEs. Those that strive to become suppliers of world-class corporations frequently face challenges related to their size, their own organisational capacity (i.e. qualified human capital, quality control and international certifications), external conditions in the economy that are particularly constraining for small firms (such as access to finance, Section on Financial sector development), and the high cost of upgrading production processes to meet the needs of MNEs. As such, while the main role of PROCOMER's Export Linkages Department throughout the past decade was to promote productive linkages between exporting companies and local suppliers, it is currently focusing on building capacities of domestic companies. Its main objective for the next two years is to promote at least 150 SMEs for international certifications (e.g. ISO 9001:2008).

Other initiatives in favour of enhancing capacities of domestic SMEs, in which PROCOMER is often a major actor, include:

- Financial incentives for SMEs that supply to exporting firms: In 2010, the Free Zone Regime Law was amended to expand the benefits of the FZR to SMEs that sell more than 40% of their products to firms operating under the regime or exporting. Moreover, this reform introduced tax incentives to FZR firms operating under category F that invest in training local suppliers. FZR firms can use this type of training to enhance the technical and managerial skills of their local counterparts. Such training has mainly been used to close gaps in areas such as quality assurance, internal logistics management, customer service, manufacturing techniques, financial administration, as well as an array of specific technical trainings to upgrade suppliers' skills in a specific project.
- Access to finance to facilitate investment in technology: Due to certain requirements set by the General Superintendence of Financial Entities, most of the banking system is not able to offer loans to firms that have the typical risk profile of an SME. This has historically made it difficult for firms to invest in upgrading their equipment and processes to meet the needs of world class clients. The government has established initiatives to address this issue (Box 3.5).
- Awareness among exporting firms of the benefits of domestic investment linkages: As previously highlighted, many MNEs have not been fully aware of the local capabilities available to fulfil their supplying demands and, consequently, were not seeking to establish linkages with local enterprises. To address this situation, the Export Linkages Department at PROCOMER has been working on facilitating interactions between MNEs and local

suppliers to explore potential business opportunities. It has put in place a supplier exchange forum, which aims at training interested parties on supply chain management.

- Programmes to connect qualified SMEs with exporting firms: Since the level of difficulty for establishing an initial connection with large companies is high for SMEs, the government has implemented matchmaking programmes, including: i) fairs to connect suppliers and buyers; ii) open house visits, in which MNEs host domestic suppliers, introduce them to their relevant internal departments and enable them to present themselves as potential suppliers; and iii) a public website providing information about the availability of qualified suppliers and the purchasing needs of MNEs. The latter will offer free and transparent information about opportunities for the establishment of linkages.
- Organisational capacity of local supply base: Many domestic SMEs do not have the organisational capacity to meet world-class standards in terms of quality, delivery and compliance. While some of these burdens are related to access to finance, many of them are largely due to a lack of know-how. PROCOMER has put in place the following initiatives to determine the strengths and weaknesses of the local supply base, and to support them to improve and reinforce their capacities: i) assessments of the state of the supply base in various manufacturing sectors, which seek to determine areas of strengths and weaknesses for all domestic firms within a sector; ii) training activities for suppliers on business management, lean manufacturing and other topics that are of critical importance to world class buyers; and iii) a Pilot Programme for Support and Technical Assistance (*Programa Piloto de Apoyo y Asistencia Técnica*), which seeks to engage multinational corporations in supporting the development of their new suppliers.
- Productivity growth through the support of innovation and strengthening of human capital in strategic sectors: The Programme on Innovation and Human Capital for Competitiveness (*Programa de Innovación y Capital Humano para la Competitividad*), funded by the IADB, was approved in November 2012 and signed in April 2013 by the government. It is administered by the Ministry of Science, Technology and Telecommunications, with the support of COMEX and is directed towards stimulating innovation in Costa Rican companies, improving the conditions to promote innovative activities in global enterprises, and fostering entrepreneurship based on new technologies. Under this programme, the advanced capacity building of human resources will focus on strategic areas identified in the National Plan on Science, Technology and Innovation, such as digital technologies,

new materials, biotechnology and renewable energies. Some of the programme's objectives include providing technical assistance and quality management to SMEs, co-financing SME innovation projects, and providing technical assistance to technologically based entrepreneurs. It also intends to finance masters' degree scholarships and to attract international experts to establish innovation programmes in the country's enterprises in order to foster training and innovation in local human resource.

### Box 3.5. Enhancing access to finance for SMEs

The government has put in place four programmes to facilitate and increase access to finance for SMEs:

1. *The Development Banking System (Sistema Banca de Desarrollo)*, created by Law No. 8634 of 23 April 2008, the funds of which are managed by the National Development Fund and used for three purposes: i) second-tier funding for financial operators that finance SMEs, including seed capital through incubators, ii) loan guarantees of up to 75% on qualifying projects and iii) non-financial services for entrepreneurial development.
2. *The Fund Support Programme for Small and Medium Enterprises (Fondo Programa de Apoyo a la Pequeña y Mediana Empresa)*, created by Law No. 8262 of 2 May 2002 and administered by the National Council for Scientific and Technological Research. It consists of a non-reimbursable fund dedicated to financing activities and projects that improve SMEs' competitiveness and organisational capacities through technologically oriented projects. The programme finances as much as 80% of the cost of projects taken on by SMEs in the industrial and trade and services sectors.
3. *The Fund for the Development of Micro, Small and Medium Enterprises (Fondo de Desarrollo para Micro, Pequeñas y Medianas Empresas)*, introduced through the Operative Regulation for FODEMIPYME, *La Gaceta* No. 84 of 3 May 2010. The Fund works to improve the competitiveness of SMEs by: i) identifying guarantors for firms that do not have sufficient collateral to qualify for a loan, ii) financing intangible assets, and iii) offering entrepreneurial development services (created through Law No. 8262 of 2 May 2002 (*Ley de Fortalecimiento de las Pequeñas y Medianas Empresas*) and administered by the Banco Popular y de Desarrollo Comunal).
4. *The Alternative Stock Market (Mercado Alternativo para Acciones)* is a joint project of the National Stock Market and the IADB, which allows the Stock Market to provide technical and direct financial assistance to firms with high growth potential that require early stage finance.

Source: COMEX.

In summary, Costa Rica has a coherent strategy and a solid institutional framework to promote FDI, with CINDE performing very well in attracting MNEs in targeted sectors. Its Aftercare Department maintains regular consultations with the business community, and provides quality pre- and post-establishment support, feeding into its policy advocacy function. The FZR has been a successful tool for attracting foreign investment, although they represent revenue foregone. Measures to streamline tax exemptions could be envisaged. The authorities could benefit from the experience of the *OECD Tax and Development Programme* when continuing to improve investment incentives systems and to evaluate their effectiveness and cost efficiency.

An important challenge remains at the level of investment facilitation, as administrative procedures to start a business continue being too burdensome, which hampers the possibility to offer a sound investment climate to investors. The government has however initiated significant changes in this area, notably with the setting up of the digital registration system *CrearEmpresa*. The authorities are encouraged to pursue streamlining and modernisation of procedures for doing business and facilitating both domestic and foreign investments. Another challenge lies in one of the major expected benefits of FDI to boost the domestic economy, which are business linkages. Productive linkages in Costa Rica, and their implications in terms of transfer of technology and know-how, have been rather limited over the past decades. However, recent government initiatives to address this issue have been numerous and increasingly targeted at enhancing domestic productive capacities of SMEs, with PROCOMER playing a leading role. Nonetheless, it is too early to assess the effective impact of these measures.

## Trade policy

Policies relating to trade in goods and services can support more and better quality investment by expanding opportunities to reap scale economies and by facilitating integration into global supply chains, boosting productivity and rates of return on investment. Based on the *OECD Policy Framework for Investment*, this section addresses the question of how signing market-expanding international trade agreements and implementing WTO commitments by Costa Rica can increase investment opportunities. It also analyses the recent efforts of the government to reduce the compliance costs of customs, regulatory and administrative procedures at the border.

### **Trade strategy**

Since the mid-1980s, Costa Rica has engaged in an on-going trade liberalisation process by phasing out and reducing tariff and non-tariff barriers. As a result, the domestic average tariff rate declined from 46.3%

in 1982 to 6% in 2012. This process has contributed to the setting up of a broad foreign trade platform that is fundamental to the country's international trade policy and development process. As presented in the previous section, the trade policy designed and implemented by COMEX is primarily based on the following three pillars:

1. strengthening and expanding the international trade platform;
2. enhancing its performance; and,
3. maximising its benefits and potential.

### ***Pillar 1: Strengthening and expanding Costa Rica's international trade platform***

Costa Rica's foreign trade platform has been progressively developed on the basis of multilateral, regional and bilateral trade negotiations, which include its incorporation to the General Agreement on Tariffs and Trade (GATT) in 1990 and to the WTO since its creation, as well as 14 free trade agreements (FTAs), 10 of which are already in force, including the Central American Economic Integration Subsystem (also called Central American System).<sup>46</sup>

The country's trade platform has contributed to the diversification and sophistication of its economy over the last few decades. This includes transitioning from a high dependence on certain traditional agricultural products until the 1980s, to *maquila* facilities, and from there to advanced electronics, software development centres, engineering and design centres, shared services centres and medical devices. Costa Rica currently exports over 4 500 products to 150 countries worldwide, which reflects a diversification of exports and destination markets. In 2012, Costa Rica exported more than USD 11 300 million in goods, which accounted for a quarter of its GDP.

Over the last decade, Costa Rica's exports of services have grown at an average annual rate of 11.5%, reaching USD 5 560 million in 2012 and accounting for 33% of the yearly total exports, up from 26% in 2002. Exports of information technology and corporate services have multiplied more than six times in over a decade, from USD 397 million in 2002 to USD 2.6 billion in 2012. As of 2010, exports of information technology services and other commercial services surpassed tourism as the leading sector supplier of export services. Tourism and technological services accounted for 77% of total exports of services in 2012. During the same year, exports of information technology and business support services accounted for a cumulative share of 15.5% of Costa Rica's total exports.

### ***Pillar 2: Enhancing performance of Costa Rica's international trade platform***

Under this pillar, Costa Rica has focused on a plan to improve the functioning of institutions related to trade agreements. COMEX leads this plan and co-ordinates its execution with over 12 private and public entities, including the Ministries of Health, of Agriculture, of Finance, as well as of Economy, Industry and Commerce.

Efforts also include upgrading and modernising the Single Window for Foreign Trade (*Ventanilla Única de Comercio Exterior*, VUCE), administered by PROCOMER. The system centralises and simplifies import and export procedures (see below).

### ***Pillar 3: Maximising the benefits of the international trade platform***

The main objectives of the activities carried out under this pillar are to expand the benefits of the international trade platform and to enhance competitiveness in order to maximise its potential. The tasks completed in the first case encompass export promotion and diversification programmes, attraction of FDI, participation in global value chains and an increase in the number of exporting companies – including SMEs. Undertakings pertaining to the second case include reforms aimed at improving the business climate, renewing airport and seaport facilities, strengthening and aligning education programmes, opening up the telecommunication and insurance sectors to private suppliers, undertaking policies to duplicate broadband penetration, amending the free trade zone system to make it compliant with WTO rules, and streamlining regulatory procedures. For these purposes, COMEX co-ordinates export promotion activities with PROCOMER and investment promotion with CINDE.

As highlighted in the previous section, COMEX defines the investment policy objectives, the promotion aspects of which are implemented by CINDE. FDI attraction is currently focusing on companies from advanced manufacturing, life sciences and services industries. As noted, FDI has played a crucial role in the shift from traditional products towards those that are more sophisticated within the country's export structure.

Another essential piece of this pillar is export promotion, which COMEX co-ordinates with PROCOMER. This includes activities such as seeking markets and identifying potential customers for Costa Rican products, implementing capacity-building programmes for the internationalisation of SMEs, fostering backward linkages between foreign and domestic companies and streamlining export and import regulatory procedures.

The government intends to maintain a clear and transparent international trade regime, and has taken measures to reduce trade policy uncertainty and increase trade policy predictability for investors, such as:

- The establishment of an Advisory Council on Foreign Trade within COMEX composed of representatives from different business sectors to represent investor interests.
- Consultations in FTAs negotiation: before and during the negotiation process of an FTA, the country promotes consultation processes, and requests the submission of written comments regarding the respective FTA negotiation.
- Information and public disclosure through the issuance of an annual report accessible on the Internet.<sup>47</sup>

The country favours the application of trade and trade-related policies aimed at reducing the cost of imported goods and encouraging productive investment that fosters the creation of new exporting capacity. In order to reduce the anti-export bias and facilitate the increase and diversification of the country's export portfolio, cuts in import tariffs were undertaken. The negotiation of FTAs has also contributed to reducing the cost of imported raw materials, intermediate inputs and capital goods. A sector in which investment could be affected by trade policy is the food industry, as Costa Rica maintains high tariffs on certain goods (e.g. meats, dairy, potatoes, onions, rice, and sugar). Nevertheless, recent FTAs, particularly the CAFTA-DR, have set the country on a trajectory of trade liberalisation that will gradually phase-out tariffs on most agricultural products.

### ***International trade agreements***

Costa Rica is a small country and, consequently, a key element in its strategy to attract investment has been to seek increased market access. FDI attracted by Costa Rica has an export-oriented profile and investors use Costa Rica as an exporting platform for other markets.

Costa Rica completed its accession to the GATT in 1990, becoming its 100th party. In 1995, the country joined the WTO as one of its founding members. Costa Rica is an active player in the multilateral trading system and furthermore has made contributions in the framework of the Doha Development Agenda negotiations and work plan. In particular, it has drawn attention to the negotiations on agriculture and access for non-agricultural goods (WTO, 2007). The government stresses that market access negotiations, including agriculture, services and non agricultural market access, elimination and reduction of trade distortions and the strengthening of the WTO rules would be highly beneficial to developing countries.

Costa Rica is also participating in the current negotiations of the Trade in Services Agreement as part of the WTO-linked *Real Good Friends of Services* group. Moreover, it is signatory of the Information Technology Agreement, a multilateral trade liberalisation instrument that removed import tariffs on certain inputs and final goods used and produced by the high-tech electronics industry as on goods that allowed education to improve and other economic activities to be more efficient. The country has also supported the G20 commitments against protectionism. It has advocated for the adoption of a standstill commitment among WTO members and for the strengthening of the monitoring mechanism. The country has also proposed the incorporation of new issues into the WTO working agenda, in particular global value chains, investment and competition policy.

In addition to its commitments to the WTO, Costa Rica has engaged in the negotiation of FTAs, which the government perceives as a way of supplementing WTO rules in enhancing trade policy certainty and increasing market access. Currently, the country has 10 FTAs in force with 17 partner countries – including the United States, Canada, Mexico, Chile, Panama, the Caribbean Community (CARICOM) and China. Additionally, the FTAs with Peru, Mexico and Singapore were recently approved by Congress and entered into force mid-2013. These preferential trading partners account for more than 70% of the country's total trade in goods (Table 3.5). Furthermore, the Association Agreement with the EU was signed in June 2012, while the FTA with Colombia in May 2013 and that with EFTA in June 2013.

Table 3.5. **Costa Rica FTAs and covered merchandise trade**

FTA	Partners	Entry into force	Exports (2012) <sup>1</sup>		Imports (2012) <sup>1</sup>	
			Value (million USD)	Share in Total	Value (million USD)	Share in Total
CACM	El Salvador Guatemala Honduras Nicaragua	23/09/1963	1 585.6	14.0%	874.6	5.0%
Costa Rica – Mexico	Mexico	01/01/1995	323.0	2.8%	1 165.5	6.6%
Costa Rica – Chile <sup>2</sup>	Chile	15/02/2002	25.7	0.2%	291.3	1.7%
Costa Rica – Dominican Republic <sup>2</sup>	Dominican Republic	07/03/2002	197.4	1.7%	38.7	0.2%
Costa Rica – Canada	Canada	01/11/2002	71.7	0.6%	243.0	1.4%
	Trinidad & Tobago	15/11/2005	62.0	0.5%	101.2	0.6%
Costa Rica – CARICOM	Guyana	30/04/2006	2.9	0.0%	0.7	0.0%
	Barbados	01/08/2006	9.3	0.1%	0.2	0.0%
	Belize	10/03/2011	11.4	0.1%	2.0	0.0%
Costa Rica – Panama <sup>2</sup>	Panama	24/11/2008	581.7	5.1%	384.5	2.2%

Table 3.5. **Costa Rica FTAs and covered merchandise trade** (cont.)

FTA	Partners	Entry into force	Exports (2012) <sup>1</sup>		Imports (2012) <sup>1</sup>	
			Value (million USD)	Share in Total	Value (million USD)	Share in Total
CAFTA-DR	US, Dominican Republic El Salvador Guatemala Honduras Nicaragua Panama	01/01/2009 (for Costa Rica)	4 451.3	39.2%	8 753.8	49.8%
Costa Rica – China	China	01/08/2011	331.3	2.9%	1 439.6	8.2%
Costa Rica – Peru	Peru	Entered into force on 1 June 2013	18.2	0.2%	46.2	0.3%
Costa Rica – Singapore	Singapore	Entered into force on 1 July 2013	61.7	0.5%	42.2	0.2%
<b>Subtotal: FTAs in force</b>			<b>7 733.3</b>	<b>68.2%</b>	<b>13 383.5</b>	<b>76.2%</b>
Association Agreement between Central America and the EU	EU-27	Pending legislative approval	2 067.9	18.2%	1 233.7	7.0%
CARICOM	Jamaica	Pending legislative approval	19.4	0.2%	1.2	0.0%
	Suriname		7.8	0.1%	0.0	0.0%
	Saint Lucia		2.2	0.0%	0.0	0.0%
	Antigua and Barbuda		0.4	0.0%	0.0	0.0%
	Grenada	(Pending legislative approval of their respective countries)	0.8	0.0%	0.0	0.0%
	Dominica		0.7	0.0%	0.1	0.0%
	Saint Vincent and the Grenadines		0.5	0.0%	-	0.0%
Costa Rica – Colombia	Colombia	Pending legislative approval	62.9	0.6%	326.8	1.9%
European Free Trade Association	Iceland	Pending legislative approval	20.4	0.2%	140.6	0.8%
	Liechtenstein					
	Norway Switzerland					
<b>Subtotal: FTAs signed but not yet in force</b>			<b>2 183.5</b>	<b>19.2%</b>	<b>1 702.4</b>	<b>9.7%</b>
<b>Total: FTAs in force and signed</b>			<b>9 916.8</b>	<b>87.4%</b>	<b>15 085.9</b>	<b>85.9%</b>
<b>Total trade<sup>3</sup></b>			<b>11 343.3</b>		<b>17 572.1</b>	

1. Overlaps in the share of trade flows covered by FTAs are avoided by accounting total trade flows with a specific partner only under one FTA (for example, total trade flows with Central America are accounted only under the CACM, whereas total trade flows under CAFTA-DR comprise solely the total trade flows with the US).

2. These FTAs have been signed by the partner country and Central America (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua), and contains a bilateral protocol with Costa Rica.

3. Preliminary data, subject to changes.

Source: COMEX.

CAFTA-DR co-exists with other agreements but none of the FTAs abrogate those that already exist. They co-exist and the exporters/importers are free to choose the FTA under which they want to conduct their businesses. For example, a Costa Rican firm exporting to El Salvador can decide whether to

use a CACM certificate of origin or a CAFTA-DR one. This overlapping of trade agreements with same countries, if this tendency is maintained in the future, might beget increased uncertainty for businesses and complexity for the government in the management of its various agreements. The authorities are aware of this issue but for the time being they consider it as an opportunity for exporters, as more legal instruments are available. In the future, the government could consider, as best practices suggest, to replace existing FTAs with those renegotiated with the same countries, so as to avoid excessive multiplication within the same network of international agreements.

#### ***FTA Costa Rica – Mexico***

Costa Rica's first FTA negotiation, following its accession to GATT, was with Mexico. Costa Rica was the first Central American country to negotiate an FTA with Mexico, which entered into force in January 1995. Moreover, this was the first FTA between developing countries that was based on the North American Free Trade Agreement (NAFTA) model. As of 1st January 2009, all products traded between the two countries were duty-free, except for those excluded from the tariff elimination schedule. While trade flows between Costa Rica and Mexico were relatively small and concentrated on a few products before the agreement, the latter delivered positive results in terms of trade growth and exploitation of comparative advantages (COMEX, 2000).

In November 2011, Mexico, Costa Rica, and the four other Central American countries signed the agreement for the modernisation and convergence of all FTAs between Central American countries and Mexico, which will supersede the original FTA between Mexico and Costa Rica. This agreement was approved by Congress and entered into force on 1 July 2013.

#### ***FTA Costa Rica – Chile***

Costa Rica negotiated its second FTA with Chile. For this agreement, legal provisions were agreed at a regional level between Central America and Chile, while tariff schedules were negotiated bilaterally. Costa Rica was the first Central American country for which the FTA with Chile became effective (it entered into force in 2002). As of 2010, 95% of Costa Rican exports entered the Chilean market free of duties and 82% of Chilean exports entered the Costa Rican market under the same condition. Duty-free access to the Costa Rican market reached 95% in 2013 and both countries will complete tariff elimination in 2017 for all goods covered by the phase-out schedule.

#### ***FTA Costa Rica – Canada***

In the early 2000s, Costa Rica started FTA negotiations with Canada, marking its first agreement with a developed country. The FTA was signed in 2001 and entered into force in November 2002. By 2011, almost 100% of

Costa Rica's exports to Canada and 91% of Costa Rica's imports from Canada were duty-free. Costa Rica and Canada started to negotiate the modernisation of their FTA in an effort to update the rules and broaden the coverage of the initial agreement. However, these negotiations are currently suspended and no further rounds of negotiation are planned until both countries find a zone of possible arrangement.

### ***FTA Costa Rica – Dominican Republic/FTA Costa Rica – CARICOM***

In the late 1990s and early 2000s, Costa Rica negotiated FTAs with Caribbean countries to expand preferential market access for its exports to neighbouring regions. Negotiations with the Dominican Republic were concluded in 1998 and the FTA entered into force in 2002. In 2004, all products traded between Costa Rica and the Dominican Republic became free of duties, with the exception of a list of products excluded from the tariff elimination process. The FTA between Costa Rica and CARICOM was signed in 2004 and is in force for Costa Rica, Trinidad and Tobago (since 2005), Guyana and Barbados (since 2006), and Belize (since 2011). In April, the Cabinet of Ministers of Jamaica approved the implementation of the free trade agreement, though its entry into force is still pending. All products traded between Costa Rica and these Caribbean countries are now free of duties, with the exception of those excluded from tariff elimination and some agricultural products for which the duty-free condition is applied seasonally.

### ***FTA Central America and Panama***

The Central American Common Market (CACM) is in force in Costa Rica since 1963. All trade between Costa Rica and the other member countries is duty-free, with the exception of coffee, sugar and some petroleum derivatives. Trade flows between Costa Rica and the other CACM members have increased steadily, scoring an 8.7% average annual growth between 2000 and 2011. Originally, the other four members of the CACM were El Salvador, Guatemala, Honduras and Nicaragua. However, Panama officially joined the CACM in June 2013.

Negotiations for the FTA between Central American countries and Panama started in 2000. Costa Rica and Panama concluded them bilaterally in 2007, and the FTA entered into force between these two countries in November 2008 (although tariff staging started on 1 January 2009). By 2011, 91% of Costa Rican exports to Panama were duty-free; meanwhile 89% of imports from Panama benefitted from the same duty-free access. The tariff elimination process would be completed by 2025.

### **FTA United States, Central America and the Dominican Republic (CAFTA-DR)**

Central American countries and the US launched FTA negotiations in January 2003, which were concluded in August 2004. This agreement superseded the rules of the multilateral trading system and the Caribbean Basin Initiative – a unilateral tariff preference scheme provided by the US government to promote trade with these countries. CAFTA-DR was approved in Costa Rica through referendum organised in October 2007. The implementation process required for the agreement to come into effect included the elimination of public sector monopolies on telecommunications and insurance (Section on Competition policy), as well as the enactment of new laws and regulations. In January 2009, Costa Rica completed the implementation and entry into force of CAFTA-DR. Costa Rica was the last country to ratify the treaty among its signatories. The authorities consider CAFTA-DR as the country's most important FTA because of the following key features:

- First, it allows for the participation of private providers in the domestic market for three strategic services that are fundamental for competitiveness: Internet, mobile phones and insurance services. These activities were previously reserved to monopolistic state-owned providers.
- Second, this is the first time in Costa Rica's history of bilateral trade negotiations where full – though highly gradual – liberalisation of the agricultural sector takes place.
- Third, the comprehensive and robust set of trade rules put in place by CAFTA-DR consolidates an environment of transparency and certainty for investment and that boosts the attraction of foreign investors, particularly as the US has historically been the major source of FDI for Costa Rica. In this regard, the treaty also consolidates and expands Costa Rica's preferential access to the US market.

A distinctive feature of this negotiation is the multilateral application of the agreement, meaning that the legal provisions and the tariff schedules granted by each country are not only applicable bilaterally between such country and the United States, but also to any other member country. Hence, CAFTA-DR contributes to updating and consolidating the regional integration scheme of Central America.

### **Association Agreement Central America – European Union**

After CAFTA-DR, Costa Rica, together with the other Central American countries, engaged in the negotiation of an Association Agreement with the EU (*Acuerdo de Asociación entre Centroamérica y la Unión Europea*, AACUE), to pursue further diversification of the destination markets for its exports – which in turn reduces the expected impact of international business cycles on

the domestic economy – as 18% of Costa Rica's total exports are directed to the EU market. AACUE goes beyond the scope of a traditional FTA, given that it also includes provisions on co-operation and political dialogue, which are aimed at supplementing the provisions on trade liberalisation. Perhaps the most distinctive feature of AACUE is its "region-to-region" approach, which led the Central American countries for the first time ever to agree on one single tariff elimination schedule, equally applicable to the products of all countries in the region. The Parties signed the agreement in June 2012.

### ***FTA Costa Rica – China***

In June 2007, Costa Rica established diplomatic relations with China. In 2008, both countries prepared a joint feasibility study for the negotiations of a bilateral FTA, which started in 2009. The FTA entered into force in August 2011 and, during its first year, exports from Costa Rica to China increased around 70% compared with the same period of the previous year. Some of the goods that experienced an increase in exports include leather, cables and other electrical conductors, concentrated and frozen orange juice, aluminium and copper waste and scrap, and coffee.

### ***FTA Costa Rica – Singapore***

In order to open up greater opportunities in various Asian markets and promote trade relations, increase investment and encourage co-operation, Costa Rica decided to strengthen its relationship with Singapore through FTA negotiations, which started in 2009. Certain characteristics of Singapore, such as a population equivalent to that of Costa Rica and high levels of consumption, make this country an economy dependent on imports that Costa Rica could supply. The agreement was signed in 2010 and entered into force on 1 July 2013.

### ***FTA Costa Rica – Peru***

In 2010, Costa Rica, Panama, Honduras, El Salvador, Guatemala and Peru agreed to initiate the negotiation of an FTA, in order to create a clear, stable and transparent legal framework for trade and investment. In May 2011, the Parties concluded negotiations. This agreement was approved by Congress and entered into force on 1 June 2013. This FTA has the potential to create significant opportunities for potentially exporting SMEs.

### ***FTA Costa Rica – Colombia***

In order to strengthen their trade and investment relationship, Colombia and Costa Rica launched FTA negotiations in 2012. This FTA would contribute to consolidate Costa Rica's presence in South America and to expand market

access for Costa Rican products in this geographically near market. This agreement was signed in May 2013 and has been submitted for discussion at Congress to seek legislative approval.

### **FTA Central America – European Free Trade Association**

Costa Rica, together with Honduras, Panama and Guatemala, is currently negotiating an FTA with the European Free Trade Association (that includes Norway, Switzerland, Liechtenstein and Iceland). A deal to conclude the negotiation was reached at the end of 2012. This agreement was signed on 24 June 2013.

### **Pacific Alliance**

Costa Rica has observer status at the Pacific Alliance, a regional trade block formed by Mexico, Chile, Peru and Colombia, with the purpose of deepening and increasing trade and investment among its members, as well as developing a platform to foster commerce with the Asia-Pacific region. A key membership requirement of this group is having FTAs with all member countries; Costa Rica already has FTAs with all countries.<sup>48</sup>

### **Facilitation of cross-border trade**

The government has adopted a unified and global strategy to streamline and reduce compliance costs in customs, regulatory and administrative border procedures, as part of a trade facilitation initiative. Some of the most recent efforts in this strategy are: the expansion of the procedures covered by the Information Technology for Customs Control (*Tecnología de la Información para el Control Aduanero*, TICA), the implementation of the Single Window for Foreign Trade (VUCE and VUCE 2.0) and the modernisation of the main border crossings.

### **Customs procedures**

The Directorate General of Customs implemented TICA in 2005. This electronic tool facilitates customs formalities and controls, which are standardised for all borders, allowing the authorities to better monitor operations and enforce transparency in all trade transactions. Furthermore, users can complete their customs declaration forms through TICA, making tax and tariff e-payments easier and eliminating bank commissions.

The system is in constant renewal with the aim to interact with other governmental and regional databases as well as to incorporate recent technological developments. In 2011, TICA was adapted to enable its interconnection with the International Merchandise Transit system, which operates among Central American countries to trace and facilitate all land

cargo in transit within the region. The last adjustment to the system, made in August 2012, enabled the e-payment of sanitary services, such as the fumigation of containers at the borders. The customs authorities however acknowledge that this digital platform requires a reform to bring it up to date with best international standards and the current necessities of the trade community. Hence, the government has included the system's improvement in a trade facilitation programme. Starting in 2014, with the support of the IADB, the initiative will include investments in border infrastructure, optimisation of procedures and enhancement of information technology tools.

### ***Administrative and regulatory procedures***

The VUCE, administered by PROCOMER, was created in 1996 to centralise and simplify import and export procedures. Currently, VUCE allows users to elaborate their customs export declarations online and electronically complete various export and import permits (i.e. health, sanitary and phytosanitary measures). According to the IADB (2011), VUCE has contributed to reducing the time and costs of operations, while enhancing transparency and avoiding corruption as users have no contact with authorising agents.

In November 2013, Costa Rica will launch a new version of its single window: VUCE 2.0. With this reform, all permits will be included in the system, which will also allow electronic payments and will operate 24 hours a day all year round. Additionally, the implementation of this new technology will entail going paperless, as well as reduce transaction costs and the time needed for the completion of all procedures.

### ***Administrative procedures at the border***

In 2011, the government initiated a comprehensive plan for modernising its main border crossings with Nicaragua (Peñas Blancas) and Panama (Paso Canoas). COMEX is leading this project, which involves more than 12 public and private entities that operate at the borders, and requires the revision of their procedures and responsibilities.

In Peñas Blancas, reforms have been adopted to address critical points that impact the movement of persons and goods, including the extension of the operating hours until midnight, a comprehensive remodelling of the immigration building, the reconstruction of the fumigation facilities and the construction of an export station that allows truck drivers to complete trade procedures in Peñas Blancas without leaving their vehicles. Construction is underway to broaden the main access road and create parking spaces for transport units.

With regard to Paso Canoas, the sanitary and immigration authorities of both countries have reached agreements to facilitate the transit of persons and agricultural goods. A Sanitary and Phytosanitary Directive, signed in December 2011, promotes the elimination of inspections and other measures for certain goods according to their sanitary risk. In addition, an immigration agreement provides for expedite procedures for cargo truck drivers. Authorities from both countries are moving forward with an initiative to establish an integrated border management system at Paso Canoas. To complement these efforts, and extend the benefits to other border crossings, the government is working with the IADB on the design of an integral renewal of their infrastructure, equipment and procedures. The execution of this trade facilitation programme is scheduled for 2014.

The results of these initiatives are reflected in the 2013 *Doing Business*, where Costa Rica ranks 51st for the indicator on “trading across borders”, improving its position by 11 places compared to the previous edition. According to the indicator, 6 documents and 13 days are necessary to export, and 6 documents and 14 days are needed to import. These figures are below the LAC average (6 documents and 17 days to export; 7 documents and 19 days to import) but remain higher than the OECD average (4 documents and 10 days to export; 5 documents and 10 days to import). Costs of exporting and importing – respectively USD 1 030 and USD 1 020 per container – are below LAC average (respectively USD 1 268 and USD 1 612) and comparable to OECD average (respectively USD 1 028 and USD 1 080).

In short, Costa Rica has a well-designed trade policy that is well-articulated with investment policy, which reflects the country's broader economic objective of integrating global value chains. Costa Rica has signed a number of FTAs, most including investment provisions (either by reference to a BIT or incorporating a specific chapter), in order to build a predictable and open environment with its trade and investment partners. There are some overlaps in terms of countries covered by FTAs, however, which might lead to increased uncertainty for businesses and complexity for the government if this tendency continues in the future. Several initiatives to facilitate trading across borders have also taken place in recent years, including the Information Technology for Customs Control and the Single Window for Foreign Trade (VUCE), though the authorities recognise that customs procedures should be further improved.

## Competition policy

Competition policy favours innovation and contributes to conditions conducive to new investment. Sound competition policy also helps to transmit the wider benefits of investment to society.

Article 46 of the Costa Rican Political Constitution recognises that actions taken by the state to avoid or impede any monopolistic tendency or practice are to be considered a matter of public interest. Private monopolies as well as any act that threatens or restricts the freedom of commerce, agriculture or industry are prohibited. These early competition principles started developing since 1917 when the Political Constitution of the time recognised the defence of the economic freedom as a constitutional right.

Costa Rica enacted a particular law on competition policy as part of a broader strategy to convert the country into a market-oriented economy. The Law for the Promotion of Competition and Effective Consumer Protection (*Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor*, LPCDEC, Law No. 7472 of 20 December 1994) entered into force in January 1995, to protect and promote free and fair competition by preventing and prohibiting monopolies, monopolistic practices and other restrictions to market efficiency.

The law draws on the United Nations' Guidelines for Consumer Protection adopted in 1985 and revised in 2003, and contains provisions on a series of consumer rights. It establishes both business and producers' obligations towards consumers, and provides for administrative and judicial resources for consumers to claim their rights. The law created the Commission to Promote Competition (*Comisión para Promover la Competencia*, COPROCOM), which is an entity under the Ministry of Economy, Industry and Commerce. COPROCOM constitutes the authority in Costa Rica in charge of investigating and sanctioning the anticompetitive practices regulated by the LPCDEC. It is composed of five regular members and five alternate members appointed by the Executive Branch, and it is assisted in its functions by a special technical unit. COPROCOM is considered as a sound institution, which enjoys the highest degree of autonomy but somehow underfunded to effectively perform its tasks.

The law is applicable to all economic agents, with the exception of i) providers of public services by virtue of a concession, under the conditions provided by law; ii) those who execute authorised acts in special laws; iii) state monopolies;<sup>49</sup> and iv) municipal or local governments, both internally and in their relations with third parties. All State-Owned Enterprises (SOEs) operating in liberalised sectors, and hence competing with private entities, are subject to the LPCDEC.

Until recently, Costa Rican law did not provide for an *ex ante* control of economic concentrations, as pre-merger notification was not required.<sup>50</sup> Nevertheless, COPROCOM had the power to investigate concentrations that have already been formed and to order corrective measures. COPROCOM dealt with very few concentrations since the LPCDEC entered into force. This

situation was reverted recently, since Law No. 7472 was reformed to allow prior control of economic concentrations. The authorities report that the implementation rules should be developed to give more authority to COPROCOM.

In order to promote transparency and non-discrimination in competition-related regulation and measures, COPROCOM publishes guidelines on several aspects relating to competition and the prevention of anti-competitive practices and provides information on its website on the protection of competition and how to file complaints.

Caution should however be taken as regards fair competition between SOEs and private companies. While Costa Rica has liberalised key sectors, namely insurance in 2009 and telecommunications in 2008, former state monopolies – the National Insurance Institute (*Instituto Nacional de Seguros*, INS) and the Costa Rican Electricity (and telecommunications) Institute (*Instituto Costarricense de Electricidad*, ICE) – have become SOEs directly competing with private operators. These sectors are now regulated by specific sectoral regulation bodies, the General Superintendence on Insurance (*Superintendencia General de Seguros*, SUGESE) and the Superintendence on Telecommunications (*Superintendencia de Telecomunicaciones*, SUTEL), complementing COPROCOM's role as regards to ensuring fair competition. The exact role of the latter differs from one sector to another.

In the case of insurance, COPROCOM has the authority to impose sanctions on anticompetitive practices. However, in the case of prior notification of concentrations, the decision is taken by SUGESE with a technical opinion issued by COPROCOM. Even though the opinion issued by COPROCOM is not binding, SUGESE must justify its decision if it reneges on it. SUGESE also has the obligation to inform COPROCOM about anticompetitive practices that are occurring in the market. The authorities note that, so far, it has complied with this obligation (Section on Financial sector development).

In the area of telecommunications, COPROCOM has more limited powers since SUTEL is responsible for imposing sanctions on anticompetitive practices. As regards prior notification of concentrations, the situation is similar to the insurance sector as it is for SUTEL to decide. In both cases, it also requires a technical opinion from COPROCOM. In the case of illegal conducts, SUTEL must consult COPROCOM both at the beginning of the procedure and before the final decision is taken. COPROCOM has already issued opinions at least eight times upon the request of SUTEL. Competition provisions in this sector are extensively described in the General Telecommunications Law (Box 3.6).

### Box 3.6. Competition provisions in the telecommunications sector

The General Telecommunications Law (*Ley General de Telecomunicaciones*, Law No. 8642 of 4 June 2008) is the main legal document guiding Costa Rica's telecommunications sector and aimed at establishing effective competition mechanisms for all market operators and suppliers. These mechanisms provide guarantees to operators and suppliers on access to markets; periodically evaluate the intensity of market competition and sanction anticompetitive practices. Regulations for the telecommunications sector are public and meant to be applied in a transparent, non-discriminatory and objective manner to all participants in the market. The domestic legal framework regulates the asymmetries that may exist in the market due to the existence of major suppliers and hence avoid monopolistic practices.

Particularly, Title III of Law No. 8642, "Competition Regime" establishes two chapters that define the necessary mechanisms to ensure the conditions of competition in the market. This competition regulation is established in two ways. The first one is the *Sectoral Regulation of Competition* or *Ex-post Regulation*, which is exercised in order to prevent and sanction behaviours developed by operators and telecommunications providers that are anticompetitive. The second mechanism is established in the Regulation of Access and Interconnection of Telecommunications Networks. It provides SUTEL with the mandate to determine relevant markets and their corresponding operators or suppliers. This *Regulation of the Access Regime* or *Ex-ante Regulation* seeks to analyse the level of competition in the telecommunications market in order to define specific obligations that must be accomplished by operators or major market suppliers.

Source: SUTEL.

The US Department of State (2012) reports that SUGESE and SUTEL have both "won praise for successfully managing market transitions although in both markets new market entrants point to unfair advantages enjoyed by the incumbent operator. This has been particularly notable in the insurance market where specific concerns include deceptive advertising by the former monopoly provider, disparities in approvals/disapprovals for similar or identical products, overly burdensome/inappropriate regulatory requirements, price undercutting by the former monopoly, and the use of exclusivity contracts which prevent some insurance retailers from selling the products of the new market entrants".

There are other sectoral regulators such as the Superintendence of Pensions (*Superintendencia de Pensiones*, SUPEN) and the General Superintendence of Financial Entities (*Superintendencia General de Entidades Financieras*, SUGEF) that have similar legislation to SUGESE (Section on

Financial sector development). They consult COPROCOM, which issues non-binding opinions in relation to issues related to mergers between agents of the regulated sector. Moreover, COPROCOM is solely responsible for addressing and imposing sanctions on anticompetitive conducts in this sector.

Similarly, COPROCOM has full authority in the electricity sector, where private participation is allowed in power generation (not in transmission and commercialisation) and where ICE competes with independent power producers. In this sector, COPROCOM co-ordinates with the Regulatory Authority of Public Services (*Autoridad Reguladora de los Servicios Públicos*, ARESEP), which is responsible for approving and reviewing prices charged by public utilities and private companies (Section on Infrastructure development).

In conclusion, the competition law created COPROCOM to implement the country's competition policy. Although somehow underfunded, COPROCOM enjoys political support while being fully autonomous. All SOEs competing in liberalised markets are subject to the competition law. Attention should however be given to their potential abuse of power in the newly liberalised sectors (insurance and telecommunications), where COPROCOM has an uneven role in relation to sectoral regulation bodies (SUGESE and SUTEL).

## Human resource development

Human resource development is a prerequisite needed to identify and to seize investment opportunities. Policies that develop and maintain a skilled, adaptable and healthy population, and ensure the full and productive deployment of human resources, thus support a favourable investment environment.

Costa Rica has historically pursued appropriate social policies that have resulted in high levels of human development and have driven the conformation of a cohesive and stable society (UNDP, 2013). The good quality of human resources has also been an important asset for Costa Rica in attracting FDI. The type of investor the country attracts, notably efficiency-seeking investors in high technology industries, is rather sensitive to the availability of qualified labour.

The National Development Plan 2010-14 continues to sustain the country's commitments in this area and establishes a number of objectives related to human development, which encompass actions in the fields of education, health and related matters. With regards to education, the primary goals are related to increasing coverage in early childhood education and care, extending enrolment and reducing desertion in secondary schools, increasing years of school attendance, improving schemes for retention and coverage,

raising the quality of education, strengthening technical schools and reducing the gap between supply and demand. Regarding health, the government intends to expand the coverage and quality of health services. Moreover, it aims at avoiding illnesses associated with the lack of healthier lifestyles and focuses on preventive medical attention.

Remaining competitive in human resources will be key for Costa Rica to continue attracting investors to the country, and to nurture linkages with domestic companies more efficiently. Moving forward requires enlarging the pool of talented people with specialised skills to support the expansion of the country's manufacturing and services industries. Strengthening the supply of qualified labour is also necessary to prevent a disproportionate increase in social-economic disparities in the country.

### **Educational attainment**

Education has traditionally been a key element for social and economic advancement in Costa Rica. In 1870, the country became the first Latin American nation to establish free and universal primary education both for boys and girls, nurturing the grounds for the creation of a robust pool of highly qualified workforce, fostering economic growth, social mobility and raising the standards of living. Today, Costa Rica has a sound and highly ranked educational system in Latin America (WEF, 2012). Currently, 7% of GDP is invested on public education; this percentage is set to increase by constitutional mandate to 8% by 2014. The literacy rate in 2012 was 96.2%, the fifth in Latin America (UNDP, 2013).

The country's education system has several levels: preschool, primary education (6 years), high school (5-6 years), university (tertiary) and technical training. According to the Ministry of Public Education, the enrolment rate in primary education is 100%, whereas in secondary education, it reaches 76.5%. The greatest gap is found in tertiary education, where Costa Rica's enrolment rate reaches 44.76%, in both private and public universities.

In the 2010 edition of the *OECD Programme for International Student Assessment (PISA)*, which benchmarks skills and knowledge outcomes among 15-year old students across countries, Costa Rica scores well with respect to other Latin American countries but lower than the OECD average. On the reading literacy scale, Costa Rica attains a score of 443 compared to the OECD average of 493, an outcome comparable to Chile and higher than Mexico. On the mathematical literacy scale, Costa Rican students attain a score of 409, compared to an OECD average of 496, and on the scientific literacy scale, Costa Rica scores 430, which is lower than the OECD average (501), but it is higher than other Latin American countries, including Mexico. Costa Rica also shows very low levels of gender differences in reading performance in respect to all participant countries (OECD, 2012).

### **Workforce skills**

As regards human capital formation, although Costa Rica fares well in relation to the region, it also requires further attention. It has been able to foster growth of export-oriented industries that rely more intensively on skilled workers (e.g. information technology, microchip manufacturing and communication devices), but the demand for qualified human resources in these areas has increased significantly, risking a shortage in the medium term in the supply of such labour.

The percentage of firms responding to the World Bank (2011) survey that perceived skills of the workforce as a major constraint to the development of their business was higher than the average of its regional peers. This was noteworthy for medium-sized businesses and for companies with more than 10% of foreign ownership. There is also some indication of skills mismatch between the supply of skilled labour and the skills required by the main exporting industries in advanced manufacturing. The number of students graduating in social sciences is still much higher than the number of sciences graduates. Although this relation has been improving in the last decade, the OECD (2012) reports for instance that no PhD was awarded in engineering or computational sciences in the 2007-09 period. For a small country transitioning towards a knowledge-intensive economy as Costa Rica, the share of scientists and engineers in the population must considerably increase to achieve a critical mass of postgraduates in absolute terms to leverage the use of technological products and processes in the economy (World Bank, 2012b).

Creating the environment for increasing the supply of qualified workers to these emerging industries requires further educational reforms and private sector involvement. This involves a broad increase in tertiary education enrolment in scientific areas, as well as an expansion of technical education to address the more specific needs of industries. Such measures are not only necessary to continue to attract foreign investment, but also to allow a larger proportion of the population to benefit from opportunities derived from the presence of FDI and hence to prevent a disproportionate increase in income inequality due to rising returns to education. During the 2000s, Costa Rica has experienced an increase in income inequality (World Bank, 2012b).

As a result, Costa Rica is currently working to adapt and expand the educational system to meet the overall growing demand for qualified human resources. Current efforts are focused on increasing coverage and fighting desertion, updating course programmes at technical and university levels, improving vocational orientation, promoting second language learning, offering greater connectivity to public schools, promoting the use of information technology tools and developing soft skills in the labour force.

Aiming at bridging the skills gap, an interagency working group was created in August 2011 to define and implement actions oriented to increase enrolment and graduates in those technical and academic careers that are in highest demand. This working group involves: COMEX; the Ministry of Science, Technology and Telecommunications; the Ministry of Labour and Social Security (MTSS); the Ministry of Public Education; the National Apprentice Institute; the Technical Secretariat of the CPCI; CINDE; the Private Council for Competitiveness; the National Council of Deans, which encompasses representatives from the four public universities; the National Technical University; the Unit of Deans of Private Universities; and the International Polytechnic Institute. Throughout the initial phase of this project, the interagency working group adopted commitments to contribute to reducing the skills gap. This involves gathering information from the private sector and education-related institutions to obtain a precise estimation of the gap between labour supply and demand, and determining specific actions to be developed in the short and medium term to address these gaps.

At the university level, the interagency working group is developing new programmes for careers that are competitive in the market. In particular, the National Council of Rectors (*Consejo Nacional de Rectores*), made up of the four public universities, decided to increase the enrolment of engineering and scientific careers. The Ministry of Science, Technology and Telecommunications is developing in-house master degrees to cater to employers' and employees' needs for flexibility, in continuing enhancing workers skills while facilitating the alignment of the curricula with industries' needs. A loan from the World Bank, currently under discussion in Congress, will provide public universities with funding to improve their capacity to respond to private sector priorities and focus on engineering areas, research centres and labs, infrastructure, training for faculty, and state of the art teaching materials. With the financial support of the IADB, the government is also working on the creation of a fund of human capital for competitiveness, which intends to provide support for students pursuing graduate studies and PhDs in scientific and technological fields, relocate foreign talent and reconvert existing professionals in order to increase the pool of professionals in these areas (Section on Investment promotion and facilitation). This loan was recently submitted to Congress for legislative approval.

Similarly, the government is seeking to increase the supply of technical training programmes to enhance the availability of highly qualified labour. The Ministry of Public Education and the National Apprentice Institute work to develop new technical curricula. In 2012, they included the Plastic Processing programme (targeted for the medical industry and advanced manufacturing), the Productivity and Quality programme and the Administration, Logistics and Distribution programme.

There has been considerable priority placed on second-language learning. To date, there is a shortage of English-speaking workers, as only 11% of the population is proficient in English, thus threatening the country's competitive position (US Department of State, 2012). The government is however working at expanding the population's access to bilingual education, as illustrated by the development of a National English Plan, which established the non-profit foundation *Costa Rica Multilingüe*, declared of public and national interest in 2008. Recent developments have seen an increase in the number of high school English teachers being trained while the Ministry of Public Education increased its offer of technical bilingual programmes. Moreover, public universities are leading an English Strengthening Project and aim at certifying students with a standardised English Test.

### **Population health**

Access to health in Costa Rica is widely accessible. The country grants universal health care to its citizens and legal residents by constitutional mandate. The good quality of its healthcare system is reflected by the country's very good health indicators. Life expectancy has increased from 77.1 years in 2001 to 79.4 years in 2012, above the Pan-American region average of 76 years. Infant mortality has fallen from 10.8 in 2001 to 9.6 per thousand births in 2010, well below the Pan-American region average of 18 per thousand. The adult mortality rate is 93 per thousand, also below the Pan-American region average of 125 (World Health Organization, 2012).

Public expenditure on health is high. In 2010, the country spent 7.4% of GDP on health, not far behind the average figure of 8.2% spent by OECD members and well above the LAC regional average of 3.8%. If taking into account the participation of the private sector, total expenditure in health rises to 10.9% of GDP the same year, compared to respectively 12.6% and 7.7% in OECD and LAC countries (World Bank, 2013).

The development of basic health services encompasses the care of pregnant women, children and the elderly. In order to continue improving the work force's health, the country's health strategy has shifted from a reactive to a preventive approach, aimed at promoting healthy lifestyles (with emphasis on nutrition, exercise and basic sanitation).

A public institution, the Social Security Administration, manages a national health system, along with the Ministry of Health. Contributions of employers, employees and self-employed to the national health system are mandatory and calculated as a percentage of monthly salaries. Contributions amount to 26.17% of salaries paid on the part of employers and 9.17% of salaries paid on the part of employees.

### **Labour market laws and regulations**

The Costa Rican Political Constitution includes several labour rights, which are further developed through the International Labour Organization (ILO) main conventions to which Costa Rica is a party (Chapter 4). Article 56 of the Political Constitution recognises labour as a right of the individual and an obligation to society. It foresees that the state shall strive to monitor that everyone has lawful and useful employment, are duly compensated and prevent the establishment of conditions, which may curtail human freedom or dignity.

Articles 57 to 74 of the Political Constitution recognise several fundamental labour rights related, among others, to: minimum wages;<sup>51</sup> maximum labour hours, weekly rest and yearly vacations; freedom of association and protection to the right to organise; right to collective bargaining; right to strike; health and safety of workers; social security; non-discrimination (including gender equality); special protection for women and young workers; and prohibition of forced and child labour.

The rights established in the Political Constitution and in international conventions are further developed in the Labour Code (*Código de Trabajo*, Law No. 2 of 27 August 1943, as amended),<sup>52</sup> which establishes the general rules governing all labour relationships, and other statutory provisions and regulations such as the Labour Related Risks Law (Law No. 6727 of 9 March 1982) and the Worker Protection Law (Law No. 7983 of 16 February 2000). Costa Rica also enacted the Law of Solidarity Associations in 1984 to provide the same rights and legal prerogatives to solidarity associations as to co-operatives and unions, and is well ranked on the WEF 2012-13 *Global Competitiveness Index* for labour-employer relations (Chapter 4).

To ensure adequate enforcement of labour rights, there are several instances at the Ministry of Labour and Social Security responsible for monitoring and supervising adequate respect for them. In particular, the Ministry of Labour and Social Security has a body of inspectors entitled to monitor health and safety conditions. There is also a National Council of Salaries, in which workers, employers and the Executive Branch of government discuss proposals for the fixation of salaries. A National Inspectorate Directorate monitors compliance with judicial orders and reinstatement of employees laid off without due cause. The authorities also report inter-agency inspections involving the Social Security Administration, the Ministry of Labour and Social Security and the Ministry of Health, are also conducted to seek better enforcement of labour laws.

Other measures seeking better enforcement of labour laws include programmes to shorten judicial delay and to improve efficiency in administrative sanction procedures. Actions taken towards this goal are the adoption of the Protocol of Good Investigation Practices for the Labour Inspectorate of Costa Rica (*Protocolo de Buenas Prácticas de Investigación para la Inspección Laboral de Costa Rica*) and the design and implementation of a labour inspection methodology focusing on the most vulnerable sectors. This Protocol is meant to help to address the problems of the most vulnerable sectors and to identify areas that need to be strengthened in order to improve the culture of enforcement of labour rights.

Costa Rica is working to strike a balance between providing social protection for workers and ensuring the necessary flexibility of labour regulations to enable companies to sustain their competitiveness and adapt to changes in international trade or technological changes. On the one hand, the labour market is working efficiently, as reflected by the country's ranking at the 52nd place on the 2012-13 WEF *Global Competitiveness Index*. On the other hand, the lack of flexibility of labour regulations in terms of hiring costs, use of fixed-term contracts and rigidity of working hours seem to be an issue for businesses in the country (World Bank, 2007). In the survey of enterprises conducted by the World Bank (2011), the percentage of firms that highlighted labour regulations as a major constraint for their business was higher than the world and LAC averages. The 2010 *Doing Business* report also highlights that Costa Rica underperforms in comparison to several of its regional peers and to the LAC average on the Employing Workers Index (World Bank, 2010). In 2007, the World Bank *Investment Climate Assessment* already pointed out that about 30% of companies were under-employed partially due to the costs associated with labour regulations. To the extent that labour rights are protected, the government could envisage reassessing its labour policies to enhance flexibility.

In conclusion, Costa Rica has adopted consistent and long-lasting social policies with high investments in education and health that have supported the growth of high-skill labour industries. On the other hand, reducing the gap between supply and demand of qualified workers in certain high-tech industries is becoming an increasing challenge in the country's priority sectors. Reinforcing partnerships between the government, universities, R&D centres and the private sector to develop appropriate skills for new generations is key for Costa Rica to continue its development path towards a knowledge-intensive economy. Moreover, while the labour market provides good guarantees for workers, increased flexibility in labour regulations, notably on hiring workers and in working hours, could ease business activities in the country.

## Infrastructure development

Sound infrastructure development policies ensure that scarce resources are channelled to the most promising projects and address bottlenecks limiting private investment. This section looks at the major shortages and government priorities in terms of infrastructure development with a sectoral approach. It covers, among others, the legal and institutional framework for infrastructure as well as private participation in infrastructure projects.

Costa Rica's infrastructure is rated the second most problematic factor for doing business in the WEF *Global Competitiveness Index 2012-13*. Out of 144 countries, Costa Rica is ranked 95th in terms of the overall quality of its infrastructure, and transport infrastructure (roads, railroads and ports) have proved to be particularly weak (WEF, 2012). All the same, Costa Rica has made great strides in developing a sound electricity supply infrastructure and its airports have improved greatly. According to the World Bank, virtually all the population has access to electricity (96%), water (98%) and sanitation facilities (96%), above the Latin American average in all cases.<sup>53</sup> Table 3.6 provides an overview of Costa Rica's comparative rankings.

Table 3.6. **Costa Rica's competitiveness indicators for infrastructure**

Indicator	Country ranking/144
Quality of overall infrastructure	95
Quality of roads	131
Quality of railroads	106
Quality of ports	140
Quality of air transport	60
Quality of electricity supply	42
Mobile telephone subscriptions/ 100 pop.	94
Individuals using internet, %	68
Mobile broadband subscriptions/ 100 pop.	100

Source: World Economic Forum, Global Competitiveness Report 2012-13.

The authorities are however well aware of the infrastructure investment needs and accordingly allocated USD 1.68 billion to infrastructure in 2012, according to the Office of the Comptroller General. From this amount, approximately 23% was invested to electricity, 30% to telecommunications, 42% to transport and 5% to water and sanitation.

### **The legal and institutional framework**

The regulatory framework for infrastructure in Costa Rica is developed in several legal instruments, including the Law on Public Procurement and its Regulations, the General Law on Public Concessions of Public Works with

Public Services, the Law on Financial Administration, the Regulations for Price Adjustment in Contracts, the Laws and Regulations of the Chamber of Engineers and Architects, regulations regarding the Technical Secretariat for National Environmental, the Municipal Code, the Regulation on Life Safety and Fire Protection and Special Technical Standards. However, in certain cases, the regulatory framework for the service is specified for the procurement and is governed by the contract signed between the Costa Rican government and the company that provides the service, once the procurement has been awarded.

The Political Constitution (Article 182) requires that contracts for public works carried out by the government, SOEs and local governments, as well as any purchases made with public funds, be made through public procurement procedures. Infrastructure contracts are thus, as a general rule, awarded through public procurement. Public procurement and procedures for the disbursement of public monies are established in the Law on Public Procurement and its regulations (Law No. 7494 of 2 May 1995), the General Law for Concessions of Public Works with Public Services (Law No. 7762 of 14 April 1998) and the Law for Financial Management and Public Budgets (Law No. 8131 of 18 September 2001).<sup>54</sup> The General Law for Concessions of Public Works and Public Services includes the management of Public-Private Partnerships (PPPs).

These laws generally establish procurement procedures where the government issues notice of intended procurement, receives tenders, evaluates them, awards the procurement, and formalises a contract. These provisions are applied to procurement procedures carried out by public entities or in cases where public funds are being used. Private companies must abide by these laws when participating in public procurement procedures or when public funds are involved, but if they are contracting with private parties, the commercial law applies. Depending on the total value of the procurement and the budget of the contracting institution, the procurement procedure may differ, and time limits for submission of tenders will be longer or shorter and the requirements might slightly change. Projects financed by an international financial institution must comply with additional fund disbursement procedures, which might vary depending on the financial entity.

Costa Rica works at ensuring transparency and procedural fairness in its bid proceedings. A web-based bidding system ([www.mer-link.cr](http://www.mer-link.cr))<sup>55</sup> is in place for most purchases made by the central government, public banks and autonomous institutions. It allows public institutions to publicise their demand for goods or services and suppliers to be aware of, submit tenders and follow up on public procurement procedures.

The National Concessions Council (*Consejo Nacional de Concesiones*, CNC) is a decentralised body under the Ministry of Public Works and Transportation (*Ministerio de Obras Públicas y Transportes*, MOPT), in charge of project formulation, project bidding and contract administration. It is chaired by the Minister of MOPT, and is composed of the Minister of Finance, the Minister of Planning and Economic Policy, the President of the Central Bank, a representative of union confederations, solidarity movements and co-operatives, a representative of the federation of professional associations and a representative of chambers of commerce. The CNC disposes of a technical secretariat. The CNC plays a key role in the development of infrastructure projects, as the authorities are increasingly involving private sector participation.

The Comptroller General oversees the use of public monies in infrastructure projects. Each government entity has also internal control procedures for the disbursement of public funds. The Comptroller General carries out the supervision and oversight of procurement by public entities, which includes infrastructure investment. The Comptroller General and Deputy Comptroller are appointed by Congress, have functional and administrative independence and are accountable to the Congress for compliance of their functions and may be removed from their positions by the vote of no less than two thirds of its members in cases of incompetence or undue conduct. This is one way to ensure the integrity of the procurement system in Costa Rica. In addition, Congress members and the Ombudsman office (*Defensoría de los Habitantes de la República*) may request information on the execution of infrastructure projects to ensure adequate use of public funds.<sup>56</sup> The country's anti-bribery framework penalises public officers who commit undue political interference (Section on Public governance and anti-corruption). Influence peddling is penalised with imprisonment of up to five years (Law No. 4573 of 4 May 1970).

Regarding the supply of infrastructure at fair and reasonable prices, the Regulatory Authority of Public Services (*Autoridad Reguladora de los Servicios Públicos*, ARESEP),<sup>57</sup> is responsible for approving and periodically reviewing prices charged by public utilities and private companies that provide services in areas such as electricity, gas, water, and public transportation. These prices are determined on the basis of pre-established formulas, and a public hearing must be conducted by ARESEP each time prices are going to be reviewed.

The Law on ARESEP (Law No. 7593 of 5 September 1996) was amended by the Law on the reorganisation of regulatory authorities and public administrations (Law No. 8660 of 8 August 2008). It offers the overarching framework for regulating public sectors in Costa Rica, including infrastructure. The amendments of the law cover two major areas: one related to the liberalisation of the telecommunications sector (following the country's

commitments under CAFTA-DR) and the creation of the Superintendence on Telecommunications (SUTEL), and a second including a number of provisions designed to update and strengthen the management of ARESEP, as a multi-sectoral state body that is specialised in public services regulation. As such, they improved and modernised the entire regulatory framework of ARESEP.

### **Sectoral policies and private sector participation in infrastructure**

Private participation in infrastructure is still rather limited in Costa Rica, although there is a growing investor appetite for large-scale infrastructure projects. Between 1990 and 2011, 31 projects with private sector participation have reached closure. Most of the projects (23, or 74%) have been in the energy sector but most of the investment (53%) has been in the transport sector.<sup>58</sup> Most of the private sector's role has been through concessions or Greenfield projects, respectively five and 26 projects out of 31, with no involvement in less advanced forms of private sector participation such as management contracts. Among the concessions projects, the country has had a number of PPPs in the transport sector, particularly in toll roads and airports (EIU, 2013). The most important project underway is the construction of the new container port of Moín on the Atlantic Coast.

### **Transport**

The transport sector faces significant challenges and has been at times a hindrance to economic activities. The government of Costa Rica recognises that deficient transport infrastructure has hampered the development of industry, tourism and trade in goods, while also affecting the country's competitiveness and attractiveness for FDI (MOPT, 2012). The National Transport Plan 2011-35 provides strategic orientations for the short, medium and long term as regards the development of the main road corridors, the modernisation of ports and airports, and the expansion of intercity railways as well as public transport services of passengers.

With its own resources in addition to loans with the IADB, the Central-American Bank of Economic Integration (*Banco Centroamericano de Integración Económica*, BCIE) and the Development Bank of Latin America (*Banco de Desarrollo de América Latina*, CAF), the country is planning to allocate more than USD 2.3 billion to transport projects with a view to improve the country's main corridors and its connectivity to the world, especially with the Mesoamerican region, in addition to the modernisation of the Caribbean Port System. The main ongoing and future projects are summarised in Table 3.7.

Table 3.7. **Main transport infrastructure projects (ongoing and planned)**

Type	Location	Construction		Cost Million USD	Source	Impact
		Km	Other			
Road	Inter-American Highway – North (Cañas – Liberia)	50.5	18 bridges, 3 intersections, pedestrian crossing	175.5	IADB	Connecting North, Pacific and Central regions.
Road	Sifón – La Abundancia (San Carlos)	30	9 bridges, 10 intersections	150	IADB	Road located in the North region of the country, which is an important economic area.
Road	Bajos de Chilamate – Vuelta Kooper (North – Central – Atlantic Regions)	27	8 bridges, 6 major drains	52.45	CAF	Connecting North, Central and Atlantic regions.
Road	Road improvement for local governments	1 183		10.6	Government	Urban and rural roads.
Road	Ruta Nacional N° 237, Paso Real -San Vito	45		8.32 approx.	Government	Connecting South region and borders.
Road	Paso Canoas-La Cuesta-Laurel	16		3.4 approx.	Government	
Road	Highway maintenance	4 250		120	Government	Expanded Greater Metropolitan Area (GAMA)
Road	Bridges		4 major bridges	27	BCIE	Expanded Greater Metropolitan Area (GAMA)
Port	Container Terminal at Moin Port (Caribbean)		Expansion	948	PPP – APM Terminals	The Atlantic ports are the main hub for Costa Rican trade and commerce.
Port	Grain Terminal at Caldera Port (Pacific)		Grain terminal and seawall	30	PPP – SPGC	This port is under concession since 2006; trade has been increasing since then.
Railroad	Cartago, San José, Heredia y Alajuela		Reconstruction of the national railroad	9.6	Government	Improvement of the public transportation in the Greater Metropolitan Area.
Airport	New Terminal of International Airport Daniel Oduber (Liberia)		Expansion	35	Concession	Located in the North Pacific region, one of the most important regions for tourism and investment.

Source: MOPT, 2012.

As regards private participation in transport infrastructure, Costa Rica has completed two PPPs: the Caldera toll road from San José to the Pacific, which carries 15 000 vehicles per day and a new airport terminal in Liberia (EIU, 2013). In addition, a 33-year concession has been awarded to APM Terminals to construct, finance and operate the container port at Moin (Atlantic Coast) at a cost of USD 957 million. The project highlights the importance of infrastructure connectivity, as the construction of the port necessitates a railway line that will link up Moin to San José.

In order to continue on the path of increased private sector participation in infrastructure development, the authorities could consider increasing the capacities of the National Concessions Council's technical secretariat, as it plays a pivotal role in the success of transportation projects. Enhancing its abilities in identifying, assessing and executing infrastructure projects would be particularly beneficial. The Council would also need increased operational flexibility and financial resources. Moreover, additional consultations with and communication projects for local communities should systematically be implemented by the government to help the latter to better understand and accept the advantages of concessions. The general public is still relatively reluctant to the participation of private operators in transport projects as it involves a higher cost for end users. Professional and targeted communication campaigns, with an involvement of communities from the beginning of the process, would thus help stakeholders to better appreciate the necessity of using concessions in transport infrastructure development.

### Electricity

Electricity in Costa Rica is reliable and of good quality, as illustrated by the country's ranking at the 45th place out of 185 for "getting electricity" on the 2013 World Bank *Doing Business*. The cost of electricity is however reported by the business community as a major challenge in the country's investment climate.

The Ministry of Environment and Energy (*Ministerio de Ambiente y Energía*, MINAE) is the governing body for the formulation and implementation of energy policy. The Subsectoral Council on Energy<sup>59</sup> supports MINAE in developing and executing this policy, which is further detailed in the National Energy Plan 2012-30.<sup>60</sup> This plan describes core needs and strategic actions in the energy sector, including infrastructure development. Government entities with responsibilities in the energy sector design their plans in accordance with the National Energy Plan. The main entities included are the Costa Rican Electricity Institute (*Instituto Costarricense de Electricidad*, ICE), *Compañía Nacional de Fuerza y Luz* (CNFL), *Junta Administradora del Servicio Eléctrico de Cartago* (JASEC), and *Empresa de Servicios Públicos de Heredia* (ESPH).

ICE is the national electricity utility and holds a concession for the distribution and commercialisation of electricity. However, it is mandated by law to ensure the supply of electricity and, due to the current facilities it owns for the transmission of electricity, there exists a *de facto* monopoly in that specific stage of electricity provision.<sup>61</sup> ICE has developed a power generation expansion plan to provide power supply, which is under constant review to adjust it to changes in the demand for electricity emerging out of variations in market conditions. The current electricity generation expansion plan for the period 2012-24 (*Plan de Expansión de la Generación Eléctrica – Periodo 2012-24*) is divided into three five-year terms, which are based on the priority level of each

project. For the definition of its expansion plan, ICE promotes the participation of municipalities and other entities in identifying infrastructure priorities through the submission of projects. Furthermore, there are instances of co-ordination with municipalities for specific projects.<sup>62</sup>

Private sector participation in the generation of electricity is permitted under the current legal framework, but it remains subject to certain restrictions. Private companies may invest in power plants for parallel or autonomous generation not exceeding 20 MW, provided that ICE purchases the electricity produced and provided that the power generated by all such private plants in Costa Rica does not represent more than 15% of the total power produced by all public and private plants in the national electric system. Additionally, ICE has the authorisation to purchase, through legal tenders, electricity from hydraulic, geothermal, wind and any other non-conventional source of energy not exceeding blocks of 50 MW. In this case, the percentage of purchase by ICE increases from 15% (applicable to the maximum block of 20 MW) to 30% respect of the total power produced by all public and private plants in the national electric system. In both cases, 35% of the capital stock of the company must be owned by Costa Rican nationals. There is no restriction on FDI in electricity generation for own consumption.

With the objective of enhancing private sector's participation in the electricity sector, a special legislative commission was established in September 2010 to discuss and bring together several bills related to electric energy that were submitted to Congress though not yet adopted. Bill No. 17666 is particularly important, as it intends to create a uniform legal framework compatible with regional agreements for the creation of a Central American Regional Electric Market, where private participants are granted the right to develop electricity projects and have access to the national electric system. Additionally, Bill No. 18093 is aimed at addressing in a short term a greater generation capacity with renewable energies through a more active participation of the private sector in the development of projects of energy efficiency, savings and a rational use of the energy. Lastly, Bill No. 17812 establishes a regulated wholesale electric market, lifting the condition of ICE as dominant operator and enabling the transaction of electric products through diverse legal instruments, with the participation of private parties.

The most recent bidding proceeding launched by ICE sought to purchase 140 MW from the private sector (100 MW from wind power and 40 MW from hydroelectric projects). The call for tenders attracted bids from 28 private companies, for a total of 360 MW. Six companies have recently signed letters of commitment, which will supply ICE with clean energy at a highly competitive price. Two of the main objectives pursued by ICE by purchasing energy from the private sector are to partially replace the generation of thermal energy, which may have a much higher cost, and to increase the use of renewable energy, therefore advancing towards the goal of C-Neutral (Chapter 5).

### **Water and sanitation**

The water and sanitation sector is in reasonably good condition and does not constitute an issue in Costa Rica's investment climate. The legal framework is undergoing several changes and private sector participation is growing.

The General Drinking Water Law (Law No. 1634 of 1953) is the main legal document in the water sector. It has been amended twice: the first time in 1961 to create the Costa Rican Institute of Aqueducts and Sewage (*Instituto Costarricense de Acueductos y Alcantarillados*, AyA) and to give it responsibility for the management of water resources in Costa Rica, and the second time in 1996 to create ARESEP and grant it the authority to limit the number of concessions for the provision of water services mainly related to irrigation. More recently, discussions regarding water resources have led to the presentation of eight bills to Congress intended to reform the legal framework, mainly reflecting, on the one hand, the promotion of a more effective and sustainable management of water and sewage systems, and on the other hand, the recognition of access to water and water sanitation as a fundamental human right. For example, the Law of Water (Bill No. 17694) will aim to regulate the protection, development and sustainable use of water resources, which are considered a finite, limited and vulnerable resource. It is based on the vision that water resource management must be integrated in such a way that it ensures universal access, solidarity and fairness, in adequate quantity and quality.

AyA is the main provider of drinking water supply and is responsible for the management of sewage systems.<sup>63</sup> Some municipalities and two public enterprises (ESPH and JASEC) also provide these services and manage water infrastructure in their respective areas. ARESEP serves as the sector regulator and, importantly, is in charge of approving water tariffs. However, tariff revenues at present do not cover operations and maintenance costs. Consumers in San Jose cross-subsidise those in other cities. A tariff regime based on block tariffs, where higher consumption bands are charged higher rates is in force. AyA has incipient co-ordination mechanisms with local governments and few initiatives with other service providers to establish infrastructure priorities. AyA is working with ESPH and JASEC to improve their information systems and share more data on infrastructure needs. However, it remains a challenge to further develop mechanisms between AyA, municipalities and rural water administrators to better co-ordinate infrastructure priorities.

The preliminary budget of AyA for 2012-13 (USD 253 million) will be funded as follows: i) USD 200 million (approximately 80%) will be generated by tariffs charged for services and goods provided by AyA; ii) USD 7 million (approximately 3%) will be funded from central government allocations, from

the Family Allowances Fund (*Asignaciones Familiares*); and iii) USD 46 million (approximately 17%) will be financed by loans from national and international entities (65%), and also through a surplus recorded by the institution in previous years (35%).

AyA identified investment requirements for the period 2010-30 for each operator level (i.e. municipalities, public enterprises and AyA) in a diagnosis carried out in 2010, and formulated an investment plan establishing priorities to address water infrastructure needs at national and local levels. Two priorities have been identified: drinking water treatment and wastewater collection. It estimated a required investment of approximately USD 2.4 billion for the next 20 years, notably to ensure continuity, quality and quantity in sustainable drinkable water systems as well as collection and treatment of wastewater.

While PPPs in the water sector have been limited due to public and political opposition to private sector participation in the sector, the tendering of *Los Tajos* wastewater treatment plant to a private company could potentially pave the way for other PPP projects. The contract for *Los Tajos* was awarded to ACCIONA Agua and is worth USD 45 million. It will involve designing and constructing a wastewater treatment facility that will serve 65% of metropolitan San Jose's population. The private party will be expected to transfer technology to the public sector and assist in operations and maintenance after the construction period.<sup>64</sup> Besides PPPs, private investors may identify water infrastructure needs (except in water distribution) and submit project proposals to AyA for approval (Law No. 4240 of 15 November 1968, Article 38). Once approved, they can build the needed infrastructure while AyA is responsible for guaranteeing water availability. When construction is finished, ownership of the infrastructure is transferred to AyA. This mechanism allows investors to accelerate access to water for their projects, e.g. construction of hotels. Although, relatively rarely used as of yet, AyA aims at promoting this mechanism in the short term. Six projects have been executed since this structure was introduced by the law, notably in the tourism sector.

### **Telecommunications**

Telecommunications generally work well in Costa Rica and do not represent a constraint for investors, although the authorities report that access to high speed broadband remains limited. Following the ratification of CAFTA-DR, the telecommunications market was opened to private companies in 2009 in three areas: mobile services, internet services and private networks. As a result, the sector is expected to be a strong driver for services growth in the short and medium term (EIU, 2012).

As of April 2013, SUTEL, the Superintendence on Telecommunications, had granted 115 authorisations for private operators to supply telecommunications services, including public international telephony, Internet, Internet Protocol telephony and television, instant messenger, data transfer, networks monitoring and controlling, cable television, Internet services carrier, automatic geo-localisation of vehicles, and pay-as-you-go or mobile operator services. By early 2012, the main mobile phone operators and their respective market shares were ICE (82%), Claro C.R. Telecomunicaciones S.A. (7%), Telefónica C.R. (7%), Tuyo Móvil (2%), and Full Móvil (2%). The market shares of fixed Internet (by wire and wireless) were ICE (60%), Amnet (currently Tigo) (16%), Cabletica (12%), Racsa (7%), Cablevisión (2%), and others (3%).

The General Telecommunications Law (Law No. 8642 of 30 June 2008) is the main legal document guiding Costa Rica's telecommunications sector. In early 2013, the competence over the telecommunications sector was removed from the Ministry of Environment, Energy and Telecommunications, and passed to the Ministry of Science and Technology, which has become the main government agency responsible for defining national telecommunications policies and plans.<sup>65</sup> The National Telecommunications Plan (2009-14) provides the overall policy blueprint for the sector.

Since the liberalisation of the sector, a new regulatory framework was enacted and SUTEL was created to regulate and oversee the sector. SUTEL has issued regulations on interconnection, competition, universal service, frequency allocation and other relevant matters, all of which have been published in the Official Gazette. Moreover, SUTEL contributes to promoting investment in telecommunications and participates alongside COMEX in the negotiation of telecommunications issues in the framework of FTAs.

In 2009, SUTEL conducted a preliminary process which analysed the relevant markets and determined the major operators and suppliers.<sup>66</sup> Currently, a new process of analysis and review of these markets is initiating. Several steps are required to conclude this process: i) market definition, ii) analysis of the level of competition in these markets, iii) definition of the existence of major operators and suppliers in each market; and iv) imposition of *ex ante* and/or *ex post* duties to such operators. With these regulations, legal mechanisms are established to enable SUTEL to ensure access for operators and suppliers to the market and also to evaluate the intensity of competition in the market and penalise anti-competitive practices (Section on Competition policy).

In conclusion, infrastructure is an area of concern in Costa Rica's investment climate, with the quality of transportation and the cost of electricity being the main challenges. The government is giving increased priority to private sector participation in infrastructure projects and in developing expertise in managing PPPs, yet obstacles remain. The National Concessions Council (CNC)

needs to build its capacity to better identify, evaluate and execute infrastructure projects, as well as increasing flexibility and resources. In addition, the government needs to more systematically consult and communicate with local communities to sensitise them on the advantages of concessions, so that private sector participation in infrastructure development becomes more widely accepted among the general public. To this end, the *OECD Principles for Private Sector Participation in Infrastructure* provide a coherent catalogue of policy directions that could benefit Costa Rica. In the case of electricity, increasing private sector participation, including foreign, in electricity generation should contribute to modernising the sector and lead to increased production and eventually reduced costs. Telecommunications function well and their liberalisation in 2008 has resulted in growing market penetration by private operators although ICE, the public operator, remains the major supplier. Similarly, the water and sanitation regulatory framework is sound but requires further improvements to promote a more effective and sustainable management of water resources and sewage systems, and to guarantee access as a fundamental human right. The *OECD Private Sector Participation in Water Infrastructure: OECD Checklist for Public Action* can also provide guidance to Costa Rica in this sector.

## Financial sector development

Developed financial sectors provide payment services, mobilise savings, and allocate financing to firms wishing to invest. When they work well, they give firms the ability to seize promising investment opportunities, especially small and innovative enterprises and entrepreneurs that need external funding to expand and develop their business ideas. Well-functioning financial markets also impose discipline on firms to perform, boosting efficiency, both directly and by facilitating new entry into product markets. They also enable firms and households to manage better risks.

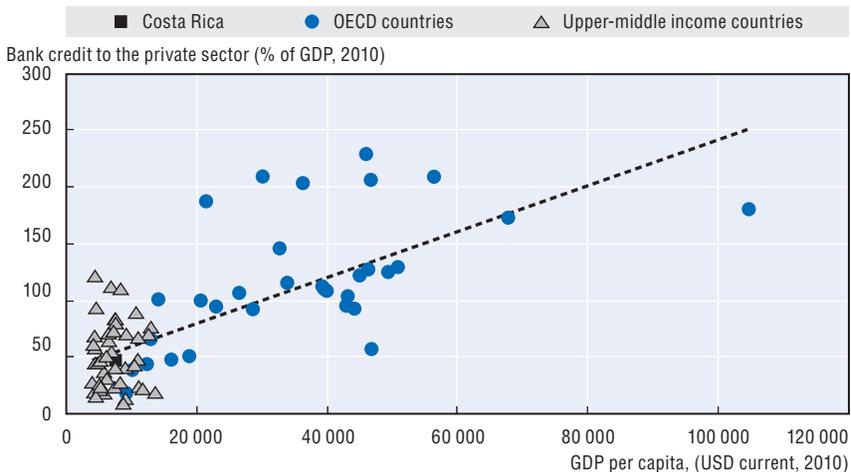
Costa Rica has a relatively deep financial sector by regional standards and although financial intermediation remains largely bank-dominated, some diversification is beginning to take place. Reforms, over the past two decades, opened up the financial sector to private competition allowing it to develop and to play an increasingly important role in the economy. The opening to competition started in 1993 with the privatisation of Costa Rican Corporation of Development.<sup>67</sup> Since then, a series of domestic and foreign financial entities have established operations in the country. A new law in 1995 opened up the banking sector to private competition, eliminating the monopoly of state banks. In 1996, the market for pensions was also opened for domestic and foreign competition through a law that allowed the creation of private complementary pension plans. Finally, the CAFTA-DR eliminated the public monopoly in insurance and opened the market to private sector participants.

These reforms represent important steps towards deepening and expanding access to Costa Rica's financial sector. Nevertheless, some challenges remain to improve its financial regulatory environment to allow a more efficient and adequate banking sector supervision and regulation, as well to level the playing field between state-owned and private banks operating in the country. More precisely, there is a need to improve the banking resolution framework and enhance consolidated supervision to bring the supervisory and regulatory framework closer to international standards, and eliminated regulatory asymmetries that favour state-owned banks. Regulatory reforms are also necessary to enable the development and diversification of capital markets, and enhance the mobilisation of financial resources in Costa Rica.

Financial sector development in Costa Rica is essentially associated with the banking sector. During the 2000s, the level of private sector credit increased from roughly 21% to 45% of GDP. Economic growth during the period induced a credit boom in the country from January 2006 up to February 2009. During this period, credit grew on average above 30% annually according to data from Costa Rican Central Bank, notably pushed by corporate loans, housing and consumer lending. Credit growth declined considerably in 2009 and 2010 and has since begun recovering, growing around 11% between December 2011 and November 2012. While Costa Rica has made great progress during the last decade, private sector credit to GDP remains about 10 percentage points below the expected level for a higher middle-income country, and much lower than the OECD average (Figure 3.4).

Access to finance by SMEs in Costa Rica is also relatively limited in comparison to the Latin American and OECD averages (OECD and ECLAC,

Figure 3.4. **Bank credit to the private sector (% of GDP, 2010)**

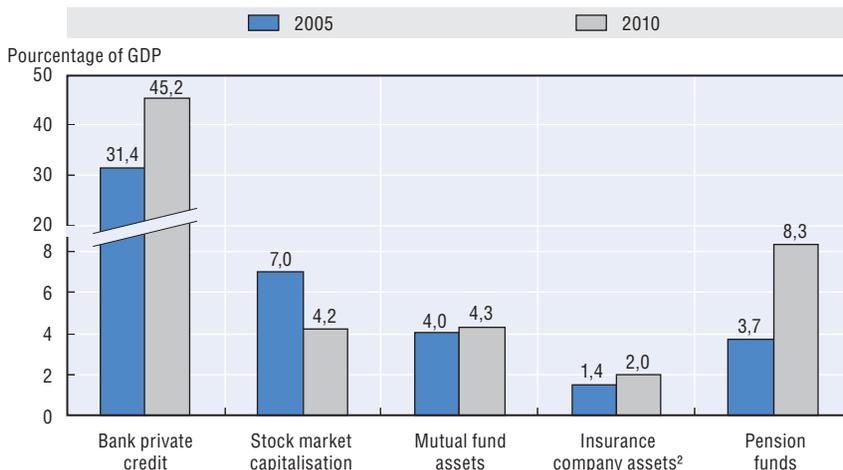


Source: World Bank, Global Development Finance Database.

2012). While less than 10% of total credit flows to SMEs in Costa Rica, their average shares in Latin American and in OECD countries are 12.5% and 25% respectively. According to the authorities, regulatory constraints have hindered the extension of banking loans to SMEs. Aware of this challenge, the government has launched several programmes to enhance access to finance by SMEs (Section on Investment promotion and facilitation).

Although financial intermediation remains largely dominated by the banking sector, some diversification is beginning to take place with reforms that opened some financial sectors to private participation. Reforms to the pension system that introduced the private complementary system in 1995, and made it mandatory in 2000, enabled the rapid accumulation of assets by pension funds, although their size remains modest in relation to banks. At the end of 2010, pension funds' assets accounted for more than 8% of GDP, increasing from approximately 4% in 2005. The insurance sector has also benefited from regulatory reforms implemented following CAFTA-DR that opened the sector to domestic and foreign private participation in 2009.<sup>68</sup> A number of insurance companies established operations in the country since then, including a few large foreign players. Insurance assets saw a double digit growth of roughly 23% in 2009, compared to an average annual growth of 8% between 2005 and 2008. The mutual funds industry has yet to recover from the crisis it went through in 2004 that reduced its size by roughly three quarters in relation to GDP. At the end of 2010, mutual funds' assets under management accounted for roughly 4% of GDP, slightly above its 2005 level (Figure 3.5).

Figure 3.5. **Costa Rica's financial system**



1. Comparable data on domestic bonds outstanding was not available for comparison.
  2. Data on insurance assets is from SUGESE (2012a) and GDP from the Central Bank of Costa Rica.
- Source: World Bank, *Global Development Finance Database*, SUGESE (2012a) and Central Bank of Costa Rica.

Capital markets are still incipient, with stock market capitalisation around 4% of GDP, having constantly declined since the mutual fund crisis. The private debt securities market is also limited and dominated by financial institutions (IFC, 2012). Between 2007 and July 2012, the private sector was responsible for roughly 11% of the total amount of bonds issued. Non-financial private corporations accounted for only 2.3% of the total amount bonds issued in the period. This is equivalent to 21% of the total amount issued by the private sector. For an order of magnitude, the total amount of bonds issued by the private sector in the period represents only 11% of GDP. Costa Rica like other countries in the region suffers from small market size, small number of issuers, lack of investor diversification, and large participation of government securities. Reforms to capital market regulations are necessary to bring it closer to international standards, and possibly facilitate a regional integration of capital markets in the medium term.

### **The regulatory environment**

In Costa Rica, the control and supervision of the financial sector is the responsibility of the National Council of Supervision of the Financial System (*Consejo Nacional de Supervisión del Sistema Financiero*, CONASSIF). There are four agencies under this umbrella that regulate each of the sectors of the financial system:

- SUGEF (*Superintendencia General de Entidades Financieras*) regulates and supervises state-owned banks, private banks, savings and credit co-operative, and non-banking financial corporations.
- SUGEVAL (*Superintendencia General de Valores*) regulates stock entities (securities stock exchanges, brokerage houses, corporations administering investment funds and risk rating companies).
- SUPEN (*Superintendencia de Pensiones*) grants authorisations and supervises the National Pensions System, which include regimes administered by the CCSS<sup>69</sup> and by private agents.
- SUGESE (*Superintendencia General de Seguros*) regulates all insurance and reinsurance activities, except for the compulsory social security regimes administered by the CCSS.

The Central Bank plays a role in ensuring an enabling macroeconomic environment and in promoting a stable, efficient and competitive system of financial intermediation. It is responsible for the stability of the payments system, liquidity assistance to markets and solvent institutions and systemic stability. The Central Bank is an autonomous institution and it is not subject to the regulations of SUGEF.

This institutional arrangement allows the four agencies to operate in a decentralised manner while ensuring a co-ordinated approach through

CONASSIF, responsible for establishing an integrated work agenda to ensure consistency and avoid fragmentation in the supervision of the financial sector. Notwithstanding, there is still room for enhancing co-ordination mechanisms as reported in the *Strategic Plan for the Development of Costa Rica's Financial Market* conducted by CONASSIF with the support of the IFC/World Bank (IFC, 2012). The report indicates that a more organic and efficient relationship between CONASSIF and the supervisory agencies, particularly in the case of SUGEVAL, is required to enhance the process of issuing regulations. According to the authorities, CONASSIF and the Superintendences are currently working on a Protocol for Issuing Regulations that is expected to render the process more efficient and at the same time lead to closer co-ordination between supervisory and regulatory bodies.

Enhancements to the institutional environment can possibly facilitate the alignment of Costa Rica's banking regulatory and supervisory framework with international standards. The IMF (2011) reports that Costa Rica has been slow in implementing the recommendations made in 2008 by the IMF and World Bank to improve the country's supervisory framework. Costa Rica is still moderately compliant with the 25 Basel Core Principles of financial supervision and regulation. Its level of compliance is also perceived to be lower than in other countries in the region (IMF, 2011b). In particular, there is a need to enhance SUGEVAL's power to effectively conduct consolidated supervision of financial conglomerates and to strengthen the bank resolution framework (IMF, 2011). Aware of this, SUGEVAL has included in its strategic plan for 2009-13 the objective of bringing domestic regulations closer to the 25 Basel Core Principles of financial supervision and regulation (SUGEVAL, 2012). A new regulation empowering SUGEVAL to supervise banking groups on a consolidated basis has been prepared and was submitted to the Congress in 2010, but approval is still pending. The government is also working on strengthening financial supervision by introducing a risk-based supervisory approach in line with Basel Pillar II. A series of changes of regulations on supervised and regulated entities, as well as on supervisory procedures, have been introduced in order to migrate towards a risk-based supervision model. Additionally, supervisors have received training to prepare for a smooth transition towards the new supervisory scheme.

Regulatory reforms are also needed to level the playing field between state-owned and private banks operating in the country (IMF, 2011). One particular regulation that distorts competition between these two types of institutions is the absolute and unlimited guarantee of the state for their state-owned banks' liabilities. Establishing a unified deposit insurance scheme that covers private banks would contribute to reduce risks to financial stability and enhance competition in the banking sector. According to the authorities, a bill of law addressing this issue and also containing provision to

improve banking resolution in the country is currently awaiting discussion in the plenary of the Congress. The Bill of Deposit Insurance and Banking Resolution aims at reducing the existing differences on deposits insurance between private and state-owned banks, as well as enabling a banking resolution scheme in administrative procedures that facilitate the application of a “good bank-bad bank” approach to banking entities in financial distress. This will strengthen Costa Rica’s specific insolvency framework for financial institutions provided under Costa Rica’s Central Bank Organic Law, which allows SUGEF to take corrective actions as well as intervene to restore the health of the entity, but provide relatively limited bank resolution powers to SUGEF. The norms of the Commercial Code and of the Code of Civil Procedures are supplementary.

Credit reporting laws in Costa Rica provide for a relative deep flow of credit information in the country, as indicated by the Doing Business Report 2013, and to a certain extent facilitate access to finance in the country. The public credit registry – the Credit Information Centre operated by SUGEF – collects the credit history of bank customers and disseminates the information to banks and other regulated financial entities. The coverage of the public registry system is estimated at 28% of the adult population by the World Bank Doing Business Report 2013. Costa Rica also allows the operation of private credit bureaus, which are estimated to cover about 83% of the adult population. The activity of private credit bureaus is regulated by the Law for the Protection of Persons regarding the Treatment of their Personal Data. This law protects personal data and subjects companies collecting or disseminating personal information to the supervision of a specialised department within the Ministry of Justice. The law also guarantees the right of borrowers to inspect their personal data.

A public collateral registry system is also in place to support the use of property as collateral to secure loans. The registry system has been expanding and improving its services considerably throughout the last decade. The registry records property rights, as well as mortgages and other liens and limitations affecting real estate property and vehicles. The system is fully computerised and most information is available for consultation via Internet. Movable property can be used as collateral against a loan in Costa Rica, but this is currently limited to automotive vehicles. Other significant movable assets for SMEs, such as equipment, accounts receivables and inventory, cannot be used but are subject of a new bill of law, announced by the government in early 2013, that aims at expanding the roll of assets that can be used as collateral not only to these movable tangible assets cited above, but also to intangible assets such as brands and intellectual property rights. According to the government, the new legislation is in line with modern international legislations on the subject and once enacted will provide an

important support for the development of Costa Rican SMEs. The government has also implemented other programmes to support financing to SMEs (Section on Investment promotion and facilitation).

This new legislation is also expected to strengthen creditor rights in Costa Rica by making clear and transparent what is the applicable order of priority among conflicting interests between secured creditors, and by establishing provisions to facilitate the rapid enforcement of creditor rights via out-of-court mechanisms. This is particularly important in the case of movable assets that quickly depreciates and change their market value. Moving forward with these reforms can contribute to strengthen Costa Rica's rankings on the strength of legal rights indicators that compose the Doing Business Report of the World Bank. While Costa Rica performs relatively well in the indicator on the depth of credit information in the Doing Business Report 2013, its performance under the indicators of strength of legal rights for getting credit is low, both in comparison to the regional and OECD average.

The government has also strengthened its Anti-Money Laundering and Counter Terrorism Financing regulations by amending in 2009 its AML/CFT Law that has been in force since 2001.<sup>70</sup> The law establishes provisions on money laundering and terrorism financing and entitles CONASSIF to issue regulations to prevent these types of offenses within the national financial system.

### **The banking sector**

The Costa Rican banking sector has weathered rather well the global financial crisis, despite the country's strong economic links with the US. Banks had limited exposure to the financial market in the US and did not rely on external borrowing for their lending activities. Currently, banks are relatively well capitalised and operate at profit, though the latter has considerably shrunk since the crisis. The quality of assets also remains sound with the level of nonperforming loans to total loans below 2% (IMF, 2011). In the 2000s, the sector went through a wave of mergers and acquisitions, including of foreign banks, which has contributed to strengthen banking institutions and expand the role of private banks in the country. Concentration levels in the banking sector have declined in the late 1990s and stabilised in the 2000s. Both domestic and foreign private banks operate in the country,<sup>71</sup> but there is a large dominance of state-owned banks, which accounted for 65% of total commercial banking assets in the country in 2011 and for 55% of total assets held by financial institutions supervised by SUGEF (SUGEF, 2011).<sup>72</sup> Private banks were responsible for 35% and 30% respectively.

As of April 2013, there were three state-owned banks, two banks created by special law and 11 private banks in the country.<sup>73</sup> The two biggest state-owned banks, the National Bank of Costa Rica and the Bank of Costa Rica, held

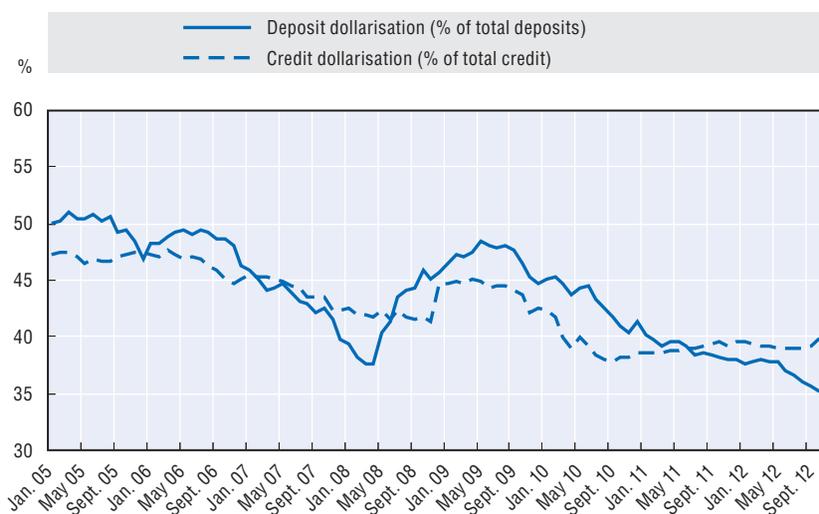
respectively 28% and 21% of total banking assets (SUGEF, 2013). This large presence of state-owned banks in Costa Rica is a result of regulatory asymmetries that have historically benefited them and limited the competitive supply of financial services by private banks. The state guarantees all liabilities of state-owned banks and exempts from taxation their dollar-denominated deposits<sup>74</sup> and contributions to the development finance system (IMF, 2011). In addition, state-owned banks have a special access to cheap funds through the so-called *peaje bancario* that obliges private banks to hold at least 17% of their short-term deposits in state-owned banks at below-market interest rates. On the other hand, state-owned banks are subject to costly and cumbersome government procurement regulations. While there is no state deposit insurance scheme applicable for private banks, deposits at private banks are partially covered by the Costa Rican Bankers Association's deposit insurance scheme. As cited earlier, the government is working to reduce regulatory asymmetries between private and state-owned banks, notably in regard to deposit insurance, through the introduction of an insurance deposit scheme for private banks and savings and credit co-operatives as envisaged in the Bill of Deposit Insurance and Banking Resolution submitted for approval by the Congress.

In the recent past, this uneven regulatory environment combined with a relatively weak supervisory framework had encouraged the development of offshore banking in Costa Rica. Up to 2008, it was common for banking groups established in Costa Rica to set up a bank abroad, usually in the Caribbean, to serve clients residing in Costa Rica. Private banking institutions were particularly keen on using offshore banks for tax and regulatory purposes to overcome more disproportionate regulations at home. In 2006, the assets of Costa Rican banks abroad accounted for nearly 50% of total private banking assets (WTO, 2007). The government has however been successful in discouraging offshore banking in the country, reducing it to virtually zero by end 2008. This year the government introduced a new regulation that increased supervisory scrutiny and tightened rules for the authorisation and organisation of financial conglomerates in Costa Rica, leading banks to terminate their offshore activities and transfer them onshore (IMF, 2009).

Financial dollarization remains important despite being in a declining trend (Figure 3.6). Deposits denominated in foreign currency at Costa Rican banks represent 35% of total deposits as of November 2012, a notable reduction from the 50% found in January 2005. Credit dollarization is at 40% of total credit portfolio, also significantly reduced from the levels seen in early 2005. Private banks were the main institutions holding foreign currency denominated loan portfolios as of December 2011 (SUGEF, 2011). Dollarization of credit in such institutions was at 77% of their total loan portfolio, while deposit dollarization reached 68%. In state-owned banks, the level of credit dollarization was much lower at 28% of total credit, and deposits dollarization was at 33% of total.

While dollarization exposes banks and the economy to interest and exchange rate risks, the declining trend indicates an increasing confidence in the Costa Rican colon. In 2008, the government approved a new regulation on foreign exchange derivatives that facilitated the hedging of foreign currency denominated operations by banks and discouraged the unhedged borrowing in foreign currency. The adoption of the exchange rate band system in 2006 has also discouraged the extension of dollar denominated credit to enterprises that have cash flows mainly denominated in the local currency.

Figure 3.6. **Financial sector dollarization (2005-12)**



Source: World Bank, Global Development Finance Database.

### **The insurance sector**

In the context of CAFTA-DR, Costa Rica adopted commitments to open up the insurance sector to private competition and to enact the necessary domestic legislation for their implementation (Section on Competition policy). In 2009 the sector was opened following the enactment of legislation that introduced the new regulatory framework for insurance activities. The law also established SUGESE, the new regulatory institution for the sector. The insurance and reinsurance sector are now fully opened to national and foreign enterprises, subject to the fulfilment of legal requirements (i.e. compliance with prudential solvency and integrity requirements) which are applicable on a non-discriminatory basis. Reinsurance, retrocession, their intermediation and auxiliary services can be supplied on a cross-border basis independently of the existence of a trade agreement. On the other hand, any natural or juridical person may contract, on a cross-border basis, with insurance entities

or suppliers of intermediation or auxiliary services with a country with which Costa Rica has undertaken commitments in a free trade agreement, subject to the conditions set out therein. Currently, only suppliers from countries part of CAFTA-DR can provide insurance, intermediation and auxiliary services on a cross-border basis. Once the Association Agreement with the European Union enters into force, it will allow European insurers to provide a number of insurance services in Costa Rica, such as maritime shipping and commercial aviation, among others, on a cross-border basis.

Following the opening of the sector in 2009, the number of registered insurance products increased about three times. In 2012, the insurance market grew 8%. Life and health insurance have substantially expanded their share in the insurance market since 2010. As of December 2012, life-insurance, and health and personal accident insurance accounted for 17% and 12% of total insurance premiums respectively, against 7% and 13% at the end of 2010. Currently, there are 12 enterprises<sup>75</sup> incorporated and authorised to provide insurance services in the country. Although only a small period of time has passed since these reforms were implemented, they have already had significant effects in the market structure of the sector. From 2010 to March 2012, the market share of insurance premiums held by the National Insurance Institute, the former state insurance monopoly, was reduced by 7.6 percentage points. If mandatory insurance is ignored, the reduction reaches 11 percentage points (SUGESE, 2012b). This decline in INS' market share is associated with the entrance of important foreign and regional players in the Costa Rican insurance market in 2011, such as MAPFRE and ASSA. As of December 2012, INS held 92% of total insurance premiums, followed by ASSA with 3.3%, MAPFRE with 2.2% and Pan American with 1.1% (SUGESE, 2012a).

Since SUGESE began operations in 2008, it has issued several norms and regulations to ensure that a modern insurance framework is in place. SUGESE Regulation 1-08 regulates the authorisation and requirements for licensing insurers, reinsurers, and intermediaries, and also provides rules for mandatory policy and rate filings. SUGESE Regulation 2-08 establishes the rules on the solvency of insurers and reinsurers. SUGESE Regulation 3-10 sets the rules for the activities of insurance agents, agencies and brokerage firms, and other insurance distributors. The new Insurance Contracts Regulatory Act<sup>76</sup> issued in 2011 introduces a modern and consumer-oriented regulatory framework for insurance and reinsurance activities, governing all aspects of insurance contracts. Amendments to the financial sector accounting rules were also made to encompass insurance companies. Currently SUGESE is working on the introduction of a risk-based supervision model to strengthen the supervisory and insolvency framework for insurance and reinsurance activities, and is working on improving the mechanisms to protect consumer's rights in the sector.

## The capital market

Costa Rican capital market is at an early stage of development. The Securities Law of 1998 and its amendments have provided the institutional framework for the development of capital markets and for the creation of collective investment schemes, but market development has been slow. The capital market is largely centred in the government, which plays the role of issuer, intermediary, investor and underwriter. Public debt securities are essentially the only product available in the market, and represent around 44% of GDP. Costa Rican equity market remains underdeveloped accounting for 4% of GDP in 2011 (Figure 3.7). Market capitalisation has considerably declined since 2000 when it accounted for roughly 18% of GDP. By 2005, it had already declined to 7% of GDP. The number of listed companies has declined during the period. Since 2009 there are only 9 listed companies. The corporate debt securities market is equally nascent. The few outstanding securities are from financial institutions, which accounted for 8.5% of the total value of bonds issued from 2007 to July 2012. Non-financial institutions were responsible for only 2.3%. Secondary markets for equity and corporate debt securities are virtually inexistent.

Figure 3.7. **Evolution of Costa Rica's Equity Market**



Source: World Bank, World Development Indicators.

In view of Costa Rica's need to mobilise savings for long term investments, there is a strong consensus in the government that further efforts to develop the domestic capital market are necessary. Since 2007, SUGEVAL is working to bring domestic regulations closer to international standards set by the International Organization of Securities Commissions (IOSCO), which include regulatory principles to ensure the protection of

investor rights, an effective, fair and transparent marketplace, and the reduction of systemic risks. According to the authorities, as of end 2007, out of the 30 evaluated principles, 11 principles were qualified as fully implemented, 6 principles as widely implemented, 8 principles as partially implemented, and 4 principles as non-implemented. A full action plan addressing the weakness encountered has been set out and is currently being implemented by SUGEVAL. Enhancing the regulatory environment is also necessary if Costa Rica moves towards the integration of regional capital markets in the medium term. While this is not yet possible as the existent regulatory frameworks in neighboring countries are quite different, a transparent and efficient integrated capital market could increase economies of scale and facilitate the deepening of regional financial markets.

The need for further developing Costa Rica's capital markets gained importance in the government's agenda in 2012. With the support of the IFC, the government undertook the exercise of assessing what are the required reforms to increase access and depth of its capital markets. The results of the exercise were compiled into a *Strategic Plan for the Development of Costa Rica's Capital Market*, which identified reforms to be undertaken in four areas: products, regulation and supervision, access to market and operational risks (IFC, 2012). Succinctly, the report highlighted the need to enhance the market for public securities to enable the development of other products by providing a reliable benchmark. In Costa Rica, both the Central Bank and the Treasury are allowed to issue sovereign debt securities, but often this is carried in an unco-ordinated fashion. The issuance of public bonds does not follow a pre-established calendar and bonds are not regularly issued for all maturities, which prevents the formation of a reliable benchmark yield curve to support the development of corporate debt securities. The market infrastructure also imposes higher costs for investors and affects their profitability. Differently from most countries that have organised OTC markets for debt markets, Costa Rica's debt market takes place in an exchange-based market organised by the Costa Rican National Exchange (BNV), which does not provide market players with the desired flexibility and to which institutional investors have no direct access. Institutional investors have to go through security brokers (*puestos de bolsa*) to operate in the market.

Burdensome regulations for the issuance of securities have until recently led market players to opt for private placements for raising capital. In 2012 however, the government simplified and eased issuing requirements, facilitating the registration of corporate debt and giving entities more flexibility to manage their funds and sources of funds. SUGEVAL is also planning to revise and reform the pertinent regulations on public offerings in order to reactivate the Costa Rican securities market through a greater offer of products and a more diverse participation of entities. Particularly, the government seeks to ease

listing requirements and facilitate the commercialisation of securities issued under the restricted public offer mechanism, which is a special market that only sophisticated and institutional investors can participate. The programmed amendments are to create a special registry procedure for the restricted public offer and to establish special provisions on the responsibilities of qualified investors regarding the information provided by the issuer. This will allow SUGEVAL to concentrate its work on the optimisation of the procedures for public offerings in general, a market which requires greater protection regarding the disclosure of information.

In regard to the equity market, since 2007 the BNV has concentrated efforts to develop an alternative stock market – MAPA. The initiative seeks to promote capital investment and the development of Costa Rican SMEs with high growth potential through an organised private placement mechanism that is not subject to the supervision of SUGEVAL. All share negotiations through MAPA are made outside of the normal negotiations mechanisms of the BNV and under the exclusive responsibility of the contracting parties in the specific negotiation. In 2010, the Inter-American Development Bank (IADB) and the BNV agreed to work together to strengthen the initiative. As an intermediary and organised equity market with lower and less expensive requirements, MAPA can facilitate SMEs' access to equity financing, which is an important source of capital to support these companies' long term investment projects. SMEs that are allowed to issue shares in MAPA are those with no more than 50 shareholders and with no securities registered in other public markets. As of August 2012, only two companies had been listed in MAPA.

For investors MAPA represents the possibility to participate in the capital of these high growth potential enterprises, under a scheme that ensures access to relevant information of the enterprises, a professional and transparent management, the protection of their minority interests and equal treatment with respect to other shareholders. Investor participation in MAPA is however limited to institutional and other sophisticated investors as these are investors capable of bearing the higher risks presented by SMEs, but that usually do not count with an appropriate platform to easily carry out these types of investment. For the issuing companies, MAPA not only provides access to a pool of capital from institutional investors but also facilitates their professionalisation by promoting the adoption of standards of corporate governance and transparency in their relations with investors, as well as facilitating the exit of founding shareholders or of any other investor, once the enterprise has reached a greater stage of development. While the initiative has raised attention by the private sector and international organisations, its development has been slower than expected.

Overall, Costa Rica has a relatively deep financial sector to regional standards, although financial intermediation remains largely bank-dominated. Reforms, over the past two decades, have opened up the financial sector to private competition and have strengthened the regulatory framework in general. However, moving forward will require additional efforts to bring financial sector regulations closer to international standards and to level the playing field between state-owned and private investors operating in the country. Enhancing the mobilisation of financial resources in Costa Rica will also require regulatory reforms facilitating access to capital markets. Aware of this, the government, with the support from the World Bank and IADB, is working on a few initiatives that address these challenges.

### Public governance and anti-corruption

Regulatory quality, public sector integrity and anti-corruption policies are critical for the confidence and decisions of all investors and for reaping the development benefits of investment. While there is no single model for good public governance, there are commonly accepted standards of public governance to assist governments in assuming their roles effectively. In the area of anti-corruption, the *OECD Convention of Combating Bribery of Foreign Public Officials in International Business Transactions* requires States Parties to criminalise, investigate and prosecute foreign bribery, thereby aiming to stop the flow of bribes to public officials in other countries. Costa Rica's efforts towards a corruption-free business environment are a positive signal for investors from Parties to the *Convention* and contribute to defend the interest of the Costa Rican society as a whole.

#### **Regulatory improvements in public administration**

Public governance constitutes one of the challenges for Costa Rica to enhance its investment environment. The 2012-13 WEF *Global Competitiveness Report* highlights that "inefficient government bureaucracy" is perceived by the business community as the most problematic factor for doing business in Costa Rica (out of 16 factors). The government has been working on improving effective public administration for a long time and, in the past few years, has given a particular focus to regulatory improvements in the business environment through various initiatives.

The General Law of Public Administration (*Ley General de la Administración Pública*, Law No. 6227 of 2 May 1978) and the Law on the Protection of Citizens from Excessive Administrative Requirements and Procedures (*Ley de Protección al Ciudadano del Exceso de Requisitos y Trámites Administrativos*, Law No. 8220 of 4 March 2002) provide the general legal framework for public governance. While the former provides for consultations when drafting regulations of

general application, the latter mandates public entities to conduct cost-benefit analyses before issuing any new regulation or reforming existing ones, when those regulations are intended to impose requirements and/or procedures to be fulfilled. The Law on the Protection of Citizens from Excessive Administrative Requirements and Procedures was amended in 2011 (Law No. 8990 of 27 September 2011) to create sanction mechanisms towards institutions and public officials breaching legislation. In addition, the Political Constitution protects the right of access to information and transparency (Articles 27 and 30), and publicity (Articles 124 and 129) as core principles.

The Directorate on Regulatory Improvement (*Dirección de Mejora Regulatoria y Reglamentación Técnica*), under the Ministry of Economy, Industry and Commerce (MEIC), is responsible for overseeing compliance of the legislation by all public entities. The Commission on Regulatory Improvement created in 1994<sup>77</sup> issues recommendations on the elimination or reform of specific laws and executive decrees establishing procedures or requirements found to be unnecessary. The Commission proposes implementation of corrective measures to public entities to achieve increased procedural efficiency. The Commission, attached to MEIC, is composed of 15 members appointed by the Executive Branch.<sup>78</sup> The law also compels all public entities to perform a cost-benefit analysis on regulations that have an effect on trade, and on the procedures and requirements established to grant market access to goods and services provided in the country or abroad. Unnecessary procedures identified in the analysis shall be eliminated, and those to be kept shall be rationalised.

The Law on the Protection of Citizens from Excessive Administrative Requirements and Procedures established the National Procedures Catalogue (*Catálogo Nacional de Trámites*), as an instrument aimed at compiling all procedures required by public entities to be fulfilled by the general public. It works as a one-stop shop for a total of 2 059 different procedures before 59 public institutions, including: ministries, decentralised governmental agencies, public enterprises and municipalities. The National Procedures Catalogue is accessible online<sup>79</sup> and includes information for each of these procedures related to the relevant institutions, the requirements, the time period and the costs. Additionally, it has an online evaluation form to provide feedback on the procedures and on the public officials' work. The authorities point out that the Catalogue and associated mechanisms have enabled greater legal certainty and transparency to both national and foreign investors regarding the requirements, documentation, costs and time necessary for various procedures.

In recent years, Costa Rica has put strong emphasis on improving public governance related to the business environment. In the National Development Plan 2011-14, the authorities included a commitment to foster a coherent regulatory reform programme – consistent with its development and investment strategy – to streamline procedures and facilitate business. To this end, a National Strategy on Regulatory Improvement was launched in August 2010 with the support of the World Bank. Implemented under the leadership of MEIC and with the support of the Presidential Council on Competitiveness and Innovation (CPCI), it identifies actions to raise competitiveness and improve the business climate, notably focusing on improving the World Bank *Doing Business* indicators. The most notable achievements of this strategy are *CrearEmpresa*, a digital system for the registration of legal entities (Section on Investment promotion and facilitation) and the simplification of procedures to obtain construction permits (Section on Investment policy).

As part of the strategy for regulatory reform and streamlining of procedures, MEIC has also undertaken other actions to digitalise procedures. For instance, the E-Regulation programme (*Costa Rica Facilita Negocios*) consists of a digital platform that summarises the steps investors must follow to start a business in Costa Rica.<sup>80</sup> It was launched in September 2010 with the financial support of UNDP and the government of Luxembourg together with UNCTAD's technical assistance. Other initiatives within this strategy include improving tax collection and the establishment of a single window for foreign trade called VUCE (*Ventanilla Única de Comercio Exterior*) (Section on Trade policy).

Costa Rica is also participating in the Open Government Partnership (OGP), an initiative that aims to promote transparency, accountability, and citizen participation. In 2013, Costa Rica delivered its OGP commitments after conducting a series of public consultations. The country's Action Plan focuses on improving public services, increasing public integrity, transparency, accountability, and citizen engagement, as well as managing public resources more effectively. For Costa Rica, working on these fields will also serve to increase competitiveness, as has been the case with the implementation of initiatives such as *Mer-Link* and *CrearEmpresa*.

In conclusion, Costa Rica is carrying out efforts to strengthen efficiency of public governance with a focus on regulatory improvements in the business environment. The implementation of the legal system is supported by sound strategies and institutions. Notable reforms for the digitalisation of procedures for business facilitation are being conducted. However, bureaucracy is still perceived as an obstacle by investors. The authorities recognise that there is a need to pursue streamlining and modernisation of procedures for doing business and facilitating both domestic and foreign investments.

### **Anti-corruption and integrity**

Costa Rica is committed to fighting corruption and improving integrity in its public governance. It has enacted laws and regulations to fight against corruption and has ratified international conventions. It is considered as a relatively low corruption country.

Two former presidents, as well as Congressmen, heads of government agencies and state-owned enterprises have been involved in corruption cases concerning undue payments from foreign companies or officials.<sup>81</sup> To allow for prosecution of these types of cases, the Law against Corruption and Illicit Enrichment of Public Officials was enacted in 2004. Corruption cases are now under greater scrutiny. Several members of the current government have resigned for allegations of corruption.

Costa Rica ranks at the 48th place out of 176 analysed countries on the 2012 Transparency International *Corruption Perceptions Index*. It is the third best ranked country in Latin America, after Chile and Uruguay (both in joint 20th place), and the ninth if the Caribbean countries are included. However, only six OECD countries (out of the 34 members) rank inferior to Costa Rica (Czech Republic, Turkey, Slovakia, Italy, Greece and Mexico).

Corruption remains a challenge in the investment environment of Costa Rica, as it is classified as the fourth most problematic factor (out of 16 factors) for doing business in Costa Rica according to the 2012-13 WEF *Global Competitiveness Report*, whereas it was only the eighth factor (out of 15) in the previous edition (WEF, 2012). According to the US Department of State (2012), while corruption is not identified by US firms as a major obstacle of doing business in Costa Rica, some have made allegations of corruption in the administration of public tenders and in the approvals and timely processing of permits, as well as at the municipal level in concession contracts.

Costa Rica ratified the Inter-American Convention against Corruption in 1997<sup>82</sup> and the United Nations Convention against Corruption (UNCAC) in 2007.<sup>83</sup> The FTA between Central America, Dominican Republic and the United States also contains provisions on anti-corruption<sup>84</sup> (Chapter 4). Following the ratification of these international agreements, the country worked towards complying with their provisions. Both the Inter-American and the UN instruments have review mechanisms which Costa Rica has voluntarily joined. Though participating in the meetings of the UNCAC Implementation Review Group, the country has not yet been subject to a review but is listed for the next cycle. In 2012, it went through the fourth review round of the Mechanism for Follow-Up on the Implementation of the Inter-American Convention against Corruption (MESICIC) and the final report was adopted in March 2013. Each round reviewed the implementation of selected provisions of the Convention. The Committee of Experts noted the progresses made by

Costa Rica in the implementation of the recommendations of the last reports and recalled pending issues to which the country should continue to pay attention (OAS, 2009 and 2013).

The Costa Rican legal system establishes an administrative<sup>85</sup>, civil<sup>86</sup>, and criminal<sup>87</sup> framework that seeks the prevention and penalisation of acts of corruption. The general standards of conduct for public servants are set forth in the Political Constitution, the General Law of Public Administration (Law No. 6227 of 2 May 1978), the Law against Corruption and Illicit Enrichment of Public Officials (Law No. 8422 of 6 October 2004) and the Law for Public Procurement (Law No. 7494 of 2 May 1995). The Constitution establishes a system of checks and balances between the executive, legislative and judicial branches of government. It protects the legality principle<sup>88</sup> and confers the judicial branch the authority to review administrative acts to ensure compliance with this principle.

The objectives of the Law against Corruption and Illicit Enrichment of Public Officials are to prevent, detect and sanction corruption in the public service. The law includes rules to prevent corruption practices and promote the effective fulfilment of public duties, and establishes systems of disclosure and control. High-level public officials and public officials who manage public funds are required to declare their wealth and assets in a sworn statement annually. The ones who fail to provide this sworn statement are subject to fines, administrative sanctions or imprisonment. This system seeks to detect unlawful wealth increases by public officials and aims at reducing bribe solicitation. Moreover, the law creates an administrative, civil and criminal responsibility regime that categorises illegal behaviour and sets proportional penalties in accordance with the severity of the breach. Since the entry into force of the law in 2004, the competent entities have carried out training programmes for their staff to enhance its implementation. The law has allowed for the prosecution of corruption cases involving high-level government officials in the exercise of their function.

To enforce the legislation, Costa Rica has specialised institutions that work for the prevention, detection and punishment of acts of corruption, which include the Offices of the Public Ethics Prosecutor and of the Public Prosecutor; the Office of the Comptroller General of the Republic; the Office of the Ombudsman; and the Criminal Jurisdiction of the Treasury and Civil Service.

The Office of the Public Ethics Prosecutor (PEP) is part of the Ministry of Justice and Peace. It is the state's anti-corruption office, whose main functions include prevention, detection and eradication of corruption. It also has a role in the enhancement of ethics and transparency in the public administration. PEP has an investigation power in the prosecution of corruption cases involving public officials. After a preliminary investigation, it might present a

criminal complaint to the Public Prosecutor for further investigation. The latter is responsible for filing charges and for the prosecution in cases of public action. PEP is also entitled to file charges in corruption cases, though most charges are filed by the Public Prosecutor. PEP has also two main roles in corruption cases, first to represent the state when a victim and second to file a civil action for damages when required (including civil action for social damage in the presence of “diffuse or collective interests”<sup>89</sup>). The Public Prosecutor's Office has a specialised unit, the Probity, Transparency and Anti-Corruption Unit, that prosecutes the most serious corruption offenses involving public officials and private individuals, as well as cases in which the accused is a judicial official.

The Office of the Comptroller General of the Republic (CGR) controls and approves public finances and audits state institutions and public officials. It has full operational and administrative independence in the performance of its duties. It elaborates and updates the registry system for public finance sanctions, which keeps record of disciplinary sanctions to public servants and penalties applicable for non-justifiable equity increases. The Office of the Ombudsman (*Defensoría de los Habitantes de la República*) is responsible for protecting the rights and interests of the country's population. One of its main functions is to ensure that government authorities act within the boundaries of morality, justice, the Constitution, legislation, conventions and general principles of law. In that regard, the Ombudsman participates in a wide range of anti-corruption activities including the Interinstitutional Transparency Network (see below), lectures, workshops or courses aimed at informing the general public on how to file a complaint for corruption cases. The Criminal Jurisdiction of the Treasury and Civil Service is a specialised jurisdiction that has competence over breaches of duties made by public officials.

These institutions have implemented co-ordination mechanisms in the fight against corruption. They have been promoting inter-institutional programmes, such as the inter-institutional commission between the Public Prosecutor, PEP, CGR and the Costa Rican Institute on Drugs. It is a strategic alliance to help co-ordinate actions in specific cases. The Financial Intelligence Unit (FIU) of the Costa Rican Institute on Drugs examines suspicious financial transactions to determine if they might be considered as money laundering.

One of the recommendations deriving from the last report of the Mechanism for Follow-up on the Implementation of the Inter-American Convention against Corruption (MESICIC) is to provide these oversight bodies with the financial and human resources necessary for the adequate fulfilment of their functions and responsibilities (OAS, 2013). The institutions are required *inter alia* to improve and better disseminate information on their activities and the cases (through website, annual reports, statistics,

information on performance, among others), to strengthen training programmes for their staff, judges and the public administration, to develop technological tools to improve their efficiency, to increase institutional co-ordination and to consider the possibility of assigning an anti-corruption prosecutor to each province in the country.

The 2009 MESICIC report recommended that Costa Rica strengthens the standards for the prevention of bribery of domestic and foreign government officials, including facilitating the work of the bodies responsible for investigating non-compliance of accounting records and holding awareness and integrity promotion campaigns targeting the private sector and encouraging production of companies' guidelines of corruption prevention. It also recommended strengthening the existing procedures and indicators used by the agencies in charge of the investigation and/or prosecution of the offense of transnational bribery and illicit enrichment.

In application of the MESICIC recommendations, provisions to encourage public servants and the general public to report acts of corruption in the public service and to protect them have been adopted.<sup>90</sup> However, the MESICIC report notes the need to continue giving attention to related recommendations, in particular in terms of protective measures, sanctions, and competence of the judicial and administrative authorities. A bill of law to increase protection measures for whistleblowers is currently in the legislative approval process.<sup>91</sup>

The 2013 MESICIC report notes progresses in the strengthening of the mechanisms for consultation and for encouraging civil society participation in public management. However, the issue of the right of access to public information still requires additional attention. The adoption of a comprehensive legislation is recommended besides the fact that this right is protected by the Constitution (Articles 27 and 30) and allows civil society and the media to scrutinise public officials in the performance of their duties.<sup>92</sup> The Constitutional Chamber allows for direct appeals on issues related to the right of access to public information. It has also asserted that the press and the general public should have access to all information of public interest made or kept by public institutions and even, in some cases, private individuals, in a complete, accurate and timely manner. The Interinstitutional Transparency Network (*Red interinstitucional de Transparencia*),<sup>93</sup> established by the Ombudsman in November 2004, seeks to ensure the constitutional right of access to public information, in particular in relation to the management of public resources. Despite these measures and the fact that the authorities report that adequate protection is in place, the 2013 MESICIC report still recommends to "institute legal rules and measures to support access to public information", and in particular to integrate and systematise in a single regulatory text the provisions that guarantee this right, and to reinforce mechanisms and procedures.

Other noteworthy recommendations made in the last MESICIC report relate to the need to strengthen the implementation of laws and regulatory systems related to conflicts of interest, in order to permit the effective and practical enforcement of a system of public ethics; to improve the systems for supervising and evaluating the contents of declarations of income, assets and liabilities, and regulate their publication; and to develop procedures designed to analyse the mechanisms and recommendations of the report. On the latter point, in 2010 the Office of the Public Ethics Prosecutor prepared a national plan for the implementation of the MESICIC recommendations, which indicates the actions to be undertaken, the responsible agencies, timeframe, indicators and estimated costs. This plan is meant to be a useful tool to analyse the results and impact of the anti-corruption system in Costa Rica and monitor the implementation of the MESICIC recommendations.

Costa Rica's framework on anti-corruption and integrity provides for review mechanisms to assess the performance of laws and regulations. First, the Political Constitution grants Congress the power to appoint legislative commissions in order to investigate and issue a report on any matter that it deems appropriate (Article 121). The Permanent Commission on Control of Public Revenue and Expenses, as well as other special commissions created under this constitutional mandate, have had an active role in investigating cases of corruption. These commissions can recommend moral and political sanctions on public officials under investigation, including temporary suspensions or disqualification from office.<sup>94</sup>

Second, entities that supervise the effective application and enforcement of the anti-corruption framework must render annual reports on objectives and actions taken regarding the exercise of their functions. The Office of the Public Ethics Prosecutor's annual report is made public through its website. The Office of the Comptroller General presents an annual report to Congress and can report to the different legislative commissions on particular matters.<sup>95</sup> The Office of the Public Prosecutor also provides an annual report to the Supreme Court of Justice and publishes it on its website. However, as mentioned in the 2013 MESICIC report, dissemination and comprehensiveness of information needs to be strengthened in these various institutions.

Third, as required by law, all agencies and bodies subject to the supervision of the Office of the Comptroller General must have an internal audit department (Law No. 8292 of 31 July 2002). These departments should carry out audits and special investigations regarding the use of public funds, verify compliance with internal control procedures and propose corrective actions, when required. The internal audit staff is supposed to perform its duties with complete independence. The Office of the Comptroller General has also implemented an online complaint system to allow individuals to report instances of mismanagement of public funds or illegal acts by public

officials. This system protects the identity of the person filing the complaint (Article 6 of Law No. 8292). It also provides training to its personnel regarding confidentiality of information and periodically reviews its control system.

Some figures or statistics on corruption cases are available to the public (Tables 3.8 and 3.9). However, as mentioned in the MESICIC reports, these statistics need to be improved and reflect the accurate number of complaints brought to the Office of the Public Ethics Prosecutor and referred to the Public Prosecutor's Office for investigation and prosecution.

**Table 3.8. Cases of corruption processed by the Public Prosecutor, notified to the PEP**

Year	Number of Cases
2011	1 119
2010	1 060
2009	825
2008	607
2007	472

Source: Response by Costa Rica for the fourth round of the MESICIC, [www.oas.org/juridico/PDFs/mesicic4\\_cri\\_resp\\_organos.pdf](http://www.oas.org/juridico/PDFs/mesicic4_cri_resp_organos.pdf).

**Table 3.9. Complaints received by the Office of the Public Ethics Prosecutor, 2007-11**

	2007	2008	2009	2010	2011
Rejected	29	91	70	78	85
Dismissed	13	10	21	17	19
Report with recommendation (reports that are issued when apparent unethical behaviors are found, and communicated to the appropriate authorities)	13	15	16	8	22
Referred to competent authority (an assessment was made on the admissibility, though for jurisdiction reasons, are referred to another institution which is the competent authority)	11	10	13	6	2
Resolution with recommendation (although no corrupt or unethical behaviors are determined, the events under investigation could promote those behaviors, which is why a recommendation is given to the administration to implement better internal control mechanisms)	5	3	3	7	7
Preliminary investigation	0	0	0	0	5
<b>Total</b>	<b>71</b>	<b>129</b>	<b>123</b>	<b>116</b>	<b>140</b>

Source: Response by Costa Rica for the fourth round of the MESICIC [www.oas.org/juridico/PDFs/mesicic4\\_cri\\_resp\\_organos.pdf](http://www.oas.org/juridico/PDFs/mesicic4_cri_resp_organos.pdf).

Costa Rica is committed to fighting corruption and improving integrity in its public governance. It has enacted laws and regulations to fight against corruption and has ratified international conventions. It is considered as a relatively low corruption country. The Law against Corruption and Illicit Enrichment of Public Officials was enacted in 2004 and allowed to improve the anti-corruption system. However, the review mechanism of the Inter-American Convention against

Corruption still identifies recommendations to be implemented, such as providing the oversight bodies with the necessary financial and human resources, improving information flows and training programmes, ensuring the effective enforcement of a public ethics system, strengthening mechanisms encouraging public servants to report acts of corruption, and adopting a comprehensive legislation on the right of access to public information. The authorities also recognise that additional efforts are required to address corruption in the business sector (Chapter 4).

With a view to improve its anti-corruption legislation and mechanisms and to benefit from best practices, Costa Rica has requested to participate as an Invitee in the Working Group on Bribery in International Business Transactions and participated in the March plenary meeting of the Group. It has expressed interest in aligning itself with the standards of the OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*. In January 2013, the authorities officially considered undertaking an *Integrity Scan* under the CleanGovBiz Initiative,<sup>96</sup> a self-assessment exercise supported by the OECD based on a tool covering all relevant OECD anti-corruption and other integrity instruments.

## Notes

1. This survey relies on interviews conducted in 2010-11 of business owners and top managers in 538 firms.
2. Law No. 3883 of 30 May 1967.
3. The Public Registry is composed of the following registries (Article 2 of Law No. 5695 of 28 May 1975 (as amended)) : i) the real estate registry, which comprises land property, mortgages and mortgage bonds, condominiums, maritime-terrestrial zone concessions, concessions in the Papagayo Gulf, tourist marinas – the National Cadastre is a section of this registry and includes cadastral maps, surveys and records of real estate in Costa Rica; ii) the legal entities registry, which comprises mercantile persons, civil associations, mass media and publicity agencies and sports associations; iii) the movable assets registry; iv) the intellectual property registry; and v) the National Geographic Institute.
4. [www.rnpdigital.com](http://www.rnpdigital.com).
5. Extra-registry cases: Public notaries are responsible for endorsing contracts regarding the transfer of properties. When a party challenges the validity of a deed entry, the complaint must be submitted before the judicial courts. Over the last two years, the Public Registry has published 100 warnings per year of properties involved in fraud cases and under trial.

Intra-registry cases: When there are inconsistencies regarding the entry of a property movement and where responsibility is attributed to the Public Registry, the affected party has the right to challenge the Public Registry's decision through an administrative process. However, in more than 70% of these cases, there is no need to immobilise the involved properties. There are no reported cases of fraud for intra-registry causes. The Administrative Registry Tribunal is the competent

superior legal entity for the issuance of administrative decisions. It was created in October 2000 and the volume of resolutions issued on a yearly basis has been growing constantly.

6. Registration fees are correlated to the amount of the transaction. They include stamp taxes for the Public Registry and the National Archive, the agrarian stamp tax, the fiscal stamp taxes, and the municipal stamp taxes (cost of 0.83% of the property's value).
7. As a general rule, real estate property transfer tax is 1.5% of the property's value. Exceptions to the rule are properties valued less than 600 000 colones (approximately USD 1 200), welfare housing, and rural family housing (Law No. 6999 of 3 September 1985).
8. The fees of Public Notaries are established by a code of legal and notary fees under Executive Decree No. 32493-J of 9 March 2005, as issued by the Ministry of Justice and the Presidency of the Republic. Public notary fees are established in a gradual manner, according to the property's transaction value.
9. The 2012 US Investment Climate Statement notes that US real estate investors "have suffered adverse possession by squatters or have found themselves working with unscrupulous lawyers. Landowners should be sure to demonstrate a continuing presence on and control over their land." Some websites also mention the issue, e.g. [www.property-in-costarica.com/costa-rica-investment-property.html](http://www.property-in-costarica.com/costa-rica-investment-property.html) or [www.costaricanproperty.net/realty/162/costa-rican-property-rights.html](http://www.costaricanproperty.net/realty/162/costa-rican-property-rights.html).
10. Ministry of Health, Ministry of Agriculture, Ministry of Science, Technology and Telecommunications, Costa Rican Institute of Aqueducts and Sewage, and municipalities.
11. Regulations on the Review Procedure of Construction Plans (*Reglamento para el Trámite de Revisión de los Planos para la Construcción*, Executive Decree No. 36550-MP-MIVAH-S-MEIC of September 2011).
12. *Reglamento Sobre la Limitación a la Responsabilidad de los Proveedores de Servicios por Infracciones a Derechos de Autor y Conexos de Acuerdo con el Artículo 15.11.27 del Tratado de Libre Comercio República Dominicana-Centroamérica-Estados Unidos*, Executive Decree No. 36880 of 18 October 2011.
13. This Commission was formally installed through Executive Decree N° 35631-J-COMEX-MICITT-SP-H, published in *La Gaceta* No. 233 of 1 December 2009.
14. Application costs are for trademark USD 50, geographical indication USD 50, patent USD 500 and industrial designs USD 75. Publication costs vary as they depend on the length of the notice to be published, it usually amounts to approximately USD 100.
15. *Ley de Procedimientos de Observancia de los Derechos de Propiedad Intelectual y sus reformas*, Law No. 8039 of 12 October 2000, Article 16, Chapter V and Article 40bis.
16. The Civil Tribunal, upon the submission of an appeal by an interested party, has the authority to review the facts and legal assessments made by the civil court. The Second Chamber of the Supreme Court is the instance where the party may challenge the decision by the Civil Tribunal, but only in matters related to legal interpretations made by the Civil Tribunal or the Civil Court.
17. US Department of State (2011); World Bank (2012); and Heritage Foundation (2012).

18. [http://sitios.poder-judicial.go.cr/planificacion/Estadisticas/Compendio\\_de\\_Indicadores/compendio\\_indicadores\\_2007-2011.pdf](http://sitios.poder-judicial.go.cr/planificacion/Estadisticas/Compendio_de_Indicadores/compendio_indicadores_2007-2011.pdf).
19. Dirección Nacional de Resolución Alternativa de Conflictos (DINARAC), Ministerio de Justicia y Paz, <http://culturadepaz.mjp.go.cr>.
20. The 1997 Alternative Conflict Settlement Law allows for the creation of dedicated entities to manage institutional processes of mediation, conciliation and arbitration (Article 71), subject to an authorisation of the Ministry of Justice.
21. DINARAC, Ministerio de Justicia y Paz.
22. Constitutional Chamber Decision No. 2081 of 25 March 1998.
23. Articles 18, 25, 31, 41 and 45 of the Expropriation Law.
24. The Constitutional Chamber has stated that an internal disorder is a manifestation of what is known as a “state of necessity and urgency”, whereby the weaker legal interest must yield to the stronger legal interest. Constitutional Chamber Decision No. 8420 of 22 June 2012.
25. Constitutional Chamber Decision No. 1307 of 23 February 1999.
26. For instance, for the creation of the National Marine Park Las Baulas, the MINAE had to expropriate 64 private properties. Out of this total, 24 cases are being discussed at courts, 32 cases are being subject to administrative processes, and 8 cases are pending the initiation of the expropriation process by MINAE.
27. Term used by the Costa Rican authorities to mention that they have no longer the intention to ratify the BIT in its current form.
28. Law No.7638 of 30 October 1996 and Law No.8056 of 21 December 2000.
29. This instrument was ratified by Law No. 6157 of 2 December 1977.
30. This instrument was signed in 1981 and ratified by Law No. 7332 of 30 March 1993.
31. Executive Decree No. 35452-MP-COMEX.
32. Services include contact centers, shared services centers, engineering and design, media and entertainment, and information technology.
33. COMEX was created by the Budgetary Law No. 7055 of 11 December 1986, while the law formally instituting it was enacted in 1996 (*Ley de Creación del Ministerio de Comercio Exterior de Costa Rica*, Law No. 7683 of 30 October 1996).
34. The Free Zone Regime and the Inward Processing Regime.
35. They include the Ministers of Finance; Presidency; Planning and Economic Policy; Foreign Trade (COMEX); Economy, Industry and Commerce; Agriculture and Livestock; Public Works and Transportation; Public Education; Environment and Energy; Science, Technology and Telecommunications; Tourism; Health; Decentralisation and Local Development; and Justice and Peace.
36. [www.oecd.org/daf/investment/pfi](http://www.oecd.org/daf/investment/pfi).
37. [www.oecd.org/dataoecd/45/21/2506900.pdf](http://www.oecd.org/dataoecd/45/21/2506900.pdf).
38. [www.oecd.org/ctp/tax-global/Transparency\\_and\\_Governance\\_principles.pdf](http://www.oecd.org/ctp/tax-global/Transparency_and_Governance_principles.pdf).
39. This category has been rarely used and will therefore be eliminated by 31 December 2015 at the latest.
40. Domestic suppliers are granted training by PROCOMER if they are classified as micro, small or medium enterprises.

41. The OECD *Tax and Development Programme* considers that Costa Rica features, together with Ireland, Malaysia and Mauritius, amongst the four most successful cases of attracting FDI by providing effective investment incentives schemes.
42. [www.procomer.com/contenido/informaci%C3%B3n-comercial-3.html](http://www.procomer.com/contenido/informaci%C3%B3n-comercial-3.html).
43. Costa Rica has deposited its instrument of ratification of the OECD *Convention on Mutual Administrative Assistance in Tax Matters*, which entered into force on 1 August 2013. The Convention helps counter cross-border tax evasion and ensures compliance with national tax laws, while respecting the rights of taxpayers.
44. These beneficiaries must export at least 75% of their sales to qualify for the incentives of the FZR.
45. These include first transactions; long-term business relationships established via a contract, blank orders or simply through periodic purchases.
46. In this chapter, Central America refers to the region that includes Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.
47. The latest report (May 2011 – April 2012) is accessible at [www.comex.go.cr/acerca\\_comex/%20Informe%20de%20Labores%202012.pdf](http://www.comex.go.cr/acerca_comex/%20Informe%20de%20Labores%202012.pdf).
48. The FTA with Peru entered into force on 1 June 2013 while that with Colombia was signed in May 2013 and has been submitted to Congress for approval.
49. They include: the National Liquor Factory, the Costa Rican Oil Refinery (RECOPE) and the Costa Rican Institute of Aqueducts and Sewage (AyA).
50. According to Article 16 of the law, concentrations are understood as merger, acquisition control or any other act that joins companies, partnerships, shares capital stock, trusts or assets in general, made between and among competitors, suppliers, clients or other economic agents with the purpose of reducing, damaging or preventing of free competition, with respect to the same, similar or substantially related goods or services. The law stipulates that the criteria for measuring substantial relevant market power with respect to vertical agreements must be followed for analysing these operations.
51. The minimum wage in Costa Rica for an unskilled worker is of approximately USD 500. The minimum wage scale is revised and published every six months by the Ministry of Labour and Social Security, and considers the nature of the activities and the different territorial or economic circumstances (e.g. inflation).
52. This includes provisions regarding work shifts, minimum wages, overtime pay, vacation, sick leave, Christmas bonuses, workers compensation insurance, contracts, trial periods, employment termination and social security.
53. Private Participation in Infrastructure Database: <http://ppi.worldbank.org>.
54. In particular, the Law for Financial Management and Public Budgets main objectives are: i) to ensure that public monies are obtained and used according to the principles of economy, efficiency and efficacy; ii) to develop systems to provide timely and trustworthy information on public finances; and iii) to define the accountability framework for participants in the financial administration and public budgeting systems.
55. Currently, *Compra Red* (the former web-based bidding system), is still in place, while public entities transition to using only *Mer-Link*. A ruling has been issued in order to have *Mer-Link* as the only system to be used by all public entities in 2014.

56. Political Constitution, Article 121, Section 23; Law No.7319 of 17 November 1992, Article 12.
57. ARESEP is an independent agency governed by Law No. 7593 of 9 August 1996, and its regulations. For further, information, see [www.aresep.go.cr/index.php/aresep/principios-regulatorios](http://www.aresep.go.cr/index.php/aresep/principios-regulatorios).
58. Private Participation in Infrastructure Database: <http://ppi.worldbank.org>.
59. Subsectoral Council on Energy (*Consejo Subsectorial de Energía*) is composed of the Minister and Vice-Minister of MINAE, the heads of entities and SOEs in this subsector, as well as the Director of the Executive Secretariat of Subsectoral Energy Planning.
60. The VI National Energy Plan 2012-30 is available at [www.dse.go.cr](http://www.dse.go.cr).
61. ICE, ESPH, JASEC and co-operatives participate in power distribution. Private investors participate in power generation under certain restrictions described in more detail in Chapter 2.
62. For instance, ICE has reached agreements with the municipalities of Curridabat, Desamparados, Escazú, Montes de Oca, Moravia, San José, Santa Ana, La Unión, and Vázquez de Coronado, to generate electricity from solid waste they collect.
63. AyA provides potable water to more than 78% of the population, on its own or through regional administrative associations known as ASADAS.
64. OOSKA News (13 September 2012), ACCIONA to build, operate Costa Rican Wastewater Treatment Plant.
65. The Ministry is now known as the Ministry of Science, Technology and Telecommunications. The Ministry of Environment, Energy and Telecommunications, is now known as the Ministry of Environment and Energy.
66. This process concluded with the Council Resolution SUTEL-RCS-307-2009, published in Official Gazette No. 239 of 9 December 2009.
67. The Costa Rican Corporation of Development (CODESA) was a mixed capital company created by law, as an independent legal entity with the objective of promoting the country's economic development.
68. Law No. 8653 of 22 July 2009.
69. CCSS is supervised by SUPEN but not regulated by it.
70. Law No. 8204 of 26 December 2001 – Law on Narcotics, Psychotropic Substances, Non-Authorized Drugs, Related Activities, Money Laundering And Terrorism Financing.
71. Foreign banks are not allowed to operate through branches.
72. State and private banks, development banks, co-operatives and mutual financial institutions, finance companies, exchange houses, and *Caja de Ande*.
73. State-owned banks: Banco Nacional de Costa Rica, Banco de Costa Rica, and Banco Crédito Agrícola de Cartago. Banks created by special law: Banco Popular y de Desarrollo Comunal and Banco Hipotecario de la Vivienda. Private banks: Banco BAC San José; Scotiabank; Banco Promérica; Citibank; Banco Lafise; Banco Improsa; Banco BCT; Banco General; Banco Cathay; Banco de Soluciones; and Banco Davivienda (former Banco HSBC).
74. There is an 8% tax exemption on returns at maturity for holders of fixed-term dollar deposit certificates issued by public banks (WTO, 2007).

75. One company has been authorised but has yet to start operations upon fulfilment of final requirements. Data according to SUGESE's official website, updated to May 2013.
76. Law No. 8956 of 17 of June 2011.
77. Law for the Promotion of Competition and Effective Defence of Consumers (Ley de Promoción de la Competencia y Defensa Efectiva del Consumidor, Law No. 7472 of 20 December 1994).
78. The Commission is chaired by the Ministry of Economy, Industry and Commerce, and includes representatives from the Ministries of Health, Environment and Energy, and Agriculture, as well as from private chambers, unions and co-operatives.
79. The National Procedures Catalogue is available at [www.competitividad.go.cr](http://www.competitividad.go.cr) or [www.tramites.go.cr](http://www.tramites.go.cr). Some instructions can also be found at [www.meic.go.cr](http://www.meic.go.cr).
80. Available at: <http://costarica.eregulations.org>.
81. In the cases involving the two former presidents, Caja-Fischel and ICE-Alcatel, the Office of the Public Ethics Prosecutor demanded compensation for social harm. As an example, the French telecommunications company Alcatel settled to pay the government the amount of USD 10 million to compensate for the social damage caused by this case of corruption. For more information on this case, please refer to the summary on the World Bank Stolen Asset Recovery (StAR) Initiative website: <http://star.worldbank.org/corruption-cases/node/18453>.
82. The Inter-American Convention against Corruption was approved by Law No. 7670 of 17 April 1997.
83. The United Nations Convention against Corruption was approved by Law No. 8557 of 29 November 2006.
84. Chapter 18 Section B of CAFTA-DR.
85. Law No. 1581 of 30 May 1953, Law No. 6227 of 2 May 1978, Law No. 7428 of 7 September 1994, Law No. 7494 of 2 May 1995, Law No. 8292 of 31 July 2002, and Law No. 8422 of 6 October 2004.
86. Law No. 63 of 28 September 1887, Law No. 3284 of 20 April 1964.
87. Law No. 4573 of 4 May 1970, Law No. 7594 of 10 April 1996, Law No. 8131 of 18 September 2001.
88. The legality principle is protected by Article 11 of the Political Constitution, which establishes that public officials are simple depositaries of authority, and that they are obliged to comply with those duties established by law, without exercising powers that are beyond those that have been conceded. Under this principle, public officials are required to swear an oath of observance and compliance with the Constitution and legislation, and in case of breaches to this obligation, are subject to prosecution. The Public Administration (in general) and also public officials (individually) are subject to the evaluation of results and are accountable for their actions. Moreover, the latter are personally liable for the compliance of their duties.
89. Article 38, Law No. 7594 of 10 April 1996.
90. Article 8 of the Anti-Corruption Law No. 8422 of 6 October 2004 as amended by Law No. 8630 of 17 January 2008; Law No. 8720 of 4 March 2009 on the protection of victims, witnesses and other persons involved in criminal proceedings; Article 6 of the Law No. 8292 of 31 July 2002 on internal audit; Article 332 Law No. 4573 (Penal Code).

91. Bill of law No. 18348 proposes to include protection measures for public officials, complainants or witnesses providing evidence to the investigation or proceedings against acts of corruption, breaches to integrity, conflicts of interest or any other irregular activity regarding public funds.
92. The press has been active in exposing claims of corruption involving public officials. In many instances, media publications on corruption charges have resulted in the removal or resignation of the public official from its post.
93. [www.dhr.go.cr/transparencia.html](http://www.dhr.go.cr/transparencia.html). More than 40 public institutions participate in the Network.
94. The commissions propose recommendations on moral and political sanctions to the plenary for approval. Once approved, the competent authority decides whether to carry them out or not.
95. In 2011, it participated in external voluntary peer reviews of its planning and audit procedures carried out by the General Audit Office of Mexico and the Office of the Comptroller General of Chile.
96. [www.oecd.org/cleangovbiz/](http://www.oecd.org/cleangovbiz/).

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## Chapter 4

### **Costa Rica's adherence to the OECD Guidelines for Multinational Enterprises**

*This chapter reviews Costa Rica's public policies to promote responsible business conduct and the envisaged institutional arrangements for fulfilling its commitments as an adherent to the OECD Declaration on International Investment and Multinational Enterprises, in particular the Guidelines for Multinational Enterprises. The Guidelines are recommendations jointly addressed by governments to multinational enterprises. They aim to ensure that the operations of these enterprises are in harmony with government policies, to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to sustainable development made by multinational enterprises. The Guidelines are also supported by a unique implementation mechanism, the National Contact Points, designed to promote the effective use of the Guidelines and address issues that may arise from the non-observance of the Guidelines.*

*Upon adherence to the OECD Declaration, Costa Rica will establish its National Contact Point in the Ministry of Foreign Trade, which has led the process of Costa Rica's adherence to the OECD Declaration on International Investment and Multinational Enterprises and is aware of the related commitments. The authorities have committed to take into account in establishing the National Contact Point the recommendations and commentaries on the implementation procedures provided by the Guidelines so that it can operate efficiently and in accordance with the core criteria of visibility, accessibility, transparency and accountability.*

This chapter reviews Costa Rica's public policies to promote responsible business conduct (RBC) and the envisaged institutional arrangements for fulfilling its commitments as future adherent to the OECD *Declaration on International Investment and Multinational Enterprises*, in particular the *Guidelines for Multinational Enterprises*.

The *Guidelines*,<sup>1</sup> which form part of the *Declaration on International Investment and Multinational Enterprises*, are recommendations jointly addressed by adhering governments to multinational enterprises which operate in and from their territories in all major areas of business ethics. They provide principles and standards of good practice consistent with applicable law and internationally recognised standards. They aim to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the investment climate and enhance the contribution of investors. They are not aimed at introducing differences of treatment between domestic and foreign enterprises but reflect good practices for all. Adhering governments should not use them for protectionist purposes, nor use them in a way that calls into question the comparative advantage of any country where multinational enterprises invest.<sup>2</sup>

The *Guidelines* are also supported by a unique implementation mechanism, the National Contact Points (NCP), designed to promote the effective use of the *Guidelines* and address issues that may arise from the non-observance of the *Guidelines*.

First adopted in 1976, the *Guidelines* have been reviewed five times, and most recently in 2011 (Box 4.1). In this chapter, the policies instituted by Costa Rica in the areas covered by the *Guidelines* are examined. Environmental policies promoting RBC are analysed in Chapter 5 on the investment framework in support of green growth. Competition and tax policies are considered in Chapter 3 on Costa Rica's investment policy framework.

#### Box 4.1. **The OECD Guidelines for Multinational Enterprises and the 2011 update**

The *OECD Guidelines for Multinational Enterprises* are recommendations jointly addressed by governments to multinational enterprises. They aim to ensure that the operations of these enterprises are in harmony with government policies, to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to sustainable development made by multinational enterprises.

Following the update in May 2011, the *Guidelines* include new recommendations notably on human rights and a general principle on the need to exercise due diligence to avoid or mitigate negative impacts on third parties, notably with respect to the management of supply chains and other business relationships.

The recommendations of the *Guidelines* cover all major areas of corporate responsibility, namely:

- disclosure;
- human rights;
- employment and industrial relations;
- environment;
- combating bribery, bribe solicitation and extortion;
- consumer interests;
- science and technology;
- competition; and
- taxation.

The *Guidelines* comprise a distinctive implementation mechanism, the National Contact Points (NCP), which are government offices charged with advancing the *Guidelines* and handling enquiries in the national context and supporting mediation and conciliation procedures, called “specific instances”. The 2011 update has clarified and reinforced these procedures to strengthen the role of the NCPs and foster functional equivalence.

Source: OECD, <http://mneguidelines.oecd.org>.

## Establishment of a National Contact Point

Upon Costa Rica's adherence, the *Guidelines* will apply to foreign enterprises operating in the country as well as to Costa Rican enterprises investing abroad. Costa Rica also undertakes the commitment to set up a NCP in the country to further the effectiveness of the *Guidelines* by undertaking promotional activities, handling enquiries and contributing to the resolution of issues that arise relating to the implementation of the *Guidelines* in specific

instances, taking account of the procedural guidance. The business community, worker organisations, other non-governmental organisations and other interested parties shall be informed of the availability of such facilities.<sup>3</sup>

NCPs should be composed and organised so as to be able to operate in an impartial manner while maintaining an adequate level of accountability to the adhering government. Upon adherence to the *Declaration*, Costa Rica shall make available human and financial resources to their NCP so that they can effectively fulfil their responsibilities, taking into account internal budgetary priorities and practices.<sup>4</sup> The 2011 update has clarified and reinforced the implementations procedures, notably as regards the handling of specific instances, to strengthen the role of the NCPs and foster functional equivalence as provided by the *Implementation Procedures of the Guidelines*.

### **Costa Rica's National Contact Point**

Costa Rica will establish its National Contact Point (NCP) in the Ministry of Foreign Trade (COMEX). COMEX led the process of Costa Rica's adherence to the *OECD Declaration on International Investment and Multinational Enterprises* and is aware of the related commitments. The Ministry indicated it is well placed to host a visible, accessible, transparent and accountable NCP as it has the resources and network to make it effective. COMEX is the government agency responsible for trade and foreign investment policy, and has established strong links with representatives from other public entities and private sector chambers that participate in COMEX's Advisory Council. The Council is provided for by the law and serves to promote co-ordination and co-operation mechanisms between the public and the private sector regarding trade and investment policies and associated international negotiations.

As they will establish the NCP, the authorities are committed to take into account the recommendations and commentaries on the implementation procedures provided by the *Guidelines*. They indicated that the NCP will have a monopartite structure and may comprise an advisory board in the future. They have also indicated that the NCP will be staffed with one public official and will receive the necessary budget so that it can operate efficiently and in accordance with the core criteria of visibility, accessibility, transparency and accountability.

In order to carry promotional activities, handle inquiries, resolve issues, and perform all other functions necessary for an adequate implementation of the *Guidelines*, COMEX has set forth an initial programme of work for the NCP, which includes the following activities:

- A multichannel dissemination and promotion of the *Guidelines*. The NCP will engage with other entities that currently promote responsible business conduct, such as the National Consultative Council on Social Responsibility (CCNRS), Association of Enterprises for Development (AED) and the Local Network of the Global Compact to disseminate and promote the *Guidelines*.

It will also promote the *Guidelines* on COMEX's website, in social networks, public events and through the participation in other responsible business conduct events and activities.

- The establishment of procedures for the management of specific instances. The NCP will consult with experts, NGOs and business associations and co-ordinate with other public entities.
- The establishment of procedures to report periodically to the OECD Investment Committee on the activities of the NCP.

## General policies for promoting responsible business conduct in Costa Rica

According to the *Guidelines*, enterprises should take fully into account established policies in the countries in which they operate, and consider the views of other stakeholders.<sup>5</sup> Effective implementation of the *Guidelines* and a meaningful contribution of companies to economic, environmental and social progress require governments and business to work in partnership and in a framework of mutual trust in accordance with their respective rights and duties (Box 4.2). It is the government's primary role to provide an adequate regulatory framework in the areas covered by the *Guidelines*, and to provide incentives for companies to comply with this framework and build on it to further develop good business practices.

### Box 4.2. Working in partnership to implement the Guidelines for Multinational Enterprises

*"The common aim of the governments adhering to the Guidelines is to encourage the positive contributions that multinational enterprises can make to economic, environmental and social progress and to minimise the difficulties to which their various operations may give rise. In working towards this goal, governments find themselves in partnership with the many businesses, trade unions and other non-governmental organisations that are working in their own ways toward the same end.*

*Governments can help by providing effective domestic policy frameworks that include stable macroeconomic policy, non-discriminatory treatment of enterprises, appropriate regulation and prudential supervision, an impartial system of courts and law enforcement and efficient and honest public administration.*

*Governments can also help by maintaining and promoting appropriate standards and policies in support of sustainable development and by engaging in ongoing reforms to ensure that public sector activity is efficient and effective.*

*Governments adhering to the Guidelines are committed to continuous improvement of both domestic and international policies with a view to improving the welfare and living standards of all people."*

Source: OECD *Guidelines for Multinational Enterprises*, Preface, paragraph 9.

In addition to the recommendations encouraging enterprises to contribute to economic, environmental and social progress, to build local capacity and to uphold good corporate governance principles, the updated *Guidelines* address several new issues, notably aspects related to due diligence, supply chains and the role of Internet. In particular, enterprises are invited to carry out risk-based due diligence to identify, prevent and mitigate actual and potential adverse impacts on matters covered by the *Guidelines*.<sup>6</sup> They should avoid causing such adverse impacts through their own activities and when they are directly linked to their operations, products and services by a business relationship.<sup>7</sup>

Costa Rica has taken a series of initiatives to promote responsible business conduct, but has not yet developed a comprehensive national strategy on the issue. One of the areas where the implementation of RBC policies led to significant results is the protection of environment (Chapter 5).<sup>8</sup> Today the country is considered a model of effective environmental policies. The ecotourism industry is also adopting RBC standards in relation to environmental protection, responsible consumption and community development.

The government is conducting several RBC initiatives in topics covered by the *Guidelines*. It supported the creation in 2008 of the National Consultative Council on Social Responsibility (*Consejo Consultivo Nacional de Responsabilidad Social*, CCNRS), a multi-stakeholder alliance of public and private entities providing support and guidance for the discussion, validation, implementation and monitoring of national measures promoting corporate social responsibility. The CCNRS's working plan for 2010-15 covers the following topics: employment for youth, eradication of child labour, prevention of sexual exploitation of children and youth, promotion of equality and gender equity, promotion of job placement, and rights of people with disabilities, indigenous people, immigrants and other vulnerable populations.

The government is also co-operating with the Association of Enterprises for Development (*Asociación Empresarial para el Desarrollo*, AED) to promote specific themes of corporate social responsibility (Box 4.3). The partnership with AED led to initiatives to promote gender equality and inclusive business networks, eco-efficiency and sustainable environmental practices, and to encourage the promotion of RBC practices in SMEs. The authorities are also relying on advisory councils to ensure regular consultations with the private sector on thematic issues. For example, the Higher Labour Council, hosted in the Ministry of Labour and Social Security, is a tripartite advisory body (chambers of commerce, government and trade unions) which carries consultations on labour and socio-productive issues and seeks to strengthen the social dialogue. The Foreign Trade Advisory Council, composed of public institutions and business associations, discusses foreign trade and investment policies with a view to ensure their implementation and co-ordination.

**Box 4.3. Association of Enterprises for Development  
(Asociación Empresarial para el Desarrollo, AED)**

Founded in 1997, AED is a membership-based non-profit organisation dedicated to the promotion of corporate social responsibility and corporate philanthropy through the development of guidance and tools, capacity building and knowledge-sharing. AED actively builds alliances with different sectors to develop programmes in priority areas for the competitiveness and sustainable development of Costa Rica.

As of April 2013, 120 public and private companies, including MNEs, were members of the association. AED is also the Costa Rican chapter for the World Business Council for Sustainable Development, United Way Worldwide and UN Global Compact Network. It also part of the Central American Network for Corporate Social Responsibility (*Integración Centroamericana por la Responsabilidad Social Empresarial, INTEGRARSE*).

Besides being involved in a broad range of CSR initiatives in Costa Rica, for instance in gender equality, eco-efficiency and inclusive businesses, AED assists companies integrate CSR into their business strategies through a CSR model developed in co-operation with INCAE Business School. The model serves as tool for companies to review their management practices according to seven pillars: governance, employees, environment, suppliers, clients, community and public policies. In addition, AED has developed a tool (INDICARSE) to assist companies to benchmark themselves against international CSR standards.

Source: AED's website: [www.aedcr.com](http://www.aedcr.com).

The government included strategic actions for the labour sector within the National Development Plan 2010-14. The aim is to strengthen the culture of compliance with labour obligations within the private sector through informational campaigns and public-private alliances. To that aim, the Ministry of Labour and Social Security launched initiatives in co-operation with private sector representatives.<sup>9</sup> More recently, the government improved the corporate governance framework in Costa Rica with the issuance in 2009 of a Corporate Governance Code by the National Council of Supervision of the Financial System (*Consejo Nacional de Supervisión del Sistema Financiero, CONASSIF*) amended in 2013 (Section on Disclosure). In addition, most of the recent free trade agreements signed by Costa Rica contain environmental and labour provisions.

Besides government-supported activities, business associations and civil society organisations in Costa Rica are active in mobilising resources for promoting corporate social responsibility (CSR). Examples of private sector

initiatives include the Business Performance Excellence Award granted since 1997 to leading firms complying with certain criteria on social responsibility, and the dissemination of guidelines and the provision of advisory services on how to integrate CSR practices into businesses by a number of private institutions and chambers of commerce, such as the Centre for Corporate Social Responsibility of Costa Rica's Chamber of Commerce and the Costa Rican-American Chamber of Commerce (AMCHAM).

The Costa Rican Institute for Technical Norms (*Instituto de Normas Técnicas de Costa Rica*, INTECO)<sup>10</sup> and the Chamber of Industries of Costa Rica published a technical guideline for the implementation of ISO 26000 approved by ISO at the end of 2012. The document provides a definition of social responsibility and for advice to integrate related principles in companies' operations. It sets the specific requirements of a Social Responsibility Management System. INTECO is working jointly with AED on a pilot project to assist companies and train them on how to implement it.

In 2010 the Costa Rica Local Network of the United Nations Global Compact<sup>11</sup> was launched. The local network was established with the support of CCNRS, UNDP Costa Rica, the Global Compact Regional Support Centre for Latin America and the Caribbean, and Intel. As of April 2013, there were 24 participants, including public entities, companies, academia, and civil society organisations. Members of the local network issue an annual public report (Communication on Progress) to stakeholders on progress made in implementing the ten principles of the United Nations Global Compact and in supporting broad United Nations Millennium Development Goals.

In conclusion, the government carries out various activities in co-operation with the private sector to promote responsible business conduct, ensures consultations with business representatives in the definition of policies and in the law making process, and has engaged into international initiatives (e.g. ratification of conventions covering RBC areas and FTAs with environmental and labour provisions). However, it has not yet developed a comprehensive national strategy and still has a fragmented approach. The *OECD Guidelines for Multinational Enterprises* could serve as a tool to further promote and structure RBC policies in Costa Rica.

The Costa Rican authorities have been invited to consider the opportunity to adhere to the *OECD Recommendation on Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*. As a companion instrument of the *Guidelines*, the *Due Diligence Guidance* promotes responsible business in global value chains in the extractive industry.

## Costa Rica's policies in specific areas covered by the Guidelines

In addition to general recommendations to improve corporate responsibility and strengthen the contribution of enterprises to sustainable development, the *Guidelines* include a set of voluntary recommendations in all of the major areas of responsible business conduct. Costa Rica's policies addressing such issues are presented in the following sections.

### Disclosure

The *Guidelines* chapter on disclosure recommends that enterprises disclose timely and accurate information on all material matters regarding their activities, structure, financial situation, performance, ownership and governance and carry out annual audits by an independent, competent and qualified auditor. Enterprises are further encouraged to communicate additional information on social, environmental and risk matters, such as value statements; codes of conduct; information on internal audit, risk management and legal compliance systems. The chapter also recommends that enterprises apply high quality standards for accounting and financial and non-financial disclosure.

Costa Rica has enacted comprehensive legislation and regulations on the disclosure of information. Legal entities are required to comply with disclosure rules provided in the Commercial Code, which establishes minimum standards on disclosure of financial information and requires companies to register any modifications to its bylaws and in the board of directors. The Commercial Code also contains minimum standards on access to relevant information of the company by minority shareholders, with restrictions in the case of strategic or confidential information. For instance, minority shareholders may, in certain circumstances, call for a shareholders meeting to discuss specific matters of their interest (Articles 159-161); prior to and during shareholders meetings, the management must grant shareholders access to all relevant information, with certain exceptions having to do with strategic or confidential information (Article 173); shareholders who vote against a majority resolution may file for judicial review, following certain rules (Articles 176-180).

Although elements of corporate governance are observed in some legislative texts, such as the Commercial Code, corporate governance is a relatively new topic in the country. At the end of 2004, following the crisis of the mutual funds industry, the National Council of Supervision of the Financial System (*Consejo Nacional de Supervisión del Sistema Financiero*, CONASSIF) introduced some corporate governance measures in the external auditing regulation, such as the need to establish audit committees. However, up to 2006, the issue received only minor attention by corporations and public authorities (IGCLA, 2011). The selection of Atlas Eléctrica SA in 2006 to be part of the Companies Circle, a selective group of companies identified to be

leaders in corporate governance issues in Latin America, has contributed to raise attention to the issue of corporate governance in the country. The Companies Circle initiative was launched in 2005 at the Latin American Corporate Governance Roundtable and seeks to disseminate the benefits of implementing higher corporate governance standards in Latin America. The initiative receives the support from the OECD, the International Finance Corporation (IFC) and the Global Corporate Governance Forum.

Building on this initiative, the Costa Rican Stock Exchange adopted in 2007 a voluntary Corporate Governance Code. Companies adopting this code are required to report on the basis of the “comply or explain” principle. Then in June 2009, CONASSIF issued the Regulation No. 16-09 establishing a Corporate Governance Code, which provides for the disclosure of non-financial information. The Regulation requires all supervised enterprises and financial institutions to adopt the Corporate Governance Code and set the rules and principles of corporate governance with which they must comply. It has been amended in April 2013 and covers a broad range of topics relating to corporate governance, including the functioning of the board of directors, conflicts of interest, relationships with clients and suppliers, treatment of shareholders, disclosure of and access to information, internal auditors and other related matters. While financial listed companies have to apply the CONASSIF Regulation, the non-financial listed companies have the choice of adopting either the Stock Exchange Code or the CONASSIF Corporate Governance Code. The Costa Rican Central Bank has its own code of corporate governance enacted in December 2011, which is based on the OECD *Principles of Corporate Governance for Public Enterprises*.

For the financial sector and listed companies, further disclosure requirements have been introduced by CONASSIF, which regulates and supervises the financial system through its four sector-specific agencies (SUGEF for financial institutions, SUGESE for insurance, SUPEN for pensions and SUGEVAL for the securities market and its participants). These regulations address the rules for the hiring of external auditors,<sup>12</sup> for periodical disclosure of information of relevant facts,<sup>13</sup> and for policies to prevent the improper use of privileged information and on the public offer of securities.<sup>14</sup>

Rules for financial disclosure are provided for in the Law Regulating the Securities Market,<sup>15</sup> which also contains provisions on the prevention of conflicts of interests (Articles 101 to 114). Financial institutions must also comply with specific regulations on the procedures to submit financial information to regulators and to publish it.<sup>16</sup> The registry of economic transactions should also comply with the Conceptual Framework for the preparation and presentation of financial statements based on the International Financial Reporting Standards (IFRS).

Costa Rica has implemented reforms to establish disclosure requirements and issued the CONASSIF corporate governance code for the disclosure of non-financial information of supervised entities and financial institutions. However, in comparison to other Latin American economies in terms of the strength of disclosure requirements as measured by the World Bank 2013 *Doing Business Disclosure Index*,<sup>17</sup> Costa Rica is below the average. While the average score on the extent of disclosure index for Latin America and the Caribbean is 4 and for OECD countries is 6, the score for Costa Rica is 2. On the aggregate indicator determining the strength of minority shareholder protection, Costa Rica ranks 169 out of 185 economies. In the 2013 *Doing Business*, the World Bank recommended improvements to the disclosure framework to increase the transparency of potential conflict of interests and the protection of minority shareholders. Based on these recommendations, the Corporate Governance Code was amended in April 2013 in order to enhance access to information, increase transparency of potential conflict of interests and the protection for minority shareholders, taking into account international standard practices. This adds to the existing regulations which directly contain provisions to avoid conflict of interests<sup>18</sup> and is expected to improve Costa Rica's ranking for the next evaluation.

### **Human rights**

The new *Guidelines* chapter on human rights aligns with the United Nations Framework for Business and Human Rights and is in line with the Guiding Principles for its Implementation. It establishes that in every country in which they operate, enterprises have the responsibility to respect human rights, which means exercising due diligence to avoid infringing on the human rights of others and addressing such impacts when they occur, i.e. providing for, or co-operating in, the remediation of adverse human rights impacts they have caused or to which they have contributed. The due diligence process should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed.

In Costa Rica, civil and political rights are embodied in the 1949 Political Constitution. Historically, the country is a precursor in Latin America in the recognition of fundamental human rights, as the Constitution comprises many rights that were not common in Latin American constitutions until the 1980s (Coll, 2011). For instance, Costa Rica's Constitution incorporates right of association, which provides for due process guarantees and grants free access to government departments for purposes of information on matters of public interest. Domestic legislation also grants protection of fundamental rights, recognises principles derived from international human rights instruments and covers specific populations. This legal framework includes,

among others, the Code of Childhood and Adolescence,<sup>19</sup> the Law on Women Equality,<sup>20</sup> Law for the Penalisation of Violence against Women,<sup>21</sup> Law for the Strengthening of the Fight against Sexual Exploitation of Underaged Persons,<sup>22</sup> Indigenous Law,<sup>23</sup> Law of Equal Opportunities for Persons with Disabilities,<sup>24</sup> Law for the Elderly,<sup>25</sup> General Law on HIV-AIDS<sup>26</sup> and General Law on Immigration.<sup>27</sup> These laws have been complemented by decrees and regulations.

Costa Rica has adhered to most of the human rights and humanitarian international instruments. The country is a signatory of International Covenants on Civil and Political Rights and on Economic, Social and Cultural Rights (1968), and of the American Convention on Human Rights (1970). It has also adopted all but one of the main United Nations human rights instruments.<sup>28</sup> The country has also ratified the core conventions of the ILO and has become on February 2012 the first American country to be State Party to every international humanitarian law convention and related conventions. Costa Rica has played an active role in drafting the 1970 American Convention on Human Rights (the San José Pact) and was also the first country to accept the binding jurisdiction of the Inter-American Court of Human Rights, headquartered in San José.

The Constitutional Chamber<sup>29</sup> has established that international human rights instruments, including labour rights, have a supra-constitutional value and hence take precedence over the Constitution itself, provided they encompass wider individual rights or guarantees. Any domestic law or practice contrary to such instruments is automatically considered to be without effect from the moment it enters into force; any law or measure subsequently adopted that is contrary to their provisions is absolutely null and void. All available judicial and administrative recourses may be used to remedy violations of international human rights instruments. The Constitutional Chamber is the authority responsible for constitutional control and for securing the enforcement of the fundamental rights established in the constitution or any other international instrument to which Costa Rica is a party. There is also an Inter-Institutional Commission responsible for following up and ensuring adequate implementation of international obligations on human rights. The commission is formed by 21 representatives from ministries, Congress, judicial branch, the Supreme Electoral Tribunal and autonomous institutions.

In 1992, Costa Rica established the Ombudsman Office (*Defensoría de los Habitantes de la República*), which is the national human rights institution responsible for defending human rights of nationals and immigrants against state actions or omissions, channelling civil society's claims in the relation to the public sector and protecting community interests. Although attached to the legislative power, by law the Ombudsman Office enjoys political and

operational independence. It has addressed complaints and investigations on a wide range of subjects in recent years, including the prison system, the health system and the situation of indigenous population. In 2006, the Special Legislative Commission on Human Rights was created to study and report cases involving alleged human rights violations and to follow up on the recommendations of the Ombudsman Office and related bodies. Costa Rica has also established public bodies that monitor and promote human rights related to specific populations and topics.<sup>30</sup>

Complementary to the legal and institutional framework, the government has established policy co-ordination mechanisms to ensure the protection of core human and labour rights, with particular attention placed on the issue of child labour. Several legislative actions on the employment of children, on the prohibition of dangerous and unhealthy work for young people, and the implementation of the Second National Plan for the Adolescent and Child Labour have been launched. Other initiatives focus on ensuring equal opportunity and non-discrimination against workers and on ensuring freedom of association, collective bargaining and strike (Section on Employment relations).

While some policy areas related to human rights have seen considerable improvement, for instance in the case of child labour,<sup>31</sup> others need further attention. One recent case related to the rights of indigenous people has drawn the attention of the government to the need of promoting an adequate consultation process with interested parties before allowing or implementing projects that have an impact on their lives. The report on the *El Diquis* hydroelectric project, prepared by the Special Rapporteur to the United Nations Human Rights Council, notes that the indigenous population living in the area affected by the project had not been adequately consulted (United Nations, 2011). To remedy this deficiency, the government has set up a permanent dialogue table with representatives of the concerned indigenous communities, carried out with the support of the UN Resident Co-ordinator and with the participation of the Costa Rican Ombudsman as observer. Based on this experience, the government is now seeking to review its policies and incorporate consultations with local communities as an institutional mechanism prior to any private or public projects. The UN Special Rapporteur on the Rights of Indigenous People has recognised the government's efforts, which were particularly brought to light by the measure setting up a consultation process for the *El Diquis* project that conforms to international human rights standards and which sets a good example for other countries (Anaya, 2012).

The government is also working to strengthen the institutional framework and implementation of policies to prevent and prosecute the trafficking of persons and forced labour. The US Department of State (2012a) recognises the significant efforts conducted, but highlights that implementation has to be

strengthened for the country to fully comply with minimum standards for the elimination of trafficking. The report notes that enforcement of the 2009 Anti-trafficking Law remains weak and requires attention by the public authorities. Likewise, the report notes that sexual exploitation of children remains a serious concern in the country. To address these problems, a new Law against Trafficking of Persons was enacted in early 2013.<sup>32</sup> It increases prison sentences, establishes the National Coalition against Human Trafficking as a permanent body with financial resources, and creates the National Fund against Trafficking of Persons (*Fondo Nacional contra la Trata de Personas y el Tráfico Ilícito de Migrantes*, FONATT). The coalition is responsible for promoting the development, implementation, monitoring and evaluation of public policies that prevent and prosecute the smuggling and trafficking of persons and ensure the care and protection of victims.

In conclusion, the government has set in place a comprehensive legislative and institutional framework for human rights protection and continues to improve it based on international reports and recommendations. It has ratified all major related international conventions and seeks to improve monitoring, development and implementation of human rights instruments and policies. Efforts are ongoing in the implementation of a consultation process with indigenous people for any public and private projects. The *OECD Guidelines* will encourage the government to enhance foreign enterprises' responsibility to respect human rights, to monitor infringements and to seek for their remediation.

### **Employment and industrial relations**

Under the *Guidelines* chapter on employment and industrial relations, several recommendations echo the ILO Declarations on MNE and on Fundamental Principles and Rights at Work and related core ILO Conventions. Enterprises should respect basic labour rights, such as equal and non-discriminatory treatment; the elimination of child labour and forced or compulsory labour; workers' rights to join trade unions and representative organisations of their own choosing, and to have workers' representatives engage in collective bargaining. Enterprises should also promote consultation and co-operation between employers and workers, pay the best possible wage that should be at least adequate to satisfy the basic needs of the workers and their families, and ensure adequate health and safety conditions in their operations. Further recommendations are to employ local workers and provide training and to mitigate to the maximum effect possible adverse employment effects linked to changes in their operations.

In Costa Rica, core labour rights are guaranteed in the Constitution (Articles 56 to 74), including the right to minimum wage and labour hours,<sup>33</sup> the right to organise and constitute unions,<sup>34</sup> the right to collective bargaining,

the right to strike, the right to social security, the right to health and safety of workers, the right to prior notice of dismissal, the right to severance payment, the right to non-discrimination, the right to child and youth labour protection as well as the prohibition of forced labour. These rights are also governed by the 1943 Labour Code, which establishes the general rules concerning labour relationships.

The country has ratified all the eight fundamental conventions of the International Labour Organization (ILO)<sup>35</sup>. It has also signed 38 out of the 177 technical ILO conventions<sup>36</sup> and is an adherent to the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policies.

Several trade agreements signed recently by Costa Rica incorporate labour standards provisions. The Central America-Dominican Republic-United States FTA (CAFTA-DR), entered into force in Costa Rica in 2009, provides for very comprehensive provisions and can be set as an example in this regard. In Chapter 16 on labour, the parties reaffirm their obligations as members of the ILO and their commitments under its instruments. They recognise that it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in domestic labour laws. They commit to afford guarantees that ensure workers and employers have access to fair, equitable, and transparent procedures in the enforcement of labour laws. To this end, each Party must ensure that workers and employers have access to tribunals for the enforcement of its labour laws. Public awareness on labour laws should be promoted. The Agreement provides for co-operative consultations if a Party believes that another Party is not complying with the Chapter's obligations and offers the possibility to refer the matter to a dispute settlement panel. A Labour Affairs Council, comprising cabinet-level representatives of the Parties, shall be established to oversee the Chapter's implementation and to provide a forum for consultations and co-operation on labour matters. Each party is required to designate a contact point. A Labour Co-operation and Capacity Building Mechanism should help countries to strengthen their institutional capacity to fulfil the established goals.<sup>37</sup> The Association Agreement with the European Union signed in 2012 contains similar provisions under its Title VIII on Trade and Sustainable Development, which deals with both environmental and labour issues. It set up institutional and monitoring mechanisms (countries' contact points, Board on Trade and Sustainable Development, advisory groups, civil society dialogue platform, and government consultations with panel of experts to resolve issues).

The Ministry of Labour and Social Security (*Ministerio de Trabajo y Seguridad Social*, MTSS) is the responsible government agency for co-ordinating and promoting the application of the ILO Principles on MNEs and Social Policies in national policies and regulations, besides being the responsible ministry for supervising the development, improvement and enforcement of

labour legislation. International co-operation on labour issues, such as ILO activities, is carried out by the Office for International Labour Affairs within MTSS. This Office is also the designated national contact point for labour affairs under the CAFTA-DR and is co-operating with its treaty partners on promoting responsible business conduct.

Costa Rica is amending its labour proceedings with the intention to improve the enforcement of fundamental conventions related to freedom of association, union rights and collective bargaining and to reduce the judiciary backlog. A bill<sup>38</sup> was drafted with the participation of the MTSS, employer and union representatives. It proposes amendments, such as the establishment of an autonomous judicial process with streamlined procedures to reduce length of trials; the introduction of oral proceedings, the regulation of collective bargaining and strikes, in particular in the public sector. The bill was approved by Congress in September 2012, but a presidential partial veto was exercised in October 2012 on the issues of strikes in essential services and prohibition of hiring temporary staff to replace strikers. Once adopted, this reform will have direct effect on the effective protection of workers' rights.

Costa Rica is a particular country in terms of employer-employee relations. In addition to trade unions, the country has authorised solidarity associations (the so-called *solidaristas*) under the 1984 Law of Solidarity Associations. In 2011 a new law<sup>39</sup> gave solidarity associations constitutional recognition comparable to that afforded to labour unions by recognising the right of workers and employers to organise freely in solidarity associations.

Solidarity associations are a different form of worker association than unions. They represent workers within a single company and provide for negotiations, but they are not allowed to undertake union functions or represent workers in collective bargaining and direct settlements. Solidarity associations also operate as credit unions, offering subsidised credit, housing loans, health and savings plans for their members. The Costa Rican legal system allows worker unions and solidarity associations to coexist within an enterprise, and workers are free to become a member of both organisations.

In terms of mandates, solidarity associations can be complementary to unions as they contribute to improving working and living conditions of a company's employees, though they do not get involved in core labour rights and employment relations discussions with the company's management. Their focus is to enhance the employee-employer relations and promote the dialogue between management and workers. The culture of *solidarismo* is deeply embedded in Costa Rican companies.

Unions and solidarity associations compete for membership and funding. The solidarity associations have a competitive advantage as they are partially funded by monthly contributions by the company and by deductions

in workers' wage offer. They also offer workers the possibility of recovering their contributions and those of the employer once they leave the company. Funds are managed by a board of directors appointed by the workers assembly and are returned with interest to workers upon leaving the company regardless of the reasons for departure. In reality, the contributions to solidarity associations are equivalent to a savings account, while contributions to unions are not directly recoverable and serve different purposes.

Solidarity associations have grown in number in the past decade while trade union membership has declined during the same period, particularly in the private sector. According to CINDE (2011), around 97% of private sector companies have a solidarity association. The Solidarity Movement of Costa Rica estimates that more than 500 000 workers or roughly 22% of the workforce are affiliated to more than 1 500 solidarity associations. Labour unions are mainly concentrated in the public sector and union membership would represent less than 3% of the workforce (ITUC, 2012).

According to the government and the Solidarity Movement of Costa Rica, solidarity associations have prompted constructive relationships between employers and employees and promoted the habit of savings among employees, providing an additional source of financial resources to workers. As employees are free to engage in solidarity associations or unions, these institutions have played a complementary role in strengthening labour organisation and conditions for workers. This practice led to a good ranking in terms of labour-employer relations in the WEF 2012-13 *Global Competitiveness Report*, which placed Costa Rica first in Latin America and 13th in the world for this indicator (WEF, 2012).

However, there are also indications that the prevalence of solidarity associations has lessened the role of trade unions in protecting workers' rights. A report by the International Trade Union Confederation (ITUC, 2012) highlights that there is an imbalance between the low number of collective agreements and the number of direct arrangements with non-unionised workers in the private sector. The report estimates that there are only 13 collective agreements in the country against 74 direct arrangements. Data from the MTSS provided by the authorities confirm this imbalance even though collective bargaining has a privileged protection for its constitutional status under Costa Rican legal framework. In 2012, it estimated that there were 16 private sector collective agreements against 125 direct arrangements.

The US Department of State (2012b) reports that unions allege that private business use solidarity associations to hinder union organisation. ILO (2009) also reports that unionisation is practically inexistent in free zones and in the commercial, hotel and restaurant sectors. Together with the rise of the solidarity associations, the International Trade Union Confederation (ITUC,

2012) report points out that deficiency, particularly slowness, in legal procedures related to anti-union actions has also discouraged the formation of workers unions and diminished their penetration. ILO (2009) recognises that direct arrangements might pose a threat to collective bargaining and the formation of unions. While the issue of slowness in judicial procedures in the event of anti-union actions is being partially addressed by the Bill No. 15990 mentioned earlier, the issue of imbalance between collective agreements and direct arrangements persists.

The government is nevertheless conducting efforts to enhance the understanding of collective agreements by workers in all economic sectors to enable them to take informed decisions when becoming a member of a worker association. The government seeks to promote an environment for balanced negotiations between employers and workers, without privileging unions or solidarity associations, through promotional and dissemination activities to showcase the benefits of collective agreements. MTSS is committed to facilitate collective bargaining in the country and mechanisms have been implemented to prevent and address possible violations to union freedom.<sup>40</sup>

The authorities have implemented measures to address unemployment issues and the promotion and enforcement of minimum labour standards. In partnership with the private sector, notably through AED, the government (MTSS) launched the EMPLATE initiative in 2011 to generate employment and training opportunities for unemployed young adults in condition of poverty or social risk. Those aged between 17 and 24 years represents roughly 17% of the unemployed population. A national programme was also launched in 2012 to support the development of decent work in line with the ILO Decent Work Agenda. The National Programme for Decent Work is structured around four priorities: i) the enforcement of labour regulation by raising awareness of labour rights and building capacity to support employer-worker relations; ii) the promotion of a national employment plan, particularly to reduce informality and enhance the employability of the young population through technical and professional training; iii) the strengthening of the social protection system; and iv) the enhancement of dialogue between government, workers and employers with the objective of designing better strategies for social development.

In the context of Costa Rica's efforts to achieve the Millennium Development Goals, MTSS has established a national plan to foster the employment of the disabled population through capacity-building activities to facilitate their insertion in the working environment. The plan was developed in partnership with the UNDP and completed in September 2012. The plan complements the National Policy on Disability Issues 2011-20 that seeks to promote the rights of the disabled population in the country.

The government has also launched the Businesses for Gender Equality initiative through the National Institute for Women (*Instituto Nacional de las Mujeres*, INAMU) to address the issue of gender inequality in the work environment and the increase in the unemployment rate of women in relation to men.<sup>41</sup> This initiative consists of programmes to support and protect labour rights of women in business and provide companies with tools and guidance to obtain the SIGEG certification (Labour Certification System in Equality and Gender Equity, *Sistema de Gestión de Equidad de Género*). Costa Rica is a pioneer in Latin America in promoting such a certification programme for both public and private organisations (Box 4.4).

**Box 4.4. The Labour Certification System in Equality and Gender Equity (SIGEG)**

SIGEG is a national voluntary certification granted to organisations and companies that fulfill certain criteria and comply with the requirements established therein. SIGEG criteria are based on ISO standards and include:

- Human resource management: consisting of post incumbency, career promotion, staff training, and performance evaluation.
- Integral health: covering sexual and reproductive health, occupational health.
- Work and family responsibility: including childcare and parental leave.

The organisation or company that decides to obtain a SIGEG certification is evaluated by a third party auditor on equality and gender equity conditions and compliance with the requirements of the certification.

Several multinational companies and local banks have participated in SIGEG and have implemented measures such as training on gender, sexuality, creating newsletters on gender and equity, or adapted practices and infrastructure for women.

These efforts are expected to contribute to reduce the issue of gender inequality in the business environment. A survey of 538 companies in Costa Rica conducted by the World Bank (2010) indicates that women continue to be underrepresented in the workforce and in the ownership of large companies in comparison to the world average and to the average of Latin America and the Caribbean countries. This gap is particularly evident in the proportion of women in full-time non-production positions. In the case of SMEs, however, Costa Rica is close to the average of countries in these regions.

To the extent that labour rights are protected, the government should reassess its labour policies to check if they continue to meet objectives (Chapter 3, Section on Human resources development). Balancing labour regulations and

social protection is also necessary to curb the rise in informality in the country. According to the 2011 Statistic Census carried out by the National Institute of Statistics and Censuses (*Instituto Nacional de Estadística y Censos*, INEC), informality and low quality employment in Costa Rica affects roughly 30% of the labour force.

In conclusion, Costa Rica is conducting efforts to improve its legislation, in particular on labour proceedings to improve enforcement of international conventions related to association's rights and collective bargaining. It developed a specific system of employers-employee relations and innovative initiatives, such as the SIGEG certification (Labour Certification System in Equality and Gender Equity). Government's efforts should continue to ensure that the recommendations of the *Guidelines* on employment relations be further applied by companies.

### **Environment**

The environment chapter of the *Guidelines for Multinational Enterprises* recommends that enterprises should take due account of the need to protect the environment, public health and safety, and generally to conduct their activities in a manner contributing to the wider goal of sustainable development. In particular, enterprises should establish and maintain a system of environmental management; provide information on the potential environment, health and safety impacts of the activities of the enterprise and of their products; and assess and address the foreseeable environmental, health, and safety-related impacts associated with the enterprise's activities. The *Guidelines* also recommend that enterprises continually seek to improve their environmental performance, and where appropriate, of their supply chain; provide adequate education and training to workers in environmental health and safety matters; and contribute to the development of environmentally meaningful and economically efficient public policy.

Costa Rica's measures to promote and support the adoption of environmental standards and management practices by enterprises in the country are developed in Chapter 5. These measures include among others special programmes to promote environmental responsible business conduct in agricultural production and in the tourism sector; to foster research and technology development in clean energy; to promote the adoption of the clean production mechanism and green certifications and initiatives in the area of carbon neutrality and reforestation.

### **Combating bribery, bribe solicitation and extortion**

The *Guidelines* chapter on combating bribery, bribe solicitation and extortion recommends that enterprises should not offer, promise, give, or demand a bribe or other undue advantage to obtain or retain business or other

improper advantage. The chapter covers bribe solicitation and extortion, and third parties such as agents and other intermediaries, representatives, distributors, consortia, contractors and suppliers. It also now includes the obligations for enterprises to develop and adopt adequate internal controls, ethics and compliance programmes or measures for preventing and detecting bribery. The *Guidelines* recommend that enterprises promote employee awareness of and compliance with company policies and measures against bribery, and that they refrain from making illegal contributions to candidates for public office or to political parties or to other political organisations.

The section on anti-corruption in Chapter 3 describes the legal and institutional framework to fight against corruption. Costa Rica established a legal framework to fight corruption in the public sector and ratified two major international anti-corruption conventions (the United Nations and the Inter-American Conventions against Corruption). Recent cases of corruption involved high-profile politicians. Two of such cases concerned bribes allegedly paid by foreign companies doing business with state-owned firms.<sup>42</sup> The respective former presidents were convicted,<sup>43</sup> but sentences were either overturned or reduced by the court of appeal.<sup>44</sup> Other cases of alleged corruption involving members of the current administration were also highlighted by the media.<sup>45</sup> This shows that corruption cases involving public officials are increasingly under scrutiny in Costa Rica which has in parallel improved its institutional and legal framework to fight against corruption. Overall, the country ranks relatively well in the 2012 Transparency International Corruption Perceptions Index, particularly compared to other countries in the region. It ranks in the 48th position out of 176 countries included in the Index.

The Free Trade Agreement between Central America, the Dominican Republic and the United States (CAFTA-DR) which entered into force in Costa Rica in 2009, contains a chapter on transparency and anti-corruption. In Chapter 18, parties affirm their determination to eliminate bribery and corruption in international trade and investment. Costa Rica introduced amendments to its legal system to fully comply with the agreement's requirements regarding the criminalisation of corruption activities conducted by public officials, corruptors and instigators, the adoption of effective, dissuasive and proportionate non-criminal sanctions in the absence of criminal liability of legal entities, and the enactment of provisions to protect individuals reporting acts of corruption or bribery. These amendments also responded to pressures arising from cases of corruption and bribery involving former heads of state and other high-level politicians.

In the report issued in 2009 under the Mechanism for Follow-up on the Implementation of the Inter-American Convention against Corruption (MESICIC), it is recommended that Costa Rica strengthens the standards for the prevention of bribery of domestic and foreign government officials.

Specific measures include mechanisms to safeguard the accuracy of accounting records to help detect amounts paid for corruption, awareness and integrity promotion campaigns targeting the private sector, and production of manuals and guidelines for companies on best practices that should be implemented to prevent corruption (OAS, 2009). The 2013 MESICIC Report noted improvements in the anti-corruption system of Costa Rica, but still recommends implementation of laws and regulatory systems related to conflicts of interest, mechanisms to support access to public information and the provisions of adequate resources to the oversight bodies (OAS, 2013).

The Costa Rican authorities recognise that moving forward in combating corruption will require additional efforts in addressing corruption in business. The country has no particular strategy in this area and the existing instruments would need to be improved.

In conclusion, notable efforts are conducted in Costa Rica to fight corruption in the public sector. Nonetheless, the country still has to improve its legislation, strengthen the prevention standards, foster enforcement of the laws and regulations, better address corruption in business and encourage enterprise policies and measures to fight bribery.

### **Consumer interests**

The chapter on consumer interests recommends that enterprises act in accordance with fair business, marketing and advertising practices and take all reasonable steps to ensure the quality and reliability of the goods and services they provide. Enterprises should co-operate fully with public authorities to prevent and combat deceptive marketing practices and to diminish or prevent serious threats to public health and safety or to the environment deriving from the consumption, use or disposal of their goods and services. The *Guidelines* put specific emphasis on promoting consumer education by enterprises in areas that relate to their business activities to help consumers make informed decisions, better understand the economic and social impact of their decisions and support sustainable consumption.

In Costa Rica, fundamental consumer rights are protected by Article 46 of the Constitution, which also guarantees that any bodies established for the defence of such rights shall be supported by the state. The legal framework for consumer protection is further developed with the 1994 Law on the Promotion of Competition and Effective Consumer Protection. Provisions introduced by the law facilitate the access to the judicial system for protecting rights and encourages the enforcement of consumer interests in the country. Costa Rica also has some sector-specific regulations related to consumer rights. In the case of financial services, Costa Rica has specific regulations on the disclosure of information and on the advertisement of financial products and the

compliance of which is monitored by the General Superintendence of Financial Entities (SUGEF). In the case of public services, the Regulatory Authority of Public Services (ARESEP) is responsible for regulating prices of public services and protecting its users.

The country's legislation incorporates all the consumer rights stipulated in the UN Guidelines on Consumer Protection, but their degree of adoption by the domestic legislation is uneven, with a few rights being fully adopted and others requiring further attention. According to CONCADECO (*Consejo Centroamericano de protección al Consumidor*, 2008), three rights deserved further attention from the Costa Rican government: education and information programmes; promotion of sustainable consumption; and other measures relating to specific areas (food, water and pharmaceuticals). The need for further education and information programmes on consumer rights might be associated with the reduced number of civil society organisations addressing such issues in the country. Worldwide the civil society has played an important complementary role in raising awareness to consumer rights and conducting educational campaigns, monitoring government policy and promoting the effective defence of consumer rights. In Costa Rica, Consumers of Costa Rica (*Consumidores de Costa Rica*, CONCORI) is the main association on consumer protection. The association organises a range of consumer activism initiatives. It also participates in several industry-wise technical committees created by the government for advancing technical regulations to monitor and promote consumer interests in these spheres. There are some sectoral associations to support and protect consumer rights, as for instance in the energy and transport sectors.<sup>46</sup>

The government is taking measures to strengthen consumer protection in the country. The most recent developments in this area have been the enactment of two new Decrees in 2011 targeting respectively consumer rights relating to credit and debit cards and the reinforcement of consumer recourses and rights as established under the 1994 Law on Promotion of Competition and Effective Consumer Protection. The government has also made available a Manual on Good Practices of Consumer Protection for the commercial sector. Developed by the Directorate of Consumer Support within the Ministry of Economy, Industry and Commerce, the manual is a self-regulation mechanism with guidelines for companies to implement and enhance their conduct towards consumers. The Directorate also holds capacity-building activities on several issues of interest to consumers and companies, and works on the modernisation and improvement of regulations on consumer protection.

In conclusion, Costa Rica has a law and an institution dedicated to consumer protection. The government issued a manual for companies in the commercial sector to improve their conduct *vis-à-vis* consumers. Additional efforts should concentrate on consumer awareness, legislative improvements and on promoting sustainable consumption.

## Science and technology

This section of the *Guidelines* aims to promote, within the limits of economic feasibility, competitiveness concerns and other considerations, the diffusion by multinational enterprises of the fruits of research and development activities within the countries in which they operate, contributing thereby to the innovative capacities of host countries.

Costa Rica has one of the highest innovation potentials in the Latin America and the Caribbean region according to the 2012-13 WEF Global Competitiveness Report. Out of the 144 countries covered in the report, Costa Rica ranks 43th in the capacity for innovation criterion. The country's overall potential for innovation builds on its respectable educational system (ranked 21st out 144 countries), acceptable use of ICT (58th) and above-average capacity to innovate and use technology (39th). The country also benefits from its open investment and trade regime that allows the country to import technology from abroad (5th).

The Ministry of Science, Technology and Telecommunications (*Ministerio de Ciencia, Tecnología y Telecomunicaciones*, MICITT), established in 1986, is the competent authority in science, technology and innovation (STI) policies. The subsequent 1990 Law for the Promotion of the Scientific and Technological Development<sup>47</sup> strengthened the Ministry's mandate to promote STI policies and allowed the creation of other relevant bodies and tools to foster STI in the country. The main objective of the legislation is to facilitate scientific research and technological innovation, leading to greater economic and social progress in the framework of a comprehensive sustainable development strategy (Article 1).

Additionally, the law established the National System of Science and Technology to co-ordinate private and public sectors related to the scientific and technological fields. This body is comprised of higher education institutions in science and technology and several public and private institutions, entities and offices in the field. It plays an important role in strengthening the relationship between government, private sector and academia, and in integrating the contributions of different stakeholders to STI policies and goals. The law also created financial mechanisms to finance STI policies in the country, notably the Incentives Fund. The Fund mainly supports the training of human resources in areas of STI. It focuses on granting postgraduate scholarships; supporting R&D projects; and organising scientific events, national awards, seminars, internships and conferences. Funds are allocated on the basis of priority regarding national needs in the areas of STI, according to the policies issued by the Ministry. The Incentives Commission, integrated by representatives of different sectors and Ministries, is in charge of selecting the beneficiaries.

In 2002, the fund of the SME Support Programme (*Programa de Apoyo a la Pequeña y Mediana Empresa*, PROPYME) was created to promote entrepreneurship and competitiveness of local SMEs through innovation and technological development. The fund's resources come from the public budget and are also allocated by the Incentives Commission at MICITT. As is the case with the Incentives Fund, the PROPYME fund is managed by the National Council for Scientific and Technological Research (*Consejo Nacional para Investigaciones Científicas y Tecnológicas*, CONICIT). CONICIT is an autonomous institution established in 1972 to develop financing mechanisms for research in the country and that has since been the administrator of funds dedicated to support the development of STI policies. The agency is also responsible for managing other funds of STI policy (FORINVES, GiTEC, FODETEC).

Policies implemented so far have not yet significantly raised the level of investment in STI in the country, despite a favourable foreign trade and investment regime. The IADB (2010) notes that Costa Rica's national innovation system is strongly fragmented, making it more difficult to mobilise resources to priority areas identified in previous STI plans. The protection of intellectual property rights is also another area that requires attention to support the development of innovation in the country (Chapter 3). In addition, local companies have yet to develop the skills and competences to be able to properly compete in knowledge-intensive international markets. Aware of these challenges, the government has developed a comprehensive strategy to foster innovation capacities and improve competitiveness, the National Plan on Science, Technology and Innovation, with a view to evolve towards a knowledge-based economy (Box 4.5).

Combined with a more selective policy to attract foreign investors in more knowledge-intensive sectors, the recently launched National STI Plan has set the goal of raising investments in STI from 0.49% to 1% of GDP by 2014 (in comparison with an OECD average of 2.3% of GDP in 2010). The level of investment in R&D in Costa Rica has also been lower than the Latin American average of roughly 0.5% of GDP. In addition, the plan foresees a substantial increase in private sector investment in STI, but so far the participation of the private sector has been limited to only a third of total national R&D expenditure. This is much lower than in other leading emerging countries (OECD, 2012).

Escalating the global value chain in STI areas is essential and is where FDI can be most of use if adequate policies are in place to ensure the development of local business linkages. An example of a successful arrangement is the investment by Intel in a semiconductor assembly plant in Costa Rica in 1997. The Intel project alone has allowed for the development of a local support business network that in 2006 amounted to around 460 suppliers (MIGA, 2006). But to continue to attract foreign and domestic private investors to

#### Box 4.5. **The National Plan on Science, Technology and Innovation**

In 2011, the Ministry of Science, Technology and Telecommunications launched the National Plan on STI. The Plan aims at tackling various issues that historically have impaired the development of the country's STI system, such as limited human capital availability, lack of funding, low intellectual property rights and limited competition (MICITT, 2011).

The main objectives of the Plan focus on:

- strengthening national capacities in science, technology and innovation and its impact on improving productivity and socio-economic development through the increase and better redirection of the investment in R&D, following a scheme of participation between the public and private sectors;
- strengthening training and upgrading high-level human resources in basic sciences and engineering;
- promoting scientific, technological and entrepreneurship vocations to promote social recognition of such activities;
- enhancing the institutional framework to raise the absorptive capacity of firms and institutions and to more efficiently respond to the demand of different domestic players.

To elaborate the plan, the Ministry consulted more than 200 experts from the private sector, academia and NGOs, and established seven priority STI fields, four courses of action, and indicators to measure progress. The seven fields are: earth and space sciences; nanotechnology and new materials; biotechnology; natural capital; health; alternative energy; and digital technologies.

These areas were chosen by mapping the state-of-the-art practices – both domestically and internationally, and considering their scientific relevance, the general development of the field and the existing conditions in the country regarding academic offering, human resources, specialised labs and relevant stakeholders performing related activities.

The strategic goals are focused on increasing and enhancing investment in STI from 0.49% to 1% of the GDP by 2014, where 75% of the required investment would be provided by the private sector and 25% by the government; developing more and better qualified human resources, promoting social appropriation of STI to raise awareness of the importance and the need of STI in the country; and strengthening institutional capabilities for STI, including the co-ordination between institutions and the evaluation of its performance overtime. The National STI Plan also emphasises upon the need of co-operation between academia, industry and government, and suggests actions to be undertaken to accomplish this goal.

knowledge-intensive industries in Costa Rica and benefit from potential spillovers, the government needs to upgrade the country's production and innovation capabilities and educational policies towards enhancing the supply of qualified labour to such industries and fostering linkages between business and universities. Such policies are essential to sustain backward linkages between foreign investors and local suppliers in Costa Rica in the future.

The government is aware of the importance of STI policies and how critical they are to advance towards becoming a knowledge-based economy. The country has a promising innovation potential, developed an ambitious National Plan on Science, Technology and Innovation, set up relatively solid institutions to promote STI and is working in an orderly manner to continue moving forward. Its challenges are mainly to strengthen and upgrade its national capacities to develop and absorb STI, to align skills with the market needs and to attract multinational enterprises conducting and diffusing R&D activities at the benefit of the country's competitiveness.

## Notes

1. More information on the *Guidelines* can be found on: <http://mneguidelines.oecd.org>.
2. Chapter I, Concepts and Principles, paragraphs 1, 3, 5 and 7 of the *OECD Guidelines for Multinational Enterprises*.
3. Section I.1 of *Council Decision C/MIN(2011)11*.
4. Section I.4 of *Council Decision C/MIN(2011)11*.
5. *Guidelines*, Chapter II, General Policies.
6. Due diligence is understood as the "process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems." See Commentaries on Chapter II, General Policies, *OECD Guidelines*, 2011.
7. The term "business relationship" includes relationships with business partners, entities in the supply chain and any other non-State or State entities directly linked to its business operations, products or services. See Commentaries on Chapter II, General Policies, *OECD Guidelines*, 2011.
8. After seeing its natural forests reduce by roughly 38% from 1979 to 1992 (World Bank, 2000), the country implemented several policies to promote reforestation and forest protection, and incite entrepreneurs to incorporate environmental practices into their businesses. According to the Ministry of Environment and Energy, Costa Rica's forest cover has increased from 21% in 1986 to 52.3% in 2012 as a result of policies implemented.
9. The EMPLEATE Programme offers training opportunities supported by the public and private sectors to foster employment of young people. The National Minimum Wage Programme aims at raising awareness among employers and workers about the importance of complying with the minimum wage.

10. INTECO is a non-profit association recognised by the government as the Costa Rican Institute for Technical Norms (Law No. 8279 of the National Quality System) and represents the country in the International Standardization Organization (ISO) and other international and regional organisations.
11. The UN Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption.
12. Regulation No. 893 of 3 December 2010.
13. Regulation No. 61 of 16 May 2002.
14. Regulation No. 812 of 9 October 2009.
15. Law No. 7732 of 17 December 1997.
16. Regulation No. 411 of 14 January 2004, relating to the financial information of financial entities, groups and conglomerates; Regulation No. 200 of 1 January 2001, on the rules for the presentation, sending and publication of consolidated and individual financial statements of the enterprises comprising the financial groups; and Regulation No. 640 of 9 April 2007, on the Accounts Plan for Financial Entities, Groups and Conglomerates.
17. Data used for this indicator comes from a survey of corporate and securities lawyers, as well as on securities regulations, company laws, civil procedure codes and court rules of evidence.
18. For instance, the definition of “financial group” can be found in the Regulations on Authorizations Supervised Entities by SUGEF and the one of “economic interest group” in the Authorizations and Operation of Financial Groups and Conglomerates SUGEF 8-08); the General Regulations on Investment Fund Management Companies (“Sociedades Administradoras and Fondos de Inversión”); and the Regulations on Limits to Credit to Individual Persons and Economic Interest Groups (SUGEF 5-04). For avoiding conflict of interests, the General Regulations on Investment Fund Management Companies establish prohibitions for directors of those companies and funds (Article 51). Regarding the disclosure of personal interests of directors in transactions, article 35 of the Law Regulating the Securities Market (Law No. 7732 of 17 December 1997) contains prohibitions and article 157.29 contains sanctions.
19. Law No. 7739 of 6 January 1998.
20. Law No. 7142 of 8 March 1990.
21. Law No. 8589 of 25 April 2007.
22. Law No. 8590 of 18 July 2007.
23. Law No. 6172 of 29 November 1977.
24. Law No. 7600 of 2 May 1996.
25. Law No. 7935 of 25 October 1999.
26. Law No. 7771 of 29 April 1998.
27. Law No. 8764 of 19 August 2009.
28. Costa Rica has not yet adopted the International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families.

29. Costa Rica's Constitutional Chamber was created in 1989 by Law No. 7128 of 18 August 1989 and an amendment to the Constitution.
30. These include the National Women Institute, the National Child Welfare Agency, the National Council on Children and Adolescents, the National Council for the Elderly, the National Council on Rehabilitation and Special Education, the National Commission on Indigenous Affairs, National Commission to Combat the Commercial Sexual Exploitation of Children and Adolescents and the National Coalition against Smuggling of Immigrants and Human Trafficking.
31. The Ministry of Labour and Social Security (*Ministerio de Trabajo y Seguridad Social*, MTSS) reports a reduction in the number of child labour in the country from 113 523 in 2002 to 47 400 in 2011. These figures refer to all types of child labour, including illegal and permitted labour. For 2011, permitted child labour amounted to 6 213 children or 13% of total child labour.
32. Law No. 9095 approved on 26 October 2012 and entered into force on 8 February 2013.
33. The National Council on Salaries, which counts with representatives of employers, workers and the executive, is responsible for presenting proposals for the fixation of minimum salaries.
34. Foreigners are not allowed to exercise direction or authority within unions.
35. Years under parenthesis are years of ratification by Costa Rica. The 1930 Convention on Forced Labour No. 29 (1960), the 1948 Convention on Freedom of Association and Protection of the Right to Organise No. 87 (1960), the 1951 Convention on Non-discrimination on Equal Remuneration No. 100 (1960), the 1949 Convention on the Right to Organise and Collective Bargaining No. 98 (1960), the 1957 Convention on the Abolition of Forced Labour No. 105 (1959), the 1958 Convention on Discrimination, Employment and Occupation No. 111 (1962), the 1973 Convention on Minimum Age No. 138 (1976), and the 1999 Convention on Worst Forms of Child Labour No. 182 (2001).
36. The list of conventions signed can be found on: [www.ilo.org/dyn/normlex/en/f?p=1000:11200:0::NO:11200:P11200\\_COUNTRY\\_ID:102599](http://www.ilo.org/dyn/normlex/en/f?p=1000:11200:0::NO:11200:P11200_COUNTRY_ID:102599).
37. The mechanism shall assist the Parties to carry out co-operation and capacity building activities relating to such topics as: the effective application of fundamental labour rights; legislation and practice relating to compliance with ILO child labour convention; strengthening labour inspection systems and the institutional capacity of labour administrations and tribunals; mechanisms for supervising compliance with laws and regulations pertaining to working conditions; and the elimination of gender discrimination in employment.
38. Bill No. 15990 on the Reform of Labour Proceedings, approved on 13 September 2012 by Congress.
39. Law No. 8952 of 21 June 2011.
40. The National Inspectorate issued a General Circular (Circular 018-12 of 2 May 2012) in which it established that if a union and a permanent worker committee coexist in a company, the Inspector must seek to ensure that there is no violation to union freedom and if there is any conflict that requires negotiation it will report it to the Directorate of Labour Affairs at the MTSS.
41. According to the National Development Plan 2011-14, the unemployment rates in 2002 of men and women were 5.6% and 7.9% respectively. In 2009, the difference in the unemployment rates of men and women represented 3.3 percentage points. The average of income of women in relation to men has also declined in the same period.

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## Chapter 5

### Costa Rica's policy framework for green investment

*The objective of this chapter is to analyse Costa Rica's policy framework in support of green investment. A framework for green investment is in many aspects similar to an enabling framework for investment in general. However, a good investment framework will not necessarily contribute to direct investment in green (or less polluting) activities and operations unless certain elements are also given. These include: a strong government commitment to support green growth and promote private investment to achieve these goals; policies and regulations that guide investors towards greener investment, including policies promoting green business conduct, adequate institutional capacity to design, implement and monitor green investment policies, and policies supporting private participation in green infrastructure projects; institutional capacity to design and implement investment policies in support of green growth objectives; and financial incentives for green investment.*

*Costa Rica has long-standing experience in promoting economic growth while preserving environmental resources. It has been recognised as a leader in sustainable policy and practice, and has been highly praised for the way in which it has managed its natural endowments in a sustainable way. In 2009, it pledged to become carbon neutral by 2021. Moving forward on this objective will require higher levels of private investment in sectors such as electricity generation, transport and sustainable tourism.*

The OECD defines green growth as “fostering economic growth and development, while ensuring that natural assets continue to provide the resources and environmental services on which countries’ well-being relies. To do this, it must catalyse investment and innovation which will underpin sustained growth and give rise to new economic opportunities” (OECD, 2011). Investment for green growth includes *inter alia* investments in infrastructure such as water sanitation and distribution, transport, and housing, renewable energies, energy efficiency, and natural resource conservation.

A framework for green investment is in many aspects similar to an enabling framework for investment in general. However, a good investment framework will not necessarily contribute to direct investment in green (or less polluting) activities and operations unless certain elements are also given. These include: a strong government commitment to support green growth and promote private investment to achieve these goals; policies and regulations that guide investors towards greener investment, including policies promoting green business conduct, adequate institutional capacity to design, implement and monitor green investment policies, and policies supporting private participation in green infrastructure projects; institutional capacity to design and implement investment policies in support of green growth objectives; and financial incentives for green investment.<sup>1</sup>

Costa Rica has long-standing experience in promoting economic growth while preserving environmental resources. It has been recognised as a leader in sustainable policy and practice by the United Nations Environment Programme (UNEP), and has been highly praised for the way in which it has managed its natural endowments for the purpose of sustainable development. Several initiatives have received worldwide recognition for the scale of their ambition and effectiveness, such as its system for payment of ecosystem services which has helped to significantly reverse the rate of deforestation in the country.

In 2009, Costa Rica made a pledge to become carbon neutral by 2021. Moving forward on this objective will require higher levels of private investment in sectors such as electricity generation, transport and sustainable tourism. Though Costa Rica has no formal green growth agenda in place, nor a specific strategy to promote green investment, it has developed a range of policies to increase private investment in support of the country’s environmental objectives and its commitment to become a low carbon economy. For example, it is currently working to remove some of the barriers to private participation in

electricity generation to promote investment in renewable energy. It is also promoting private investment in sustainable tourism, through incentives for companies to obtain sustainable tourism and carbon neutrality certification. While Costa Rica provides a significant number of incentives for green investment, there is to date no mechanism in place to assess the effectiveness of these incentives. Access to finance for green investment, e.g. in clean energy, is considered weak, and experience within the financial sector needs to be further developed. The government is currently designing measures to improve access to finance. A range of programmes are in place to ensure green business conduct and to involve companies in the government's carbon neutrality objectives, such as through certification under the C-Neutral label.

### Challenges and opportunities for green growth in Costa Rica

Costa Rica's location between the Pacific and the Atlantic oceans results in a variety of microclimates and a diversity of ecosystems comprising forests, wetlands, and marine areas. Despite its small land area of 51 100 km<sup>2</sup> (0.03% of the Earth's surface), Costa Rica hosts 500 000 species of plant and animal life, representing 4% of the world's total species.<sup>2</sup> The country has three significant mountain ranges and 112 volcanoes, of which six are active. The volcanic ash, together with generous rainfall and a temperate climate, has resulted in fertile soil and intense agricultural productivity.

Although Costa Rica lacks a formal green growth agenda, during the last three decades the country has put in place a broad legal and policy framework aimed at achieving green economic growth objectives. Costa Rica's early commitment to biodiversity conservation, the adoption of economic instruments to acknowledge the services rendered by ecosystems, and the pledge to become a low carbon economy, are examples of policies that have supported the country's green economic growth. Costa Rica's development model is not based upon the extractive industry, but rather, on protecting natural resources while promoting a knowledge-based economy. Around 25% of Costa Rica's territory is protected, comprising including national parks, biological reserves, forest reserves and wildlife refuges.<sup>3</sup>

Costa Rica's economy has been growing by 5% on average since the 1990s, a rate that accelerated in the new millennium, reaching a peak of 8.8% in 2006.<sup>4</sup> While growth has abated since the financial crisis, it is projected to reach 4% by 2014 (Central Bank, 2012). As recognised in the current National Development Plan (NDP), as well as in the State of the Nation report for 2012 (PEN, 2012), achieving this level of growth while ensuring environmental protection poses serious challenges. The balance between the two priorities is also source of conflict in decision-making processes. However, it is also a source of investment opportunities, for example, in the areas of energy, transport, and tourism.

### **Meeting increasing energy demand while achieving carbon neutrality**

Costa Rica generates virtually all its electricity (92%) from local renewable energy sources (mostly hydropower). On the other hand, it is also heavily dependent on imports of fossil fuels, mainly destined to the transport sector. The country produces relatively few greenhouse gas (GHG) emissions, accounting for 0.03% of global carbon dioxide (CO<sub>2</sub>) per capita emissions.<sup>5</sup> With increased economic growth and urbanisation, demand for electricity will double over the next 13 years, while demand for hydrocarbons is projected to double over the next 15 years.<sup>6</sup> Projections show that under a business-as-usual scenario, and assuming average GDP growth of 4% per year, Costa Rica's GHG emissions will increase by 51% from the 2005 baseline (UNFCCC, 2009).

One of Costa Rica's priorities in the energy sector is to reduce its dependence on oil and other fossil fuels. The government is currently developing a strategy for importing natural gas as a potential substitute for oil products, and as a measure to promote low-carbon energy solutions and diminish the country's dependence on petroleum. If natural gas were formally incorporated into the country's energy strategy, it would necessitate major investments (UNDP and MINAE, 2012). Private companies could potentially enter the market as investors, producers, and distributors if the precise scope of the private sector's activities is well defined.

The government has also recently approved a project for the construction of an oil refinery with works scheduled to begin at the end of 2013. According to the authorities, the project is in line with the country's goal to achieve sustainable economic development, as it will be able to meet the highest environmental standards on fossil fuel quality, thus contributing to improving public health and reducing CO<sub>2</sub> emissions. The project will be implemented through a joint venture between the Costa Rican Oil Refinery (Refinadora Costarricense de Petróleo, RECOPE), and the China National Petroleum Corporation (CNPC). The cost is estimated at USD 1.4 billion. This would be the biggest Chinese investment in Costa Rica to date.<sup>7</sup> The bulk of the funding will be provided by the Chinese Development Bank.<sup>8</sup> The RECOPE-CNPC project reflects an opportunity for foreign investment, but it also needs to address the challenge of aligning economic growth with environmental protection, and of applying responsible business standards, such as the *OECD Guidelines for Multinational Enterprises*. In this regard, the authorities have assured that the project is subject to Costa Rica's laws, regulations and enforcement mechanisms regarding environment, labour issues, human rights, anti-corruption and taxation, among others.

Under the NDP, Costa Rica has set a target to increase the share of renewable energy in electricity generation from 91% in 2011 to 95% in 2014. To that end, it has developed policies and incentives to promote investment in renewable energy. One key challenge for increased investment is to continue

removing current regulatory barriers to private sector participation in electricity generation. Moreover, while wind and biomass form a relatively small part of Costa Rica's electricity mix, there is potential for these renewable energy sources to grow. The policies in place to promote investment in renewable energy are discussed in more detail later in this chapter.

### **Promoting tourism while protecting nature**

Tourism is one of the main economic activities in Costa Rica's services sector. From 2002 to 2012, FDI inflows in this sector amounted to USD 1.60 billion and averaged 10.3% of total FDI inflows in the period. In 2012, tourism accounted for 5.4% of the GDP.<sup>9</sup> Costa Rica's natural endowments are the main assets of the country's tourism industry, and have made it a top destination for tourists seeking an ecologically-sound experience.<sup>10</sup> Ensuring that the tourism industry contributes to the country's sustainable development has been a strategic priority since the 1990s. The National Plan for Sustainable Tourism 2010-16 (*Plan Nacional de Turismo Sostenible*) provides a framework for developing the sustainable tourism industry.<sup>11</sup> It identifies niche areas that can be exploited to further develop Costa Rica's sustainable tourism, including adventure travel, green tourism, social responsibility, volunteer trips, destination weddings, and medical tourism.

However, in order to make the most of tourism-related opportunities, Costa Rica needs to address the poor state of transport infrastructure such as roads, railways and ports. This in turn requires finding the right balance between infrastructure development and maintaining the pristineness and remoteness of certain destinations. According to a 2011 study by UNEP, the tourism industry faces a multitude of significant sustainability-related challenges, including energy and GHG emissions; water consumption; waste management; loss of biological diversity; and effective management of cultural heritage (UNEP, 2011). These challenges are also faced by Costa Rica. In particular, the country is making efforts to ensure that growing numbers of tourists and construction in tourist destinations do not undermine the state of biodiversity and the conservation of natural areas.

The policy framework for investment in sustainable tourism and measures to ensure that the tourism industry follows responsible business practices will be analysed in greater depth in the rest of this chapter.

### **Modernising the transport sector**

One of Costa Rica's key development challenges is in the transport sector (Chapter 3 Section on Infrastructure development). Its roads, railroads and ports are considered among the worst in the world for doing business, ranking 131, 106 and 140 respectively out of 144 countries in the World

Economic Forum's 2012-13 Global Competitiveness Report (WEF, 2012). The road network, although vast, lacks quality and adequate maintenance. According to the Ministry of Public Works and Transportation, the country is planning to allocate more than USD 2.3 billion to transport projects.

Moreover, the transport sector relies heavily on fossil fuels, using over half of the fossil fuels consumed in the country (Government of Costa Rica, 2010). It accounts for 34% of Costa Rica's total GHG emissions (UNFCCC, 2009) and 69% of total energy-related emissions.<sup>12</sup> It is also the main contributor to air pollution; vehicles account for approximately three-quarters of polluting emissions in the greater metropolitan area of San Jose alone (Blackman et al., 2010). The transport sector's carbon footprint is worsening due to both the proliferation of automobiles in Costa Rica in the two decades leading up to 2012, and the old age of large part of the car fleet.<sup>13</sup> The government imposes higher excise tax rates to older and less efficient vehicles to create an economic disincentive to the purchase of older vehicles.<sup>14</sup> However, there is no private or public service in place for recycling and disposing of old fleet (UNDP and MINAE, 2012).

Costa Rica's carbon-intensive transport sector poses challenges for green growth, but it also offers opportunity to both decrease air pollution from the transport sector and develop low-carbon solutions, such as light rail for public transportation. The government's Action Plan for the National Climate Change Strategy (*Plan de Acción de la Estrategia Nacional de Cambio Climático*) identifies the transport sector as one of the four priorities for action in order to achieve the country's goals regarding climate change.<sup>15</sup> To this end, it introduces or confirms measures to rationalise transport demand, such as a vehicle use restriction programme, the implementation of dedicated lanes for buses; and converting and modernising part of the country's vehicle fleet by using market incentives and stricter emissions regulations for operators. Moreover, there is experience and interest within Costa Rica for converting part of its vehicle fleet to Liquefied Petroleum Gas (LPG), a less-pollutant alternative to diesel and petroleum (UNDP and MINAE, 2012). The government is in the process of negotiating with foreign electric and hybrid car makers and with national banks to make low-emissions vehicles available and more affordable to bus and taxi operators.<sup>16</sup>

More generally, the government is promoting carbon emissions reduction in public transportation through a range of incentives aimed at expanding the use of alternative clean-technology vehicles that run on LPG, electricity and biodiesel. The government encourages the use of biofuels, which is entirely produced by private investors, by adding ethanol to gasoline Plus 91 and diesel commercialised in the country. Costa Rica produces a large amount of palm oil and it is expected that biofuel produced from oil palm wastes will increase in the coming years.<sup>17</sup> Private investment in transport infrastructure is discussed in further detail in Chapter 3.

## Costa Rica's commitment to green growth

Costa Rica has been committed to achieving sustainable development for a long time, and has sought to foster economic growth while ensuring that natural assets continue to provide the necessary resources and environmental services. This commitment is reflected in numerous programmes and policies, and most recently, in Costa Rica's pledge to become carbon neutral by 2021.

### **National programmes and policies in support to green growth**

The 1949 Constitution of Costa Rica (Article 50) states that all citizens have the right to a healthy and ecologically balanced environment and are entitled to denounce any act that may infringe that right and claim redress for the damage caused. The state is entrusted with guaranteeing, defending and preserving that right. Environmental protection has been a priority in national policy since the 1970s, and over the years, Costa Rica has put in place a range of national plans and strategies in support of environmental protection and sustainable development (Table 5.1).

**Table 5.1. Costa Rica's programmes and policies in support of sustainable development**

Programme/policy	Brief description and highlights
National Development Plan (2011-14)	Reflects the work agenda of the current government including an Environmental Strategy, which is based on five pillars: land-use planning, water resources and waste management, carbon neutrality and climate change, biodiversity; and renewable energies.
National Climate Change Strategy (2009)	Comprises six thematic areas: mitigation; adaptation; metrics; capacity building; public awareness and education and financing. Covers seven sectors: water, energy, agriculture, fisheries and coasts, human health, infrastructure, and biodiversity.
National Climate Change Strategy Action Plan (2012)	Aims at guiding the allocation of public and private resources to achieve a national low-carbon development model. The Action Plan proposes measures to reduce the vulnerability of populations and ecosystems to the excess or shortage of water; ensure the availability of electricity generated from renewable resources; reduce electricity production by thermal sources; undertake actions to meet energy demand with cleaner fuels than oil; and measures to promote the use of public transportation.
State Policy for Food and Agricultural sector, and Rural Development 2010-21 – Climate Change and Agro Environmental Management	Governs short, medium and long-term actions to promote the food and agricultural sectors, and defines the institutional framework that supports them. It develops four main areas: competitiveness; innovation and technological development; management of rural territories and family farming; and climate change and agro-environmental management.
National Plan for Climate Change and Environmental and Agricultural Management (2011-14)	Aims at implementing the provisions regarding Climate Change and Agro Environmental of the Policy for the Food and Agricultural sector, and Rural Development 2010-21. It includes four strategic areas: variability and climate change; agro biodiversity; clean production; and sustainable management of land and other natural resources.
National Policy on Integrated Waste Management (2010-21)	Guides public and private institutions on waste management by fostering prevention and shared responsibility of all sectors in society; and by promoting sustainable production and consumption processes, and the safe handling of waste.

Table 5.1. **Costa Rica's programmes and policies in support of sustainable development (cont.)**

Programme/policy	Brief description and highlights
National Plan for Sustainable Tourism (2010-16)	Aims to achieve sustainable development of this sector and related economic activities. It describes the current situation of tourism in Costa Rica, including its policies, objectives and strategies; its need of infrastructure and services; and sets out the programmes, actions and organisational structure that should be put in place to meet its objectives.
National Energy Plan (2012-30)	Aims at increasing investment in diversified energy supply from renewable energies through an active participation of the public and private sectors, assigning the highest priority to the exploitation of clean and renewable sources of energy.
Expansion Plan for Power Generation (2012-24)	Is a tool to plan for power supply needs within the guidelines established in the National Energy Plan and the National Development Plan. It covers the 2012-24 planning horizon, divided into three different periods: construction period up to 2016; interim period up to 2020; and reference period from 2020 to 2024, which will serve as a guide to assess investment and preparation for future plans and projects.
National Plan for Forestry Development (2011-20)	Seeks to ensure the implementation and consolidation of the country's forestry policy, to contribute to sustainable development from a social, economic and environmental perspective. It is based on seven strategic elements: forest land management; positioning of the forestry sector; forestry competitiveness; sustainability of forestry; institutional co-ordination, efficiency and effectiveness; funding innovation and sustainability; and climate change, mitigation and adaptation.
National Plan for the Elimination of HCFC Gases (2013-30)	Describes the strategy to achieve the elimination of HCFC gases, according to specific requirements of the Montreal Protocol. The strategy consists of different phases: stopping importation of HCFC gases by 2013; implementation of projects for the sector conversion that will lead to a decrease of almost 60% of HCFC usage by 2015; and phased implementation of quota, prohibitions and incentives.
National Biodiversity Strategy (2010)	Provides a long-term integral policy framework for the conservation and sustainable use of biological resources. It is based on the following strategic areas: adverse impact of the productive and social activities; land use planning; inter institutional co-ordination; research and generation of information; public awareness; <i>in situ</i> and <i>ex situ</i> conservation; access to genetic resources; biosafety in biotechnology; environmental services; coastal and ocean resources; and national capacity in biodiversity management.
Protected Wildlife Areas Policy (2011)	Guides decisions on protected wildlife areas that will help to consolidate a system for <i>in situ</i> conservation.
National Strategy for the Integrated Management of Marine and Coastal Resources (2008)	Aims to achieve order, good governance and sustainability of marine and coastal areas. It is based on eight pillars, including: the strengthening or establishment of governmental and civil bodies, instruments and mechanisms; and the promotion of conditions for improving the quality of life for residents of coastal marine areas.

Source: COMEX.

One particularly successful programme has helped the country reverse the rate of deforestation, using a combination of forest conservation practices, protected national parks, fiscal resources and an innovative system of payment for ecosystem services (Box 5.1). Since the mid-1990s Costa Rica has spent USD 400 million from its national budget to reduce deforestation (UNFCCC, 2009). Thanks in part to this financial support, the annual deforestation rate decreased from 43 000 hectares in 1983 to 13 000 in 1993 to an average of 5 000 hectares since 2007.<sup>18</sup> Costa Rica's forest cover has increased from 21% in 1986 to 52.3% today, reversing the trend that had prevailed over the prior decades.

Costa Rica has also put in place a package of environmental legislation to ensure the implementation of its international obligations and constitutional duties. The Organic Law of the Environment (*Ley Orgánica de Medio Ambiente*, Law No. 7554 of 4 October 1995) sets forth a general framework for the protected areas conservation system, marine resources conservation, land planning, and for forest, soil, water and air protection; a general framework for the environmental impact assessment system including the establishment of the National Environmental Technical Secretariat (*Secretaría Técnica Nacional Ambiental*, SETENA) and an Environmental Tribunal, as well as the legal remedies to be applied in case of environmental damage. Legislation further includes the Forestry Law (*Ley Forestal*, Law No. 7575 of 5 February 1996), the Law of Wildlife Conservation (*Ley de Vida Silvestre*, Law No. 7317 of 21 October 1992), the Biodiversity Law (*Ley de Biodiversidad*, Law No. 7788 of 30 April 1998), and the Law for the Integrated Waste Management (*Ley para la Gestión Integral de Residuos*, Law No. 8839 of 24 June 2010). Costa Rica has also enacted legislation on environmental protection in areas such as energy efficiency, urban planning, land use, sustainable management of water and waste, air pollution, environmental impact assessment, industrial sanitation and fuel storage.

In 2012, the government allocated an average of USD 202 million to environmental protection, which represents 0.45% of Costa Rica's GDP (0.56% of the public budget for 2012). This estimate comprises the overall budget of the Ministry of Environment and Energy (*Ministerio de Ambiente y Energía*, MINAE) and its decentralised bodies (the National Fund of Forestry Financing and the National Parks Administrator), as well as the budget allocated by other ministries and governmental entities under the budgetary category "environmental protection" (allocations for waste disposal, waste-water disposal, pollution reduction, protection of biodiversity and landscape, and R&D related to environmental protection). External financial resources, such as loans and donations to the central government for environmental purposes, are also included in this estimation. However, this figure does not include transfers made directly to decentralised bodies like the National Fund of Forestry Financing (*Fondo Nacional de Financiamiento Forestal*, FONAFIFO) or the Costa Rican National Parks Administrator (*Sistema Nacional de Areas de Conservacion*, SINAC), hence revenues collected from contracts signed with private companies and from the entrance to the National Parks are not included. Other public investments, such as the Blue Flag certification and the Ministry of Agriculture's Climate Change agenda, are also not reflected in this estimation.

Costa Rica has been praised for the way in which it has managed its natural endowments for the purpose of sustainable development. UNEP has called Costa Rica "a leader in sustainable policy and practice".<sup>19</sup> At the UN

Summit on Biological Diversity in 2010, Costa Rica was awarded the Future Policy Award by the World Future Council for its Biodiversity Law “as a milestone of excellence in meeting the goals of the UN Convention on Biological Diversity”.<sup>20</sup> Costa Rica is ranked first in the Americas and fifth globally for the quality of its environmental performance by the Environmental Performance Index 2012, carried out by Yale and Columbia Universities.<sup>21</sup> Several initiatives have received global attention for the scale of their ambition and effectiveness, e.g. reforestation through the payment for eco-system services (Box 5.1) and sustainable tourism.

#### **Box 5.1. Costa Rica’s system of payment for ecosystem services**

In 1997, Costa Rica became the first country to initiate a national programme of payments for environmental services (PES) and to adopt the terminology of environmental services. The PES programme was developed under the 1996 Forest Law, and has been one of the key drivers of Costa Rica’s success in reforestation. It compensates landowners for conserving and managing forests in a sustainable way, recognising the importance of forests and plantations for environmental conservation and their contribution to addressing climate change (e.g. through carbon sinks). The PES covers several areas, such as forest protection, reforestation, natural forest regeneration, agro-forestry systems, and forest management. About 80% of the programme’s uptake has been in forest protection.

A semi-autonomous government agency, the National Fund of Forestry Financing (FONAFIFO), was tasked with administering the programme, including mobilising funds from various sources which are used to capitalise a Forest Conservation Fund. Under the programme, private land-owners enter contracts with FONAFIFO to conserve and protect the forests under their management. Between 1997 and 2011, FONAFIFO has contributed to the payment of environmental services for 865 684 hectares. The payment rates and type of contracts vary according to the use given to the land (for example, USD 640 to 800 per hectare are paid for forest protection over 10 years; USD 980 to 1470 per hectare for reforestation over 5 years).

The Forest Conservation Fund is financed, mainly through part of the revenues from the fuel tax (around 80% of total funding). Further funding is provided by a loan from the International Bank for Reconstruction and Development (11.8%). Revenues from a water tax introduced in 2006 are used, in part, to pay for environmental services in key catchment areas (3.7%). A contribution from KfW (2.4%) and agreements with private companies (1.8%) as well as voluntary contributions also contribute to the Fund. To date, contracts with private companies and organisations have generated over USD 10 million. Since 2007, a voluntary scheme, Clean Trips (*Viajes Limpios*) offers travellers the option of paying USD 5 per ton of carbon emitted during their international flights to and from Costa Rica. The funds raised from the programme are invested in forest protection under the PES programme.

**Box 5.1. Costa Rica's system of payment for ecosystem services (cont.)**

The main challenge currently faced by the PES is to ensure its financial sustainability. At present, the amount of the payment offered by the programme does not cover the full opportunity cost of change in land use, particularly in certain regions where economic activities such as agriculture and housing compete for land. The government is therefore looking for new and innovative financial alternatives for the PES programme. For example, it has created a "Biodiversity Trust Fund" aimed at attracting new funding from private investors and international donors. To date, the Fund has raised USD 16 million. It has utilised innovative mechanisms for fundraising such as "BN-Ecomarchamo", a voluntary emissions mitigation programme, valid for one-year compensation of average emissions per vehicle. The funds from this programme are used to pay for ecosystem services to the Trust Fund, and it targets small and medium land owners. Another mechanism is the "Green Debit Card" from the National Bank, under which the bank directs 10% of its commissions from this debit card to the Biodiversity Trust Fund.

Costa Rica was recently awarded a grant from the Forest Carbon Partnership Facility (FCPF), an international initiative under World Bank trusteeship, in order to develop a strategy aimed at attracting private investment to achieve the goal of reducing 29.5 million tons of CO<sub>2</sub> from forest protection and reforestation, by 2020. Under this strategy, the country is required to develop a monitoring, reporting and verification system in order to demonstrate reductions in carbon emissions.

Source: FONAFIFO; FCPF; World Bank, 2012; UNEP, 2009, IIED, 2012, A.E. Daniels et al., 2010; Pratt et al., 2010.

The National Development Plan (NDP) is the overarching policy document for Costa Rica's development priorities and strategies. In addition to highlighting priority areas for environmental sustainability, the NDP for 2011-14 also sets out environmental goals that are directly linked with economic growth, namely: to support the development of a low carbon economy; to boost sustainable tourism development; to increase clean, renewable energy generation to 95% by 2014; and to increase by 310 000 hectares the area of forest conservation and forestry plantation covered by the Programme for Payment of Environmental Services.

Becoming a low carbon economy is one of the major challenges that Costa Rica has assumed in recent years. In 2007, the Arias administration launched Costa Rica's initiative of becoming a carbon neutral country. As a first step, a National Strategy for Climate Change (*Estrategia Nacional de Cambio Climático*, ENCC) was developed, and the government granted support to academic research on the actions needed to put in place this initiative (Pratt et al., 2010). The costs for Costa Rica to achieve this objective were estimated at USD 7.5 billion (ibid.). When the Chinchilla administration took office, priority areas and cost-effective measures for implementing the ENCC were defined as part of a National Action Plan. This plan targeted specific

actions in key areas including transportation, agriculture and clean energy, and promoted public-private initiatives in each of them. This Action Plan was presented in November 2012 to support the implementation of the ENCC.

### **Institutions to support green investment**

The main body in charge of environmental issues, including achieving the country's transition towards carbon neutrality, is the Ministry of Environment and Energy (*Ministerio de Ambiente y Energía*, MINAE).<sup>22</sup> The Ministry has a range of bodies and independent agencies to deal with specific issues, such as FONAFIFO, which manages the System of Payment for Ecosystem Services, and SINAC, which manages national parks and oversees over 100 protected areas, including wildlife refuges, biological reserves, national monuments, forest reserves, national wetlands, and protected zones.<sup>23</sup>

In order to ensure the enforcement of environmental law, the country has a robust judicial and administrative system with a specialised Environmental Prosecutor's Office, an Environmental Department within the General Attorney's Office (*Procuraduría General de la República*, PGR) and an Environmental Administrative Tribunal (*Tribunal Ambiental Administrativo*, TAA), one of the few of its kind in the world (Box 5.2).

In spite of Costa Rica's interest in promoting green investment as part of its transformation into a carbon neutral economy, no institution or institutional arrangement is in place to deal specifically with the design, implementation and promotion of green investment policies. However, the institutions in charge of economic development, environmental protection, energy production, etc. co-operate with each other in the design of policies. For example, the Costa Rican Tourism Board (*Instituto Costarricense de Turismo*, ICT) and MINAE are co-ordinating efforts to develop infrastructure in support of the sustainability of the tourism industry, and to meet the goals of the National Plan for Sustainable Tourism. Another example is co-operation between SINAC and ICT to implement a Sustainable Tourism Programme in Wildlife Protected Areas, to boost investment in sustainable tourism and promote economic development in neighbouring communities, while ensuring biodiversity conservation.

### **International commitments**

Costa Rica is a party to the major international environmental agreements, including the UN Convention on Biodiversity, the UN Framework Convention on Climate Change (UNFCCC) and the Kyoto Protocol. It also takes part in a range of international initiatives, such as the UN Programme on Reducing Emissions from Deforestation and Forest Degradation (REDD) together with 43 other developing countries, and the World Bank's Wealth Accounting and Valuation

### Box 5.2. **The Environmental Administrative Tribunal**

The Environmental Administrative Tribunal has been operating since 1997, and is charged with ensuring the enforcement of environmental and natural resource-related legislation. It is administratively attached to the Ministry of Environment and Energy, but is an independent body, with powers to investigate on its own initiative any potential infringements to environmental laws by individuals, companies and public entities. The Tribunal's decisions are binding and are not subject to appeal.

The Tribunal analyses an average of 400 cases annually applying the legal remedies set forth in the Organic Law of the Environment, including fines, emergency closures, temporary or permanent suspension of activities, orders to mitigate the environmental damage and alternative remedies like community work and actions on environmental education. By 2009, the Tribunal had adopted over 11 000 resolutions, which include decisions and requests for technical reports from other public institutions. In 2010, the Tribunal published a manual on good environmental practices intended mainly for investors and developers (TAA, 2010).

The Tribunal has also supported private sector compliance with environmental regulations through actions such as agreements with the National Chamber of Pineapple Producers and Exporters to improve the environmental performance of producers through a better understanding of the legal requirements and penalties set forth in the case of noncompliance. As a result, 1300 pineapple producers were trained on implementing environmental standards in pineapple production.

Since 2008, the Tribunal has carried out investigations at its own initiative (*barridas*) in particularly vulnerable areas, e.g. in coastal zones, and has detected numerous infringements, *inter alia*, in relation with tourism developments by both domestic and foreign investors.

Source: Environmental Administrative Tribunal.

of Ecosystem Services (WAVES) initiative launched in 2012, which aims to ensure including the value of natural resources in national accounts.<sup>24</sup> In 2012, Costa Rica received a recognition award from the Secretariat of the Montreal Protocol on Substances that deplete the Ozone Layer for its successful actions implementing the Protocol.<sup>25</sup>

In October 2012, Costa Rica adhered to the OECD *Declaration on Green Growth*, under which countries strive, *inter alia*, to encourage green investment and expand incentives for green investment, in particular in areas where pricing carbon is unlikely to be enough to foster such private sector responses, e.g. in low-carbon infrastructure and R&D technologies that can contribute to building a sustainable low-carbon society.<sup>26</sup>

### Environmental protection in trade and investment agreements

Costa Rica has included provisions aimed at promoting mutual support between trade, investment promotion and environmental protection in two Bilateral Investment Treaties (BITs) and most of the Free Trade Agreements (FTAs) it has signed (Table 5.2).

Table 5.2. **Environmental provisions in BITs and FTAs signed by Costa Rica**

Country	Type	Main contents
Netherlands – Costa Rica	BIT	All BITs signed by Costa Rica require that investments shall be made in accordance with laws and regulations; the BIT with the Netherlands specifies that this includes the laws and regulations on labour and environment. (Article 5)
Canada – Costa Rica	BIT	The BIT provides that it does not intend to prevent parties from adopting, maintaining or enforcing any measure appropriate to ensure that investment activities in their respective territories are undertaken in a manner sensitive to environmental concerns. (Annex I (III.1))
	FTA Environmental Co-operation Agreement	The Environmental Co-operation Agreement signed in parallel with the FTA includes a commitment of each Party to ensure that its laws provide high levels of environmental protection, to strive to continue the improvement of those laws, and to effectively comply with them. The agreement also includes a co-operative mechanism to support the full implementation of these obligations.
United States, Central-America and the Dominican Republic (CAFTA DR)	FTA Investment Chapter	Nothing in the investment chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with that chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns. (Article 10.11)
	FTA Environment Chapter Environmental Co-operation Agreement	In this chapter, the Parties recognise their commitments to ensure that their laws and policies provide for and encourage high levels of environmental protection, and to strive to continue to improve those laws and policies. The chapter also includes provisions recognising that it is inappropriate to encourage trade or investment by weakening or reducing protections afforded in domestic law. The chapter provides for a dispute resolution procedure, as well as co-operative public participation mechanisms that contribute to the full implementation of such obligations. The CAFTA-DR FTA includes a Co-operation Agreement that accompanies the agreement to provide for bilateral co-operation in different priority areas including environmental protection and economic sustainable growth. The FTA also contains a clause that establishes a Committee to review environmental complaints and issues raised by the parties.
Dominican Republic – Central America	FTA Investment Chapter	The Chapter does not apply to measures adopted to restrict investment for reasons of national security or public order, protection of the cultural and environmental patrimony and the preservation of the environment (Article 9.02 2.b). In addition, Article 9.15 on environment states that each party can adopt, maintain and enforce appropriate measures to ensure that investment in its territory is undertaken according to the environmental legislation.

Table 5.2. **Environmental provisions in BITs and FTAs signed by Costa Rica** (cont.)

Country	Type	Main contents
Panama – Central America	FTA Investment Chapter	Article 10.15 states that no provision of the investment chapter can be interpreted as an impediment for a party to adopt, maintain or enforce any measure appropriate to ensure that investment activities in its territory is undertaken according to the environmental legislation. It also mentions that it is inappropriate to encourage investment through removal or lowering of internal measures applicable to health, security or related to environment. Consultations are encouraged in case an investment has been attracted in such manner.
México – Costa Rica	FTA Investment Chapter	Article 13-15 contain the same provisions as the FTA with Panama.
China – Costa Rica	FTA General Exceptions Chapter	This chapter states that for purposes of the Chapter on Investment and Trade Services Article XIV of GATS is incorporated. <sup>1</sup> It states that “the Parties understand that the measures referred to in Article XIV (b) of GATS include environmental measures necessary to protect human, animal, or plant life or health, subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on trade in services and investment.” (Article 159.2).
Singapore – Costa Rica	FTA Co-operation Chapter	Article 14.8 of this Chapter states that the Parties recognise the importance of strengthening the protection of the environment and the promotion of sustainable development, in line with their efforts to consolidate its trade and investment relations.
	FTA General Exceptions Chapter	Article 18.2 of this Chapter states that for purposes of the Chapter on Investment, Article XIV of GATS is incorporated. It indicates that “the Parties understand that the measures referred to in Article XIV (b) of GATS include environmental measures necessary to protect human, animal, or plant life or health”.
Peru – Costa Rica	FTA Investment Chapter	Article 12.8 states that nothing in the investment chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with that chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

1. The FTA with China does not contain investment provisions *per se*, but reaffirms the commitment of the BIT signed in 2007 but not entered into force. The BIT with China does not contain environment-related provisions.

Source: COMEX.

Similar provisions have been included in other FTAs that have been signed and are in process of approval in Congress: the Central American Treaty of Investment and Trade in Services and the Association Agreement between Central America and the European Union. The FTAs tend to more systematically include provision on the protection of environment, either in a specific chapter (CAFTA-DR), in the investment chapter (CAFTA-DR, DR, Panama, Mexico) or a specific co-operation agreement linked to the FTA (CAFTA-DR and Canada). The FTA with China contains limited provisions on the environment in its chapter on the exceptions.

The inclusion of environment-related provisions in most recent trade agreements contrasts with the low number of investment agreements (only two BITs out of the 21 signed by Costa Rica) which contain such provisions. While some BITs signed by other countries address in their preamble the importance of the protection of the environment, none of the Costa Rican BITs includes such reference that could guide the interpretation of the agreement. Moreover, Costa Rica's model BIT does not have any provision on the environment in the preamble nor in a specific article. This can be explained by the fact that, while the inclusion of environment-related provisions in investment agreements is relatively recent, most of the BITs concluded by Costa Rica were negotiated and signed in the late 1990s. In the case of FTAs, it included such provisions initially on the request of the trade partner, but later including this type of clause has become an element of its negotiation strategy. However, Costa Rica has consistently referred in its BITs to the fact that investments must comply with the domestic legislation, this being understood to comprise environmental legislation. According to the Costa Rican authorities, this approach does not prejudice the possibility that the country may decide in the future to include environment-related provisions in a BIT as a result of particular circumstances in a negotiation.

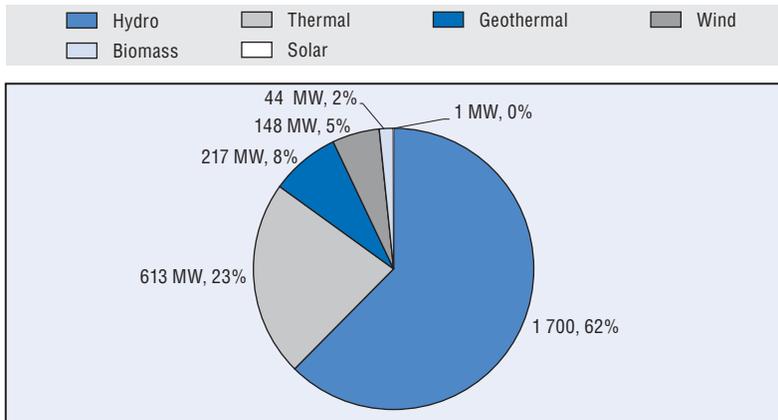
## **Policies in support of green investment**

This section describes in some detail two areas, electricity generation from renewable energies and sustainable tourism, which represent key economic activities in Costa Rica's sustainable development strategy.

### ***Policies promoting private investment in renewable energy***

Costa Rica generates over 90% of its electricity from renewable energy sources. Large-scale hydropower dominates the electricity mix and there is potential to expand it even further, as only 26% of the hydropower potential has been exploited so far (ICE, 2012) (Table 5.4). Installed capacity of renewable energy sources also includes wind, thermal, biothermal and biomass (Figure 5.1). Up to 2015, hydro, wind and biomass will have minor increases as a proportion of overall electricity generation in Costa Rica, while geothermal and thermal sources are expected to decrease. Geothermal resources have proved difficult to exploit as most of Costa Rica's geothermal resources are located in conservation areas and national parks, where electricity generation activities are prohibited.

Demand for electricity in Costa Rica is growing at an annual rate of 5.3% and is expected to double by 2023. The cost of meeting this demand is estimated at USD 9 billion (MINAE, 2010). The NDP establishes the goal to increase electric power generation from renewable sources from 91% in 2011 to 95% in 2014. To attain this goal, and to reduce dependence on imported fuels, the National Energy Plan (NEP) seeks to increase private investment in

Figure 5.1. **Costa Rica's Renewable Energy Generation Profile, 2012**

Source: ICE (2012).

electricity generation and assigns the highest priority to the exploitation of clean and renewable sources of energy. The increase in the installed capacity of the National Electric System for 2011-14 is estimated to be approximately 627 MW. In order to meet this objective, power generation capacity must increase by approximately 370 MW. Total investment required to reach this goal is estimated at USD 2 450 million (USD 650 million from private investment, and USD 1800 from public investment).

The energy policy framework is established by the NDP and the NEP 2012-30.<sup>27</sup> The NEP's main objectives regarding electric power generation are: modernising and strengthening the current legal framework to enhance legal certainty for stakeholders, ensuring a sustainable energy supply while minimising vulnerability and external dependence, increasing diversification of energy supply, establishing a pricing policy that promotes investment and competitive electricity tariffs, and promoting efficient energy consumption. The 2012 Expansion Plan for Power Generation (2012-24) (*Plan de Expansión de la Generación Eléctrica*) is a tool to plan for power supply needs within the guidelines established in the NEP and the NDP. The Plan is under constant review to adjust it to changes in the demand for electricity arising from variations in market conditions.<sup>28</sup>

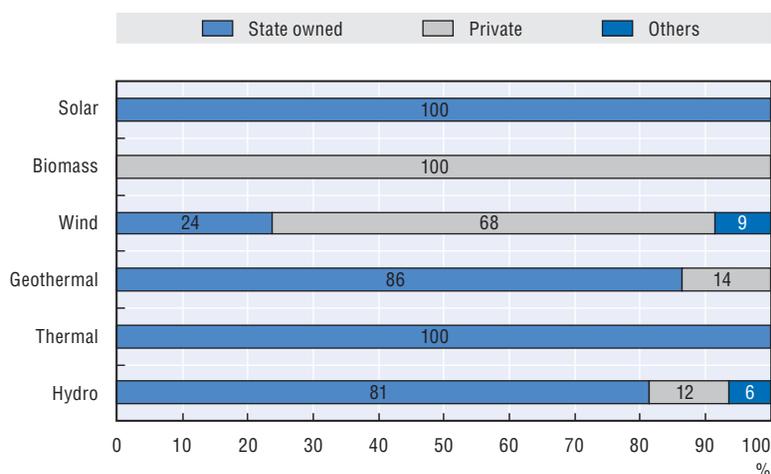
Electricity generation and distribution is managed by the Costa Rican Institute for Electricity (*Instituto Costarricense de Electricidad, ICE*). ICE has also led the development and management of infrastructure required to satisfy domestic electricity demand for the last 60 years. Since the 1990s, electricity generation has been gradually opened to the private sector, under the 1990 Law Authorizing the Generation of Autonomous or Parallel Electricity and its amendments (*Ley que Autoriza la Generación Eléctrica Autónoma o Paralela*, Law No. 7200 of 28 September 1990 and Law No. 7508 of 9 May 1995).

Private electricity generation remains subject to certain restrictions. First, it is limited to 30% (795MW) of the total power generated in the National Electric System and purchased by ICE, which is the main electricity distributor with 80% market share. The remaining 20% market share is held by two companies and four co-operatives, which do not have any limitation in the purchase of electricity from private generators.<sup>29</sup> Private companies may either invest in power plants for parallel or autonomous generation, only in renewable energy, not exceeding 20 MW, and provided that ICE purchases the electricity produced; or develop BOT (build, operate and transfer) projects, also in renewable energy, up to 50 MW through legal tenders. Participation is limited to 15% of total generation for parallel generation, and an additional 15% for BOT projects. In both cases, 35% of the capital stock of the company must be owned by Costa Rican nationals.

To respond to increasing demand for electricity, ICE is expected to expand its power generation capacity to an additional 625 MW from renewable sources, and to complete the installation of 1500 solar panels. The government expects to achieve this goal through further development of public and private power generation projects from hydroelectric, wind, and geothermal energy sources. As a public entity, ICE faces constraints to its debt level which might limit its capacity to make needed investments. For example, two of the major hydroelectric projects that are to be developed in the next ten years have an estimated cost of USD 3.2 billion, the equivalent to ICE's total investment in the last 60 years. The government therefore considers private electricity generation to be of public interest and provides tax exemptions to machinery and equipment for private generation projects (Table 5.6).

ICE has awarded contracts for electricity generation to 29 private companies, 24 parallel generators and 5 BOTs. So far, the parallel generators only produce about half (194.6 MW) of what they are legally allowed to (400 MW) (EIU, 2012), thus leaving room for further expansion. According to data from ICE, private electricity generation has been most significant in biomass and wind, while hydro and geothermal sources have only a small share of private participation (Figure 5.2).

Private investment represented 14% of total installed capacity and 17% of total electricity generated in 2012. A recent study by Bloomberg New Energy Finance and the Inter-American Development Bank (IADB) found that from 2006 to 2011, a cumulative USD 1 billion was invested in clean energy projects and businesses in Costa Rica, 0.4 billion of which in 2011 (BNEF and IADB, 2012). In 2011, the Central Bank began to report data on FDI inflows in the energy sector, which amounted to USD 18.2 million for that year. During 2012, FDI inflows in energy reached USD 133.7 million, more than seven times the amount for 2011.

Figure 5.2. **Private participation in renewable energy generation**

Source: ICE (2012).

The 2012 study by Bloomberg New Energy Finance and the IADB looked at a range of parameters relevant for climate investment readiness in LAC countries. Costa Rica's overall ranking was eighth, out of 26 countries (Table 5.3). The country scored better in terms of investment and climate finance (third) and low-carbon business and clean energy value chains (fifth), whereas it is placed only 15th in terms of its enabling framework and 11th for its greenhouse gas emission management. The study explains that Costa Rica's performance was weighed down by the regulated nature of its power market, dominated by ICE. In addition, it recognises the fact that Costa Rica benefits from the highest electrification rate in the region, but has historically limited market opportunities for private players. As such, the study acknowledges the positive signs of ICE welcoming additional private investment.

Table 5.3. **Climatescope 2012: Costa Rica's performance on climate change investment parameters**

Parameter	Ranking
I. <b>Enabling framework:</b> the existing policies, power market structures and levels of clean energy capacity online in a given country, as well as other market-size related factors	15
II. <b>Clean energy investment &amp; climate financing:</b> funds deployed in support of clean energy, plus the availability and cost of local capital such as microfinance.	3
III. <b>Low-carbon business &amp; clean energy value chains:</b> the availability of local manufacturing and supply chains for clean energy goods, services and financing.	5
IV. <b>Greenhouse gas management activities:</b> The extent of action taken and projects developed under the United Nations Clean Development Mechanism (CDM).	11

Source: BNEF and IADB (2012).

Although restrictions remain, prospects for further private investment in renewable energy are positive, since much of its potential has not been fully exploited (Table 5.4).

Table 5.4. **Renewable energy potential in Costa Rica**

Generation type	Identified potential <sup>1</sup> MW	Installed capacity MW	Percentage Exploited
Hydroelectric	6 474	1 692	26%
Geothermal	257 <sup>2</sup>	195	76%
Wind	274	129	47%
Biomass	95	39	41%
Solar	n/d	0.14	minimum

1. Identified projects that have at least a preliminary evaluation.

2. Data does not include geothermal power capacity in national parks.

Source: ICE (Expansion Plan of Power Generation 2012-24) and MINAE.

Costa Rica ranks fourth in wind power installed capacity in Latin America, after Brazil, Mexico and Chile.<sup>30</sup> However, almost half of the potential wind power identified remains unexploited. ICE encourages private investment in this sector by holding auctions for wind power purchase. Auctions for renewable energy are carried out according to a regulation issued in 2012 that establishes a special public bidding process for energy purchasing.<sup>31</sup> This regulation was set up to increase private investment participation in energy generation by improving the administrative process that was in place since 1997. This new procedure maintains the existing eligibility requirements for private generators, but creates a more transparent selection process starting with a public call for bids, the first of which was held in June 2012. This initiative has brought growing attention from the private sector, and to date close to 77% of the wind power generation is provided by private projects.

Solar energy is another resource yet to be exploited at its highest potential, and the government is making efforts to increase the development of the solar power generation sector. Although Costa Rica has good conditions for attracting investment in the photovoltaic panel sector (human resources trained in similar production activities such as semiconductors and wind turbines, high level of solar radiation, and high level of education in engineering), investment in the solar energy market remains limited.

To boost investment in solar energy, ICE has recently implemented a pilot “net metering” programme enabling residential, commercial and industrial end users to install solar systems and sell excess capacity back into the grid.<sup>32</sup> This initiative intends to assess the available capacity for private investment in low scale generation projects, and builds up technical capacity in the distribution companies for this kind of operation. This programme started in

October 2010 as a two-year project, and was extended to five years. It aims to achieve better understanding on the challenges that the electricity system would face in case of a greater expansion of small scale generators interconnecting to the system. One of the main barriers identified is the high cost of connecting to the distribution network, which results in the need of financial support for small scale generators. There is also a need to set appropriate technical regulations to facilitate these small operations. Between 2010 and 2012, 73 small generators joined the project, producing 233 kW.

Costa Rica and China have recently signed an agreement to boost Chinese investment in solar power projects in Costa Rica. One recent outcome is an alliance between two Chinese state enterprises (Jiangsu Guoxin Group, a photovoltaic panel producer, and Nari Group Corporation, an energy administrator) and the Costa Rican group Azucarera El Viejo/Greenersys to install a photovoltaic panel power plant in Guanacaste, to produce 4 MW of solar energy.<sup>33</sup> The total investment for this operation is estimated at USD 10 million, which will be provided by Chinese partners. These Chinese enterprises have also shown interest in investing in a production plant of photovoltaic panels in the country.

Private participation in generation from geothermal sources is currently forbidden.<sup>34</sup> The government is considering promoting geothermal energy generation, in order to alleviate the need for oil imports in dry periods, where hydro-energy generation capacity is reduced. The debate is still ongoing as most of the geothermal potential is located in protected national parks or reserves where it is legally forbidden to exploit this resource. Considering the existing potential, MINAE has submitted two bills to Congress, aimed at opening the possibility of geothermal generation in national parks.<sup>35</sup> The bills do not include provisions for the direct participation of private investment in geothermal electricity generation. However, private investment would be possible through public bidding procedures for providing the services, equipment purchase, and infrastructure required for the implementation of these projects.

The generation of electricity by a private investor for his own use is permitted and promoted in certain sectors: sugarcane mills, biogas in agri-business and solar panels. However, the government acknowledges that regulation has been slow in advancing with increasing market demand and this has created barriers for the development of private generation in some renewable sectors, such as sugar mill biogas and solar photovoltaic. One barrier is that the regulator (*Autoridad Reguladora de los Servicios Públicos*, ARESEP) has not yet established the prices at which excess electricity will be purchased. Another barrier are high warehouse costs involved in the import of renewable energy equipment, as there are many import procedures that cause

significant delays. On the other hand, the government grants incentives for private investors, including for the import of equipment (Table 5.6).

Further opening the electricity market to the private sector is one of the main challenges that the country faces to ensure greater private investment participation in clean power generation. There are currently seven bills under the legislative approval process, aimed at opening participation in electricity generation.<sup>36</sup> Two of these bills include special provisions related to renewable energy, and provide for specific incentives for clean generation, such as tax exemptions and differentiated conditions for bids and pricing regulations. Bill No. 17812 establishes similar incentives including the creation of a retail market enabling private generation of energy from renewable sources, without requiring a state concession.

### **Promoting investment in sustainable tourism**

Tourism is one of the main economic activities within Costa Rica's services sector, and the Tourism Development Law (*Ley de Fortalecimiento del Desarrollo de la Industria Turística Nacional*, Law No. 8694 of 11 December 2008) declares the tourism industry to be of public interest. The tourism industry relies heavily on the national system of conservation areas. In 2010, 90% of foreign tourists that visited Costa Rica for leisure carried out some nature-related activity.<sup>37</sup> In a recent report by the World Economic Forum comparing the competitiveness in travel and tourism of 139 countries, Costa Rica is ranked 5th in the Americas and 44th overall (WEF, 2011). The report acknowledges Costa Rica's performance in the conservation of natural resources (where it ranked 6th), highlights its ability to handle natural resources conservation alongside a growing tourism industry, and ranks Costa Rica as 25th for environmental sustainability (Table 5.5).

A strong government commitment is among the key drivers for sustainable tourism (OECD, 2012). In Costa Rica, the promotion of sustainability in the tourism industry is one of the government's development priorities, as reflected in the National Development Plan (NDP) and the National Plan for Sustainable Tourism 2010-16 (*Plan Nacional de Turismo Sostenible*, PNTS). The NDP emphasises that the country is committed to a sustainable tourism model that must promote the enjoyment of nature, high quality services, and the sustainable development of the industry. One of the objectives of the National Plan for Sustainable Tourism is to boost the sector's competitiveness by, for example, establishing fundraising strategies, financial and non-financial incentives and micro-credit schemes. The Plan sets quantitative goals for sustainable tourism, e.g. increasing the number of businesses with Certificates of Sustainable

Table 5.5. **Costa Rica's Performance on Travel Competitiveness**

Indicators	Rank out of 139
<b>Regulatory framework</b>	
Policy rules and regulations	66
Prevalence of foreign ownership	20
Business impact of rules on FDI	36
Environmental sustainability	25
Time required to start a business	125
Safety and security	63
Health and hygiene	74
Government prioritization of the travel and tourism industry	13
<b>Business environment and infrastructure</b>	
Quality of air transport infrastructure	80
Quality of roads	111
Quality of railroads	100
Tourism infrastructure	39
ICT infrastructure	72
<b>Human, cultural and natural resources</b>	
Quality of the natural environment	25

Source: WEF (2011).

Tourism from 183 in 2010 to at least 500 in 2016 (Box 5.3). It also seeks to improve the capacity of private companies to market Costa Rica as a tourist destination, in order to attract more visitors. The Plan further seeks to improve the sector's value chain, by identifying and facilitating entry points for private companies, where appropriate.

However, though achieving the Plan's objectives will require additional investment, e.g. to develop and improve sustainable tourism infrastructure, provide training, there is no specific data about private or public investment required to meet the goals established in these plans. In 2012, the government allocated USD 49.5 million (approximately 0.11% of GDP) from the central budget to ICT. The latter co-operates with a range of institutions, including CINDE, COMEX and PROCOMER to promote investment in the tourism sector.

Sustainable tourism also requires adequate land use policies and mechanisms to prevent illegal construction in tourist destinations. In 2012, the government launched the National Land-planning Policy for 2012-40 aimed at strengthening institutional co-ordination to achieve an integrated land-planning system.<sup>38</sup> The policy includes strategic areas to be considered in the planning process such as environmental protection and competitiveness of economic activities like tourism. ICT is currently working with the Ministry of Housing and Land Planning and local governments in order to improve and modernise the land-planning system in the Pacific coast, a region with a high influx of tourists and development potential.

### Box 5.3. Certification for Sustainable Tourism

The Certification for Sustainable Tourism (*Certificado para la Sostenibilidad Turística*, CST) was created in 1998 and is currently regulated by the Law on Incentives for Corporate Social Responsibility in Tourism (*Incentivo de la Responsabilidad Social Corporativa Turística*, Law No. 8811 of 12 May 2010). The CST, granted by the Cost Rican Tourism Board (*Instituto Costarricense de Turismo*, ICT) at no cost for the beneficiaries, is designed to differentiate businesses of the tourism sector based on the degree to which they comply with a sustainable model of natural, cultural and social resource management. It consists of a five-level scale, depending on the degree of sustainability of the company, measured against a list of criteria. According to the government, the CST fundamental purpose is to mainstream sustainability into the country's efforts towards competitiveness in tourism, while improving the way in which cultural, natural and social resources are used. It also seeks to encourage the active participation of local communities in this model and to provide a new source of competitiveness within the business sector.

In addition to the reputation attached to the certificate, the CST system awards companies direct incentives and benefits in proportion to their rating. These include training, priority participation in world tourism fairs and events, international and national marketing and promotion specifically designed for the CST, among others. A recent study by ICT, published in the magazine *Summa*, shows that companies awarded the CST may have significant savings in operational costs, e.g. 70% in electricity, 60% in water, and increase purchase of local products by 50%. These findings are in line with the benefits of sustainable tourism described in UNEP's study on energy and resource efficiency in the tourism sector.

As of mid-2013, there were 287 CST certified enterprises distributed as follows: 213 hospitality businesses, 66 tour agent operators, 5 car rental agencies, and 3 theme parks. They represent almost 30% of all companies declared as tourist establishments.\* The government's goal is to increase that number to 500 enterprises by 2014.

\* To be declared by the ICT as a "tourist establishment", companies have to comply with the Regulation of Tourist Business and Activities (Decree 25226-MEIC-TUR).

Sources: ICT, *Revista Summa*, UNEP (2011).

Another effort to attract private investment into sustainable tourism is the Sustainable Tourism Programme in Wildlife Protected Areas, designed to create private investment opportunities related to infrastructure development within protected areas, including entry booths, visitor centres, lodging for staff and tourists, restrooms and sewage systems, viewpoints, bridges, wharves, roads and signs, and maintenance work in general. The programme, based on a co-operation agreement with the IADB, is also designed to provide solutions for solid and liquid waste management, training and technical assistance on customer service, first aid and conflict management for SINAC's personnel working in conservation areas.<sup>39</sup>

## Incentives and access to finance for green investment

### Green investment incentives

In line with its sustainable development priorities, Costa Rica has put in place some mechanisms to raise revenue from the use of environmental services, and to dissuade environmental harmful behaviour. Funds raised through these mechanisms help finance activities that support the governments' environmental objectives, including investment incentives. These mechanisms include a tax on fossil fuels; water usage fees; and a national parks fee (Box 5.4).

#### Box 5.4. Sources of funding for green investment incentives

**Fossil fuel tax:** This tax (*Impuesto único a los combustibles*) applies to the production, refining, distillation and import of oil and is charged as a fixed amount per litre of fossil fuel. Different rates apply to different types of fuel.\* Of the total revenues collected through this tax, 3.5% are earmarked to finance the National Fund of Forestry Financing, FONAFIFO.

**Water pricing mechanisms:** Costa Rica has adopted three types of water pricing mechanisms that serve to assign an adequate value to drinking water and the ecosystems that guarantee the sustainability of water supply. They comprise an environmental fee included in water bills; a tax that applies to all water-use concessions; and a waste water discharge tax that is mandatory for individuals and companies that discharge pollutants. Part of the revenues from the environmental fee is used to make direct payments to the owners of forests that provide environmental services to watersheds. The Programme for Payment of Environmental Services (*Programa de Pago por Servicios Ambientales*) receives 50% of the revenues. Revenues from the water discharge tax are invested in sewer and domestic wastewater treatment projects, and in the conservation, restoration and protection of watersheds.

**National Parks Fee:** The 1977 National Parks Law (*Ley del Servicio de Parques Nacionales*, Law No. 6084 of 24 August 1977) established the National Parks Fee, which is applied to a broad range of transactions. The fee is levied on a range of administrative procedures, such as the granting of municipal licenses, passports and international travel permits; car registrations; signature authentication etc. 70% of the revenues derived from this fee are allocated to conservation activities in protected areas.

\* Current rates of the fossil fuel tax are available at: <http://dgt.hacienda.go.cr/tramosytarifas/actimpcomb/Paginas/Impuesto%C3%BAnicoalcombustibles.aspx>.

The government offers a range of incentives to promote investments that enhance companies' environmental performance through activities such as energy efficiency and technological innovation for cleaner production (Table 5.6). Incentives are available to foreign and domestic investors alike.

Table 5.6. **Green investment incentives in Costa Rica**

Incentive	Purpose of the incentive	Type of benefit	Beneficiaries
PROPYPE Fund-established by the SMEs Strengthening Law (No. 8262)	To encourage innovation and promotion of cleaner production processes.	Partial financial support for acquisition of cleaner technologies, training, courses and internships.	SMEs registered in the General Directorate of SME Support ( <i>Dirección General de Apoyo a la Pequeña y Mediana Empresa, DIGEPYME</i> ).
MICITT Incentives Fund -established by the Promotion of Science and Technology Law (No. 7169)	To promote cleaner production and modernisation of agricultural processes.	Co-financing of training, scholarships and incentives for researchers; co-financing promotion of innovative technologies; funding for research projects in science and technology.	SMEs registered in DIGEPYME.
Rational Use of Energy Law (No. 7447)	To promote investment in technologies that help reduce energy use.	Co-financing (50 % of the total investment costs) or discount on electricity bills (20% of the amount equivalent to the annual energy savings).	Companies making investments to reduce energy consumption (investment must exceed 15% of the annual energy costs).
	To promote and gradually implement a programme to promote rational energy use and achieve energy efficiency.	Tax exemptions (sales tax, excise tax, ad valorem tax, tax on imported goods) on specific machinery, equipment and materials for renewable energy production.	Private enterprises; national manufacturers or assemblers of equipment, machinery or vehicles to promote rational use of energy; importers of energy efficient goods.
Electricity Parallel Generation Law No. 7200	To encourage private energy production.	Tax exemptions on imports of machinery and equipment used for electricity generation, transformation and transmission.	Private companies interested in producing energy (35% of the company's capital must be Costa Rican).
Water Use Canon Decree (No. N° 32868-MINAE)	To promote and encourage clean energy production using renewable resources.	Water use fee reduction to 0.06 colones/m <sup>3</sup> . Water use fee reduction to 0.03 colones/m <sup>3</sup> .	Hydropower projects with a capacity below 2000 kW. Hydropower projects with an energy production capacity below 500 kW, intended for self-consumption.
Wastewater Treatment Systems Law (No. 8932)	To mitigate pollution of water sources and improve water quality.	Tax exemption on the acquisition of wastewater treatment system components, materials and equipment.	Domestic or industrial wastewater treatment system users.

Table 5.6. **Green investment incentives in Costa Rica** (cont.)

Incentive	Purpose of the incentive	Type of benefit	Beneficiaries
2007 Law on the Development and Promotion of Organic Farming (No. 8591)	To finance studies on organic farming.	Financial support for organic agriculture, by sponsoring research on indigenous and traditional farming processes and activities to promote this type of farming.	Organic farms that qualify as SMEs.
	To facilitate and promote production and agro-industrialisation of organic agricultural products.	Tax exemption on the import of motor vehicles and equipment and acquisition of machinery and supplies.	Organised Groups of Organic Producers ( <i>Grupos de Productores Organizados</i> ) registered in the Ministry of Agriculture.
	To promote organic agricultural production.	Income tax exemption for 10 years.	Organic farms that qualify as SMEs.
	To foster sales of registered organic products.	Sales tax exemption.	Individuals and organisations that qualify as micro, small and medium organic farmers.
Biodiversity Law (No.7788)	To promote investment, research, and technology transfer aimed at conservation and sustainable use of biodiversity.	Tax exemption on supplies and equipment (granted only once), preferential credit conditions for micro-businesses for mortgages; technical assistance.	Activities or programmes carried out by natural and legal persons that contribute to the conservation and sustainable use of biodiversity.
Development Banking System Law No.8634	To increase the efficiency of SMEs in reducing environmental risks and implementing cleaner production programmes.	Funding, loan guarantees and non-financial services for entrepreneurial development.	SMEs implementing cleaner production programmes or environmental risk management projects.

Source: COMEX.

As described in Chapter 3, the government also grants a range of investment incentives, some of which might appear to be in conflict with green growth and carbon neutrality objectives. For example, among the incentives to promote tourism, there are subsidies for the purchase of fuel for tourism-related aircraft and for the purchase of vehicles for the transport of tourists. There are currently no mechanisms in place to review potential conflicts of existing investment incentives with priority areas for green growth. However, the government plans to put in place a system to track progress on the goal of becoming carbon neutral by 2021 (which could help *inter alia* to align current incentives with the country's carbon neutrality objectives). This system is part of the current agenda although it remains as a pending task. In addition, under OECD-UNIDO guidance, work is underway to apply the OECD *Green Growth Indicators* in Costa Rica (OECD, 2013, forthcoming).

## **Other Incentives**

### ***Free Zone Regime***

The Free Zone Regime (FZR) grants incentives to companies in sectors considered to be strategic for the country's development (Chapter 3 Section on Investment promotion and facilitation). This includes projects implemented by companies using an ISO 14001 (14004) certification or its equivalent in its operations, as well as companies that have received Leadership and Energy Environmental Design (LEED) certification for their facilities, and companies engaged in the renewable energy value chain, including production of photovoltaic and solar cells, batteries made from polymers or other advanced materials, wind and hydroelectric turbine parts and other components.

### ***Clean Development Mechanism***

Costa Rica has registered 10 projects with the Clean Development Mechanism (CDM) under the UNFCCC programme, including in small hydro, landfill gas, wind, hydro, palm oil solid waste, agricultural residue and reforestation (BNEF and IADB, 2012). CDM projects allow countries with a commitment to reduce or limit gas emissions under the Kyoto Protocol to implement an emission-reduction project in developing countries. Such projects receive certified emission reduction credits that can be counted towards meeting the country's Kyoto targets.<sup>40</sup> By providing an emission offset credit scheme, CDM incentivises investment in sustainable development and the reduction of emissions.

## **Assessment of green investment incentives**

Costa Rica has no formal mechanisms in place to systematically assess the impact of incentives supporting green investment.

There is, however, some indication to suggest that the FZR incentives for companies that incorporate good environmental practices are yielding results. For instance, the Free Zone El Coyoil, the largest high-tech business park in Central America, is now implementing an environmental policy in order to become an "ecological business park". El Coyoil is encouraging businesses operating in the park to implement environmental measures such as the use of solar panels and other energy efficiency systems and sustainable water and waste management. Some of the buildings within the complex have LEED certifications. Furthermore, 10 hectares of forest of the business park have become a protected area in order to compensate its carbon footprint.

Another indication of possible impacts of the government's environmental incentives is the increase in employment in green activities since the incentives have been in force. According to a study drawing on ILO data, there are approximately 117 500 jobs that relate to green activities in

Costa Rica, which represents 6% of total employment. The same data shows that the number of green jobs grew by 6.8% between 2001 and 2009.<sup>41</sup>

### **Access to finance**

According to some analysts, despite attracting relatively significant foreign investment, Costa Rica lacks advanced financial products and capital from local financial institutions to support clean energy investment (BNEF and IADB, 2012). This reflects the mitigated score for financial market development in the country in the latest WEF report on global competitiveness, with particularly low scores in financing through local equity markets and access to loans, with rankings of 122 and 111 respectively (WEF, 2012). Out of 20 microfinance institutions active in the country, only three offer green micro loans: *Banco Internacional de Costa Rica*, *Banco Nacional de Costa Rica* and the Central American Bank for Economic Integration. The former is the most active of the three finance providers for clean energy projects in the country, but it has limited funding experience in this area (BNEF and IADB, 2012).

A recent study analysing strategies to implement climate policies in Latin America recommended that Costa Rica should strengthen its financial architecture in support of climate objectives (UNDP, 2012, citing Umaña and Cordero, 2011). Among the recommended measures are the creation of a National Climate Change Fund; issuing green bonds guaranteed by multilateral banks, and supported by funds from FONAFIFO's forest carbon programme, as well as renewable energy investments; public funding through the national budget and other economic instruments, such as the tax on fossil fuels; access to domestic and international carbon markets as a means to tap into private sector resources; and a range of National Appropriate Mitigation Actions which would be supported by donor countries and the international community.

The Action Plan for the National Climate Change Strategy (*Plan de Acción Estrategia Nacional de Cambio Climático*) adopted in 2012, draws on these recommendations to strengthen funding for the country's climate change objectives. For example, the government is currently negotiating seed funding to consolidate the National Climate Change Fund that is to be created. The Action Plan also suggests a better re-distribution of public funds to support the different agencies in charge of climate change actions. It further indicates that the creation of new sources of revenues, such as taxes on stock change and banking operations to fund the National Climate Change Fund will be explored. Finally, the consolidation of a national carbon market is seen as a way to better mobilise the private sector.

## Promoting green business conduct and stakeholder participation in green growth

The chapter on the environment in the *OECD Guidelines for Multinational Enterprises* recommends that enterprises take due account of the need to protect the environment and public health and safety and, in general, to conduct their business in a way that contributes to the broader goal of sustainable development. In particular, enterprises should put in place and implement a system of environmental management, provide information on the impacts that their activities and products may have on the environment, health and safety, and assess and reduce the foreseeable impacts of their activities. The Guidelines also recommend enterprises to seek to improve their environmental performance and that of their supply chain, to provide their workers with appropriate teaching and training about issues relating to environmental health and safety, and to contribute to the development of public policy that is environmentally meaningful and economically efficient.

### **Policies to prevent environmental damages**

To ensure that development projects, including greenfield private investments, are in line with environmental regulations, developers are subject to a range of environmental evaluation and approval procedures, as mandated by the Organic Law of the Environment. Approvals are granted by the National Environmental Technical Secretariat (*Secretaría Técnica Nacional Ambiental*, SETENA).<sup>42</sup> Developers must submit to SETENA a description of their proposed economic activity and the necessary information to evaluate its effects on the environment. Based on this information, SETENA estimates the level of impact the activity could have and the measures to be adopted to mitigate potential environmental damages.

For low-impact activities, the developer must submit a list of possible actions to prevent environmental harm and provide a commitment to comply with the Best Environmental Practices Code (BEPC) issued by SETENA,<sup>43</sup> a mandatory code for both private and public investors. In case of moderate impact activities, the developer must submit an Environmental Contingency Plan and a commitment to comply with the BEPC. Finally, for high impact activities, SETENA requests an Environmental Impact Assessment (EIA), which consists of a more comprehensive assessment of the environmental impacts and possible mitigation actions. The EIA must include a communication plan with civil society and the local government, as well as a contingency plan for environmental damage control and mitigation.

The projects that obtain a license from SETENA are subject to an environmental monitoring process at any time. In case of non-compliance with the commitments acquired in virtue of the EIA, SETENA may order the

closure of the project and the execution of an environmental guarantee aimed at compensating any environmental damage caused by the project.

The EIA system has been in place for over fifteen years. According to the authorities, the major concern of the private sector has been the length of the process. Another concern has been its cost. MINAE had the intention to start an assessment and revisions of the system from 2013.

### ***Policies promoting green responsible business conduct***

In addition to legislation to promote responsible business conduct discussed in Chapter 4, the government has implemented several programmes promoting green responsible business conduct. These include the Clean Production Programme, the Ecological Blue Flag Programme, the green jobs training programme, as well as initiatives to support the government's carbon neutral objectives.

At present, there is no formal system in place to promote green procurement, and thus to favour government purchases from "green" companies. However, Costa Rica is part of UNEP pilot programme "Capacity Building for sustainable public procurement in developing countries", and has been working on identifying the social, environmental and economic benefits of sustainable procurement. A Committee on Sustainable Procurement, chaired by MINAE, is currently reviewing national legislation in order to develop a national policy on sustainable procurement.

### ***Clean Production Programme***

The Clean Production Programme introduced by MINAE in 2008 promotes the use of high environmental standards and green technology to help enterprises reduce costs while improving environmental performance.<sup>44</sup> The programme is based on a voluntary agreement under which the subscribing companies commit to implement specific practice to improve handling and disposal of sewage, solid waste management, nuisance control, good production practices, and occupational health. The process is followed and monitored by a committee which includes the Ministry of Health, MINAE and the Ministry of Agriculture. To implement the programme, MINAE has partnered with private and academic entities including the National Centre of Cleaner Production and the Costa Rican Institute of Technology. The programme also supports other cleaner production initiatives such as the partnership developed between Marriott International, Coca-Cola FEMSA and the World Environment Centre to work jointly with the local suppliers on practices for cleaner production. As a result of the Clean Production Programme, the major slaughterhouses, representing 60% of meat production in Costa Rica, committed to implement cleaner production practices through

voluntary agreements. According to the government, the level of compliance with the agreements is very high, and only on one occasion the agreement had to be cancelled.

### ***Ecological Blue Flag Programme***

The Ecological Blue Flag (an adaptation of the European Blue Flag programme) promotes responsible conduct in the tourism sector and in other industries.<sup>45</sup> It identifies beaches that meet certain criteria, e.g. on the microbiological quality of ocean waters and drinking water, waste collection and treatment in the area, etc. It provides incentives to hotels, local tourism boards and coastal communities, to work together to protect the beaches and the surrounding areas. According to the government, the programme has been successfully implemented for the last 20 years, and has contributed to the improvement of environmental conditions in hundreds of communities and tourist destinations, and to raising the environmental performance of government agencies and the private sector. By end 2011, over 700 government agencies, private organisations, businesses and communities had been certified under the Ecological Blue Flag Programme.<sup>46</sup>

### ***Green jobs training programmes***

In order to increase the use of green technologies and boost green jobs, the National Apprentice Institute is incorporating environmental courses into its training catalogue. Some examples of these modules are: organic agriculture, biogas production, solid waste management, basic concepts on cleaner production, control of gas emissions, best practices on handling refrigerants, and implementation of sustainable tourism standards. It has also incorporated new subjects such as GHG emissions control in order to contribute to the country's goal of becoming a low carbon economy. In addition, the institute also provides customised training adapted to industry needs. For example, the institute has developed training courses on wastewater management and water purification, which are in high demand by industry.

### ***Programmes in support of carbon neutrality***

The government is aware that the transition to a low-carbon economy requires the active participation of the business sector, including through business practices to lower energy consumption and improve the carbon footprint of the supply chain (OECD, 2010). Over the past years, it has put in place a range of programmes to promote such practices. In 2011, MINAE launched the "C-Neutral" standard, following broad consultations with the relevant sectors to develop a common standard to serve as the basis of the certification. A Steering Committee of experts from the public and private sectors provided strategic

direction throughout the process. The standard (INTE12-01-06:2011) establishes the requirements and methodologies needed to allow the government to certify a C-Neutral management system. MINAE launched the Carbon Neutral Programme in 2012, and approved the procedures to estimate and verify the carbon footprint of companies and organisations, and grant certification under the INTE12-01-06:2011 standard.<sup>47</sup> It also established procedures for carbon offsetting through the acquisition of Certified Emission Reduction, Voluntary Emission Reduction, and Costa Rican Compensation Units.

In 2013, seven companies obtained the C-Neutral label (Café Britt, BAC Credomatic, Euromobilia, Florex, Geocycle, Travell Excellence and Mapache Rent a Car). Another sixteen companies are in the process of obtaining the C-Neutral label. At current, the Costa Rican Institute for Technical Norms (*Instituto de Normas Técnicas de Costa Rica*, INTECO) is the only accredited body to grant the certification. According to INTECO, due to the press and media coverage, there has been an increased interest of the private sector in this label.<sup>48</sup>

Another initiative for business to contribute to the country's carbon neutrality efforts include a programme allowing offsetting carbon emissions in international and domestic travel, the Climate Conscious Travellers programme (*Viajeros con Conciencia Climática*, VCC), established in November 2009 by the Costa Rican National Chamber of Tourism. The aim of VCC is to offset 20% of emissions from all flights to and from Costa Rica using 2007 as the base year. Emissions from international flights are not included in Costa Rica's inventory of greenhouse gas emissions, but nonetheless add 46% to the national carbon footprint (Canaeco, 2011). The programme is voluntary, and offers international travellers the option of paying USD 5 per ton of CO<sub>2</sub> emitted per flight. The proceeds are used to fund activities in forestry conservation, aquifer recharge areas, scenic spots and areas with high tourist flows.

### **Energy efficiency in SMEs**

Costa Rica is among the 5 Central American countries that form part of the Greenpyme Programme.<sup>49</sup> It promotes and provides tools to implement energy efficient measures in SMEs. A 2010 memorandum of understanding between BAC International Bank, based in Panama, and the Inter-American Investment Corporation provided funding to, *inter alia*, carry out training and facilitate access to finance for SMEs wishing to invest to improve energy efficiency.

### **Other initiatives**

The Programme for International Accreditation of Exporting Companies (*Programa de Acompañamiento en Certificaciones para la Exportación*, PROAGEX) is a public-private initiative that seeks to promote international certification of

exporting SMEs, including “green certifications” such as ISO 14001, LEED, Green Business Certification, and the domestic C-Neutral. The programme is led by the Chamber of Industries, the Ministry of Science, Technology and Telecommunications and the public agency charged with promoting external trade in Costa Rica (PROCOMER), and provides financial and technical assistance to SMEs interested in this kind of certifications.

In July 2012, the government launched a public-private initiative aimed at fostering research and technology development in clean energies. MINAE and RECOPE, as well as Ad Astra Rocket, a cutting-edge technology enterprise, and the Earth University signed a co-operation agreement to jointly develop knowledge and provide training in support of clean energy.

There are also initiatives in place to promote responsible business conduct in agricultural production. Acknowledging that the agriculture sector is the second biggest producer of GHG emissions in Costa Rica (MINAE, 2009), and that industrial agriculture production has significant environmental impacts related to the high usage of fuel, water and chemicals, the government has adopted an Action Plan for Climate Change and Agri-Environmental Management (2011-14). This Plan aims, *inter alia*, to promote agricultural production practices to reduce GHG emissions and prevent contamination. A number of coffee, sugar cane, dairy products, cattle and banana producers have already developed climate-friendly practices.<sup>50</sup> Since 1992, the banana sector is taking actions to reduce its environmental impact. The “Banana Environmental Commission”, comprising public and private sector representatives was established to ensure an environmentally responsible banana production in the country. Results include a 50% reduction of water use in the washing process of the fruit; reduction in electricity consumption through the use of solar energy in packaging plants; reduction of 40% in the use of nitrogenated fertilizers per hectare without reducing farm productivity; and the conservation of more than 1 200 hectares of forest.<sup>51</sup> Another example is the National Platform for Responsible Production and Marketing of Pineapples, which involves domestic and foreign investors, as well as public and non-governmental organisations, trade unions and financial institutions, and which is working to reduce the negative impacts and increase the environmental and social benefits of the sector (Ministry of Agriculture, 2011).

In addition to government-led programmes, several private companies operating in the country have developed initiatives to improve their environmental performance. One of them is Florida Ice & Farm Company, the major beverage producer and distributor in Costa Rica, which has succeeded in reducing, reusing and recycling over 99% of the waste generated in its plants and distribution centres. Another example is VICESA, a medium-sized company that produces glass bottles, which has launched a recycling programme throughout the country to collect glass. To date, it has been able to

collect 2000 tons of glass per month and has reached 628 suppliers. In the financial sector, the National Bank of Costa Rica has taken a few initiatives to both improve its own environmental footprint, and to help its clients support green initiatives. For example, it has put in place a mechanism by which vehicle owners can offset their carbon emissions through voluntary contributions to the Programme for Environmental Services (UNEP FI, 2012).<sup>52</sup>

## Notes

1. A recent OECD Working Paper (*Towards a green investment policy framework*) provides background and guidance on establishing a policy framework to promote private investment in low carbon, climate-resilient infrastructure (Corfee-Morlot et al, 2012).
2. InBio: [www2.inbio.ac.cr/en/biod/bio\\_biodiver.htm](http://www2.inbio.ac.cr/en/biod/bio_biodiver.htm).
3. National parks cover 12.26% of the country, biological reserves 0.42%, protected areas 3.07%, forest reserves 4.26%, wildlife refuges 3.42%, wetlands (including mangroves) cover 1.81%. Costa Rica Tourism, [www.tourism.co.cr/costa-rica-protected-areas/index.html](http://www.tourism.co.cr/costa-rica-protected-areas/index.html) and Convention on Biological Diversity country profiles: [www.cbd.int/countries/profile/?country=cr#nbsap](http://www.cbd.int/countries/profile/?country=cr#nbsap).
4. World Bank: [www.worldbank.org/en/country/costarica/overview](http://www.worldbank.org/en/country/costarica/overview).
5. UN Stats, Millennium Indicators, <http://mdgs.un.org/unsd/mdg/Data.aspx>. Data is for 2009, the latest year available.
6. MINAE, [www.minae.go.cr/index.php/2012-06-08-20-20-39/gris](http://www.minae.go.cr/index.php/2012-06-08-20-20-39/gris).
7. Global Post (7 December 2011), China Announces Largest Investment Yet in Costa Rica, [www.globalpost.com/dispatches/globalpost-blogs/que-pasa/china-announces-largest-investment-yet-costa-rica](http://www.globalpost.com/dispatches/globalpost-blogs/que-pasa/china-announces-largest-investment-yet-costa-rica).
8. Costa Rica Insider (17 August 2012), China to Start Refinery Operations in January, [www.insidecostarica.com/dailynews/2012/august/17/costarica12081704.htm](http://www.insidecostarica.com/dailynews/2012/august/17/costarica12081704.htm).
9. Statistics provided by Costa Rica's Central Bank.
10. For example, a 2012 survey by Trip Advisor of American travellers found that Costa Rica is the most popular destination in the world for travellers interested in an eco-friendly trip. 30% of travellers indicated that they would choose a destination because of its eco-friendly profile and 50% stated a willingness to pay more for eco-friendly accommodation. Trip Advisor Survey Reveals Traveller Growing Greener, 19 April 2012, [www.tripadvisor.com/PressCenter-i5154-c1-Press\\_Releases.html](http://www.tripadvisor.com/PressCenter-i5154-c1-Press_Releases.html).
11. National Plan for Sustainable Tourism, Chapter 2: [www.visitcostarica.com/ict/backoffice/treeDoc/files/59A5\\_Resumen%20del%20plan%20%20julio%202011.pdf](http://www.visitcostarica.com/ict/backoffice/treeDoc/files/59A5_Resumen%20del%20plan%20%20julio%202011.pdf).
12. World Bank, [http://databank.worldbank.org/ddp/home.do?Step=2&id=4&DisplayAggregation=N&Sdmx\\_Supported=Y&CNO=2&SET\\_BRANDING=YES](http://databank.worldbank.org/ddp/home.do?Step=2&id=4&DisplayAggregation=N&Sdmx_Supported=Y&CNO=2&SET_BRANDING=YES).
13. Around 40% of cars are 15 years old or more, around 26% are 5 years old or less. [www.tec.ac.cr/sitios/Vicerrectoria/vie/editorial\\_tecnologica/Revista\\_Tecnologia\\_Marcha/pdf/Tecnologia-en-Marcha-25-1/25-1-5.pdf](http://www.tec.ac.cr/sitios/Vicerrectoria/vie/editorial_tecnologica/Revista_Tecnologia_Marcha/pdf/Tecnologia-en-Marcha-25-1/25-1-5.pdf).
14. The excise tax is applied by tiers depending on the age of the vehicle, its characteristics, type, energy efficiency. It can go to up to 86% for vehicles older than six years that are not efficient, whereas electric vehicles may pay 0%.

15. Action Plan for the National Climate Change Strategy, 2012.
16. Tico Times, October 19 2012, A first step toward carbon neutrality, [www.ticotimes.net/Current-Edition/Top-Story/A-first-step-toward-carbon-neutrality\\_Friday-October-19-2012](http://www.ticotimes.net/Current-Edition/Top-Story/A-first-step-toward-carbon-neutrality_Friday-October-19-2012).
17. UNEP Country Profile on Costa Rica: [www.unep.org/forests/Portals/142/docs/Costa\\_Rica.pdf](http://www.unep.org/forests/Portals/142/docs/Costa_Rica.pdf).
18. Convention on Biological Diversity country profiles: [www.cbd.int/countries/profile/?country=cr#nbsap](http://www.cbd.int/countries/profile/?country=cr#nbsap).
19. United Nations Environment Programme (UNEP), Costa Rica profile: [www.unep.org/forests/Portals/142/docs/Costa\\_Rica.pdf](http://www.unep.org/forests/Portals/142/docs/Costa_Rica.pdf).
20. The Future Policy Award, established by the World Future Council, annually distinguishes laws with particularly positive effects on the living conditions of current and future generations. [www.worldfuturecouncil.org/3474.html](http://www.worldfuturecouncil.org/3474.html).
21. Yale Environmental Performance Index: <http://epi.yale.edu/dataexplorer/tableofmainresults> and <http://epi.yale.edu/dataexplorer/countryprofiles?iso=CRI>.
22. The Ministry was previously called Ministry of Environment, Energy and Telecommunications (Ministerio del Ambiente, Energía y Telecomunicaciones, MINAET), until 1 February 2013, when the name change became effective.
23. SINAC, [www.sinac.go.cr/Paginas/Inicio.aspx](http://www.sinac.go.cr/Paginas/Inicio.aspx).
24. [www.wavespartnership.org/waves](http://www.wavespartnership.org/waves).
25. <http://thecostaricanews.com/costa-rica-receives-recognition-award-for-protecting-the-ozone-layer/13183>. To date, CFC consumption in Costa Rica has been completely eliminated and trade of substances included under the Protocol is regulated through a digital tracking system.
26. Declaration on Green Growth adopted at the meeting of the OECD Council at Ministerial Level on 25 June 2009, [C/MIN(2009)5/ADD1/FINAL] [www.oecd.org/env/44077822.pdf](http://www.oecd.org/env/44077822.pdf).
27. VI National Energy Plan 2012-30, [www.dse.go.cr](http://www.dse.go.cr).
28. Plan de Expansión de la Generación Eléctrica 2012-24: [www.grupoice.com/wps/wcm/connect/3bd3a7804%207cdebee904df9f079241ace/PEG2011rev1.pdf?MOD=AJPERES](http://www.grupoice.com/wps/wcm/connect/3bd3a7804%207cdebee904df9f079241ace/PEG2011rev1.pdf?MOD=AJPERES).
29. These companies are Empresa de Servicios Públicos de Heredia (ESPH) and Junta Administradora del Servicio Eléctrico de Cartago (JASEC); the co-operatives are Coopeguanacaste, Coopelesca, Coopesantos and CoopeAlfaro.
30. Global Wind Energy Council, [www.gwec.net/index.php?id=103](http://www.gwec.net/index.php?id=103).
31. Executive Decree No. 37124 Regulation of Law 7200 that Authorizes the Generation of Autonomous or Parallel Electricity (June, 2012) (Decreto 37124 Reglamento al Capítulo I de la Ley N° 7200 Ley que Autoriza la Generación Eléctrica Autónoma o Paralela), and ICE's Internal Procedure for Selection of Power Generation Projects for electricity sale to ICE- Law 7200 (Chapter I).
32. Executive Directive No. 14-MINAET-2012 of 15th March 2011.
33. La Nación, 14 of August 2012, [www.nacion.com/2012-08-14/ElPais/Chinos-usaran-luz-solar-de-Guana%20caste-para-generar-energia.aspx](http://www.nacion.com/2012-08-14/ElPais/Chinos-usaran-luz-solar-de-Guana%20caste-para-generar-energia.aspx).
34. According to Figure 5.2, there is 14% private participation in geothermal energy production. This figure represents energy generated from a BOT contract signed by ICE in the end 1990s. In this case, the geothermal energy exploitation is directly

- executed by ICE, and the thermal energy (in form of steam) is sold to a private company that transforms it into electricity.
35. Exploitation of geothermal sources in national parks would be subject to certain conditions including payment of a fee to be invested in biodiversity conservation (Bills No. 17680 and No. 17707).
  36. Bills No. 18093, No. 17495, No. 17474, No. 17496, No. 17666, No. 17812, and No. 17811.
  37. Costa Rica Tourism Board, estimated data results from 2010 survey.
  38. *Política Nacional de Ordenamiento Territorial* [www.mivah.go.cr/PNOT.shtml](http://www.mivah.go.cr/PNOT.shtml).
  39. The total budget of the programme is USD 25 million of which USD 19 million will be financed by IADB, and USD 6 million will be provided by the Costa Rican government. The total budget will be used as follows: investment for sustainable tourism development (infrastructure: roads, trails) 65%; planning and sustainable tourism management strengthening (training for municipal staff and local businesses) 6.7%; training for SINAC's personnel 7%; management, monitoring and auditing 9.1%; contingencies and expenses 12.2%.
  40. UNFCCC (2013), *Clean Development Mechanism*: [http://unfccc.int/kyoto\\_protocol/mechanisms/clean\\_development\\_mechanism/items/2718.php](http://unfccc.int/kyoto_protocol/mechanisms/clean_development_mechanism/items/2718.php).
  41. *Empleos Verdes y Formación Profesional: la transición a economías verdes*, [http://cicr.com/docs/II\\_Congreso\\_Ambiental/OIT.pdf](http://cicr.com/docs/II_Congreso_Ambiental/OIT.pdf).
  42. The National Environmental Technical Secretariat was created in 1995 with the purpose of "harmonising environmental impacts and productive processes". One of its main functions is to handle environmental impact assessment procedures, prior to granting licences for development projects with potential environmental impacts, and to monitor compliance with the licence requirements, [www.setena.go.cr/normativa.html](http://www.setena.go.cr/normativa.html).
  43. Best Environmental Practices Code (*Código de buenas prácticas ambientales*), Decree No. 32079-MINAE-2004 of 14 May 2003.
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## ANNEX A

# Costa Rica's exceptions to the National Treatment instrument

## A. Exceptions at national level

### I. Investment by established foreign-controlled enterprises

*Land:* Concessions to perform any type of development or activity in the restricted maritime-terrestrial zone (150 meters from the public zone line, which includes the zone within 50 meters from the high tide line) shall not be granted to enterprises in which over 50% of the capital stock is owned by foreigners.

Authority: Article 47, Law No. 6043 of 2 March 1977.

*Electricity (generation):* Private companies may invest in commercial power generation not exceeding 50 000 kW, provided that 35% of the capital stock of the company is owned by Costa Rican nationals; that the state-owned company, *Instituto Costarricense de Electricidad*, purchases the electricity produced; and that the power generated by all private plants in Costa Rica does not represent more than 30% of the total power produced in the national electric system. Participation of foreign capital in public or private legal persons entering into joint ventures with the Public Services Company of Heredia (ESPH) is limited to a maximum of 49% of the capital stock.

Authorities: Articles 3, 5 and 20 Law No. 7200 of 28 September 1990. Article 15, Law No. 7789 of 30 April 1998.

*Mining or exploration of ores other than hydrocarbons:* Concessions for mining or exploration of ores may not be granted to foreign governments or their representatives.

Authority: Article 9, Law No. 6797 of 4 October 1982.

*Land transport (passengers):* Permits to supply international remunerated passenger road transport services can be granted only to Costa Rican enterprises whose capital is at least 60% owned by Costa Rican nationals or to foreign enterprises whose capital is at least 60% owned by Central American nationals. Reciprocity conditions apply for granting licences to operate international remunerated passenger road transport services.

Authority: Article 5 and 16, Executive Decree No. 26 of 10 November 1965.

*Land transport (freight):* Only Costa Rican nationals or enterprises incorporated in Costa Rica, whose capital stock is at least 51% owned and directed by Costa Rican nationals may supply motorised freight cabotage transport services.

Authority: Article 8, Executive Decree No. 15624 of 28 August 1984.

*Water transport:* Concessions to provide maritime cabotage services may only be granted to Costa Rican nationals or enterprises with at least 60% of Costa Rican capital stock.

Authority: Article 15, Executive Decree No. 66 of 4 November 1960.

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*Air transport:* The supply of domestic air transport services by foreign-owned enterprises established in Costa Rica is subject to reciprocity.

Authority: Article 150, Law No. 5150 of 14 May 1973.

*Agricultural aviation:* Only companies with at least 51% Costa Rican capital stock can obtain certificates for agricultural aviation activities.

Authority: Article 13, Executive Decree No. 31520 of 16 October 2003.

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## **II. Official aids and subsidies**

None.

## **III. Tax obligations**

None.

## **IV. Access to local finance**

*Mining:* Banks of the Costa Rican National Banking System may not finance foreign capital enterprises in an amount greater than 10% of the total amount invested, or enterprises in which less than 50% of capital shares are Costa Rican.

Authority: Article 70, Law No. 6797 of 4 October 1982.

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## **V. Government procurement**

None.

## **B. Exceptions by territorial subdivisions**

None.

## Measures reported for transparency by Costa Rica

### A. Measures reported for transparency at the level of national government

#### I. Measures based on public order and essential security considerations

##### a) Investment by established foreign-controlled enterprises

*Land:* Territories within a width of 2 kilometres from the borders with Nicaragua and Panama are considered national reserve and as such shall remain under state control. These territories are administered by the Rural Development Institute, and authorisations may be granted for farming, commercial, industrial, housing and public service purposes. In the case of legal entities, if the capital stock is owned by foreigners in more than 50%, its stockholders must have permanent residency status in Costa Rica.

Authorities: Article 7, Law No. 2825 of 14 October 1961. Article 3, Regulation No. 10 of 28 April 2008.

#### II. Other measures reported for transparency

##### a) Investment by established foreign-controlled enterprises

None.

##### b) Corporate organisation

*Road Transport (freight):* Enterprises supplying motorised freight transportation services must be effectively controlled and directed by Costa Rican nationals.

Authority: Article 8, Executive Decree No. 15624 of 28 August 1984.

*Transport (water):* At least 10% of the crew on Costa Rican registered vessels used for international traffic that call on Costa Rican ports shall be Costa Rican nationals, provided that such trained personnel are available domestically.

Authority: Article 41, Law No. 12 of 22 October 1941.

*Mining:* Only individuals can constitute mining co-operatives, and 75% of the members of mining co-operatives must be Costa Rican nationals.

Authority: Article 74, Law No. 6797 of 4 October 1982.

##### c) Government purchasing

None.

*d) Official aids and subsidies*

None.

**B. Measures reported for transparency at the level of territorial subdivisions**

None.

**C. Activities covered by public, private, mixed monopolies or concessions**

**At the level of national government**

**I. Public monopolies**

- Exploration and exploitation of geothermal activities.
- Import, refinery and wholesale distribution of crude oil and its derivatives.
- Production and marketing of ethylic alcohol for the elaboration of alcoholic beverages.
- Water supply and public sewage services.
- Social service of postal communication of letter classified as letters and cards (LC) according to the Universal Postal Union.
- Lottery sale services.
- Electricity transmission.
- Basic traditional telephony (fixed telecommunications).

**II. Private or mixed (public/private) monopolies**

**III. Concessions**

- Railroad, road and maritime transport services.
- Marinas, docking facilities and airport services.
- Radio and television broadcasting services.
- Wireless services.
- Electricity generation, distribution and commercialisation.
- Mining and hydrocarbons exploration.
- Irrigation services.
- Maritime and air services in national ports.
- Collection and treatment services of industrial and solid waste.

**At the level of territorial subdivisions**

None.

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