

FDI and Economic Development in Costa Rica: The Tico Tiger that hasn't.....

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FDI and Development in Costa Rica:

The Power of Path Dependency

and the Peril of Lack of Strategy



Power...

Poised to attract FDI & derive benefits

...and Peril

- (a) Lack of a cohesive development strategy
- (b) Lack of coherent pro-active government policies to overcome market failures
- (c) low tax ratio

Costa Rica's (and LA's) Approach to Development: From ISI to Washington Consensus

➤ **Trade liberalization**

Average tariff rate – 1985: 60 %, 2004: 6%

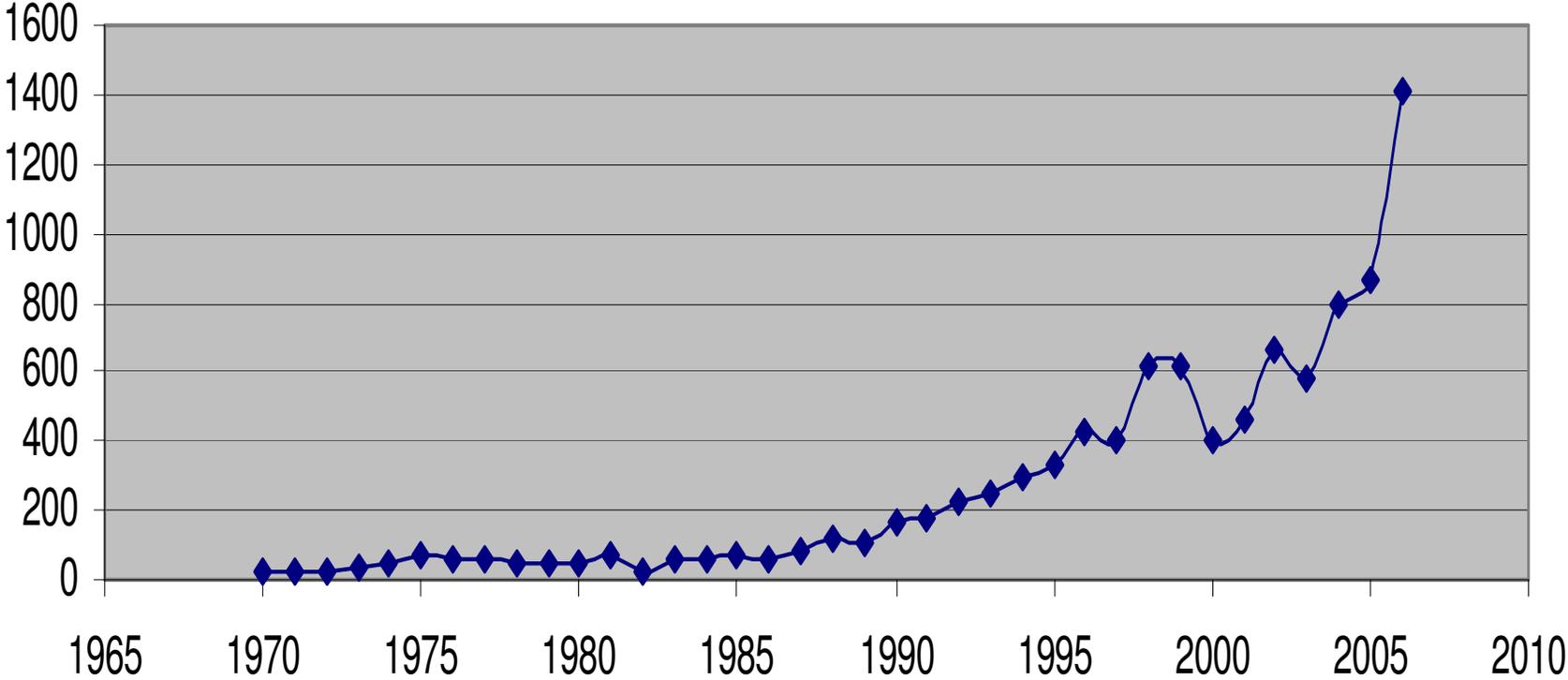
➤ **Pursuit of FDI**

CINDE & profit tax exemptions in EPZs

➤ **Retrenchment of state as producer & regulator**

Privatization & reduction of civil service

Costa Rica: Net FDI Inflows (millions of US dollars)





The **Small** Country...

... with the **Big** Difference

- **Majority of FDI in manufacturing**
- **Ability to attract FDI in high-tech sectors**
- **Most FDI in greenfield investment**

Key Destinations for FDI in Costa Rica

Efficiency-seeking FDI:

- (1) Electronics
- (2) Medical devices
- (3) IT-based services
- (4) Clothing (past)
- (5) Automotive equipment (future)

Market-based FDI:

- (1) Tourism
- (2) Real estate

Why Costa Rica?

The Country's Location-Specific Assets

(1) Strategic Location

(2) The Fruits of Past Investments

- (a) high human capital
- (b) political stability
- (c) adequate infrastructure
- (d) strong institutions

(3) The Fruits of Present Policies

- (a) English
- (b) CINDE & tax incentives in EPZs
- (c) Figueres' strategic efforts to attract Intel



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FDI and Development:

Desired Results

Investment	
Employment	
Foreign exchange	
Tax revenue	
Knowledge-based assets	

FDI and Development in Costa Rica:

Results

Investment	✓
Employment	
Foreign exchange	
Tax revenue	
Knowledge-based assets	

Investment

	Average 1970 - 1979	Average 1980 - 1989	Average 1990 - 2004
Net FDI Inflows/GDP	2.3	1.8	3.1
Net FDI Inflows/GFCF	10.1	8.8	16.1
GFCF/GDP	22.7	20.3	19.9
Real GDP Growth	6.4	2.2	4.7

FDI and Development in Costa Rica:

Results

Investment	✓
Employment	✓
Foreign exchange	
Tax revenue	
Knowledge-based assets	

Employment in Zonas Francas



1997	16,577
2005	39,009



Higher wages

FDI and Development in Costa Rica:

Results

Investment	✓
Employment	✓
Foreign exchange	✓
Tax revenue	
Knowledge-based assets	

FDI and Development in Costa Rica:

Results

Investment	✓
Employment	✓
Foreign exchange	✓
Tax revenue	—
Knowledge-based assets	

Problem I: Insufficient Tax Revenues

(1) Trade tax revenue/total tax revenue

1990: 40%

2006: 8 %

(2) Tax ratio

2006: 13.9

(3) Continued profit tax exemptions in EPZs
until 2015

FDI and Development in Costa Rica:

Results

Investment	✓
Employment	✓
Foreign exchange	✓
Tax revenue	—
Knowledge-based assets	—

**Problem II: **Insufficient Advancement in
Knowledge-Based Assets****

- (1) Some training; collaboration with technical curricula**

- (2) High-tech TNCs:
into back-office services, NOT up the value chain.**

- (3) Very limited backward linkages.**

Costa Rica: FDI and Missing Links

TNC expenditures on national inputs	1997	1998	1999	2000	2001	2002	2003	2004	2005
Total (Mill. of U.S.\$)	98.9	232.7	228	139.1	206.9	244.5	269.3	335	368.3
National expenditures as a % of imports									
Total	11.8	13.1	10.9	7.2	9.3	10.0	10.8	11.9	10.4
Machinery, electrical materials & comp.	6.6	5.8	4.4	2.7	3.1	2.4	2.6	2.6	2.0
Precision instruments & med.equipment	5.7	10.8	8.1	8.4	4.0	5.0	6.1	6.0	7.8
Agroindustry	63.0	64.1	44.7	74.3	82.7	77.7	86.2	84.0	78.1
Textiles, clothing, leather & shoes	5.4	12.0	15.3	4.7	6.2	5.7	5.5	7.6	6.0

Source: Based on Procomer

Why so few linkages?

TNCs global production strategies

- **Global sourcing, contract manufacturers**

➤ Insufficient national capabilities

- **Lack of information**
- **Lack of access to credit**
- **Lack of technical capabilities**
- **Inability to meet global standards (e.g. ISO, JIT)**

How to Respond to Market Failures: **Pro-active Policies**

Not well enough accepted for domestic linkage promotion:

e.g. Ireland:

1958: Irish Development Authority (IDA)

1985: National Linkage Program

1995: Enterprise Ireland (EI)

e.g. Costa Rica:

1982: CINDE

2003: Costa Rica Provee

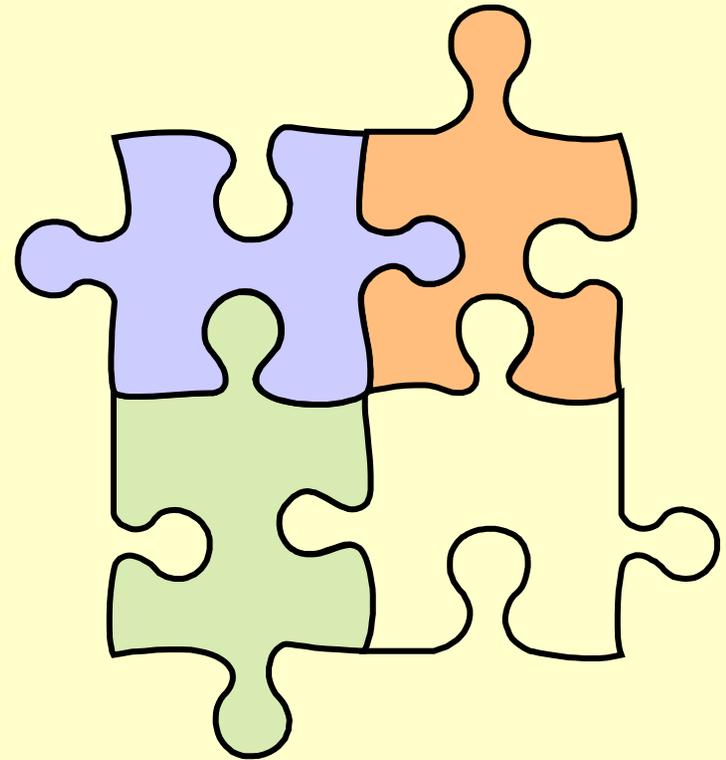


Making FDI Work for Development: Four Lessons

Lesson (I):

**FDI has to be part
of a coherent
development strategy.**

Focus: KBA



Making FDI Work for Development: Four Lessons

Lesson (II):

**Attracting FDI is not enough:
pro-active policies are needed
to develop spillovers.**



Making FDI Work for Development: Four Lessons

Lesson (III):

The need to increase fiscal resources:

- **To advance human capital**
- **To improve infrastructure**
- **To support the private sector**
- **To achieve MDGs**



Making FDI Work for Development: Four Lessons

Lesson (IV):

**The need to regulate
tourism & real estate
expansion.**

**Focus: Sustainable
Development**



