

PRESS RELEASE

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COSTA RICA'S GROWTH UNDERPINNED BY RECENT LIBERALIZATION EFFORTS EXCEPT IN SERVICES

In the last six years, Costa Rica has improved access to its already generally open market, particularly for goods, has reduced the average tariff to 7 percent and has adopted an export-oriented strategy based on tariff and other fiscal concessions. This strategy has contributed to rapid but variable economic growth, according to a WTO report on the trade policies and practices of Costa Rica.

Growth in Costa Rican per capita disposable income has only been moderate, reflecting in part the weak linkages so far established between domestic and export-oriented activities, says the reports, and adds that restrictions persist on a few service activities.

The WTO Secretariat report, along with the policy statement by the Government of Costa Rica will serve as a basis for the second trade policy review of Costa Rica by the Trade Policy Review Body of the WTO on 9 and 11 of May 2001.

The report stresses that further improvements in resource allocation would be aided by a more uniform treatment of all activities, enhanced internal competition, and addressing existing shortcomings in the services sector. The considerable achievements of the last six years bode well for Costa Rica's ability to meet these challenges and, ultimately, reach and sustain faster gains in living standards.

Between 1995 and 2000, real GDP grew at an annual average rate of 4.7%, the report says. In per capita terms, real GDP grew at an annual average rate of 2.2% over 1995-2000, while disposable national income grew at only 0.5%, the difference being mainly explained by profit remittances associated with free zone activities. At the same time, persistent deficits in Central Government and Central Bank operations have kept the public fiscal deficit consistently high. In part as a result, total public debt is sizable, having reached the equivalent of 54% of GDP at the end of 2000.

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The report notes that since its accession to the GATT in 1990, Costa Rica has participated actively in the multilateral trading system. Costa Rica is a founding member of the WTO, the Marrakesh Agreement Establishing the WTO having become an integral part of its legislation. It subsequently signed the Ministerial Declaration on Trade in Information Technology Products (ITA), and ratified the financial services protocol to the GATS; it also participated, but did not make an offer, in the basic telecommunications negotiations. On the other hand, Costa Rica's commitments under the GATS are relatively limited; in general, for the sectors included in its Schedule, only market access and national treatment for consumption abroad were bound.

Access for imported goods into Costa Rica's market has improved since its previous Review. Between 1995 and 2000, the average MFN tariff decreased from almost 12% to 7%. At 15% and 6%, average tariffs are considerably higher for agricultural than industrial products. Tariff reductions under preferential agreements have also contributed to greater access to Costa Rica's market. As part of its market access commitments under the WTO Agreement on Agriculture, Costa Rica established tariff quotas for various agricultural products, (e.g. certain dairy and poultry products). However, the relatively low levels of utilization of these quotas suggest that they have not lived fully up to expectations with regard to market access opportunities.

Costa Rica bound all but five tariff lines at the WTO, most at a maximum ad-valorem rate of 45%; exceptions include mostly agricultural products, for which bound rates are in some cases as high as 233%. Closing the wide margin between applied and bound rates would further increase the predictability of market access conditions, the report points out.

Since its previous Review in 1995, Costa Rica has promoted the expansion of export-oriented manufactures through special fiscal regimes, notably of electronics under the free zone regime. However, despite efforts to generate linkages between export-oriented activities and the rest of the domestic industry, spillovers have so far been limited. Moreover, fostering those activities has disadvantaged other industries not enjoying the same privileges. Apart from the special fiscal regimes, measures to promote industrial production have focused on small and medium size enterprises.

In spite of its decreasing share in GDP, agriculture remains an important sector because of its contribution to employment and export earnings. A small number of agricultural products for domestic consumption are protected through higher than average tariffs and safeguard measures. Agricultural production in general benefits from other support measures, including fiscal incentives and specific financing programmes. Notwithstanding such support, and in spite of the traditionally high productivity of Costa Rica's producers, its two major agricultural exports, banana and coffee, have come under considerable pressure in recent years. This reflects both adverse international market conditions as well as competition for factors of production, particularly land and labour, from other sectors.

No major changes affected the services sector between 1995 and 2000, with tourism remaining a main magnet for foreign exchange and investment. In other service areas, long-standing inefficiencies impose unnecessary costs on the rest of the economy. The State retains monopoly rights on insurance, telecommunications and energy distribution. Notwithstanding growing private participation in the banking industry, state-owned banks, favoured by current regulations, still dominate the industry. Faced with vocal opposition from interest groups, the Government was unable to pass legislation it considered of prime importance to modernize key service activities, notably telecommunications. Pressure for reform arises from the widening gap between decades-old legislation, changing technology and new market imperatives. WTO services negotiations could give new impetus to the reform process but this would require building up wider public awareness of the

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need to improve the quality and reduce the cost of bank, insurance, telecommunications and energy distribution services.

Note to Editors

Trade Policy Reviews are an exercise, mandated in the WTO agreements, in which member countries' trade and related policies are examined and evaluated at regular intervals. Significant developments which may have an impact on the global trading system are also monitored. For each review, two documents are prepared: a policy statement by the government of the member under review, and a detailed report written independently by the WTO Secretariat. These two documents are then discussed by the WTO's full membership in the Trade Policy Review Body (TPRB). These documents and the proceedings of the TPRB's meetings are published shortly afterwards. Since 1995, when the WTO came into force, services and trade-related aspects of intellectual property rights have also been covered.

For this review, the WTO's Secretariat report, together with a policy statement prepared by the Government of Costa Rica will be discussed by the Trade Policy Review Body on 9 and 11 of May 2001. The Secretariat report covers the development of all aspects of Costa Rica trade policies, including domestic laws and regulations, the institutional framework, trade policies by measure and by sector.

Attached to this press release is a summary of the observations in the Secretariat report and parts of the government policy statement. The Secretariat report and the government's policy statement are available for the press in the newsroom of the WTO internet site (www.wto.org). These two documents and the minutes of the TPRB's discussion and the Chairman's summing up, will be published in hardback in due course and will be available from the Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21.

Since December 1989, the following reports have been completed: Argentina (1992 and 1999), Australia (1989, 1994 and 1998), Austria (1992), Bahrain (2000) Bangladesh (1992 and 2000), Benin (1997), Bolivia (1993 and 1999), Botswana (1998), Brazil (1992, 1996 and 2000), Burkina Faso (1998), Cameroon (1995), Canada (1990, 1992, 1994, 1996, 1998 and 2000), Chile (1991 and 1997), Colombia (1990 and 1996), Costa Rica (1995 and 2001), Côte d'Ivoire (1995), Cyprus (1997), the Czech Republic (1996), the Dominican Republic (1996), Egypt (1992 and 1999), El Salvador (1996), the European Communities (1991, 1993, 1995, 1997 and 2000), Fiji (1997), Finland (1992), Ghana (1992 and 2001), Guinea (1999), Hong Kong (1990, 1994 and 1998), Hungary (1991 and 1998), Iceland (1994 and 2000), India (1993 and 1998), Indonesia (1991, 1994 and 1998), Israel (1994 and 1999), Jamaica (1998), Japan (1990, 1992, 1995, 1998 and 2000), Kenya (1993 and 2000), Korea, Rep. of (1992, 1996 and 2000), Lesotho (1998), Macau (1994 and 2001), Madagascar (2001), Malaysia (1993 and 1997), Mali (1998), Mauritius (1995), Mexico (1993 and 1997), Morocco (1989 and 1996), Mozambique (2001), New Zealand (1990 and 1996), Namibia (1998), Nicaragua (1999), Nigeria (1991 and 1998), Norway (1991, 1996 and 2000), Pakistan (1995), Papua New Guinea (1999), Paraguay (1997), Peru (1994 and 2000), the Philippines (1993 and 1999), Poland (1993 and 2000), Romania (1992 and 1999), Senegal (1994), Singapore (1992, 1996 and 2000), Slovak Republic (1995), the Solomon Islands (1998), South Africa (1993 and 1998), Sri Lanka (1995), Swaziland (1998), Sweden (1990 and 1994), Switzerland (1991, 1996 and 2000 (jointly with Liechtenstein), Tanzania (2000), Thailand (1991, 1995 and 1999), Togo (1999), Trinidad and Tobago (1998), Tunisia (1994), Turkey (1994 and 1998), the United States (1989, 1992, 1994, 1996 and 1999), Uganda (1995), Uruguay (1992 and 1998), Venezuela (1996), Zambia (1996) and Zimbabwe (1994).

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TRADE POLICY REVIEW BODY**COSTA RICA****Report by the Secretariat – Summary Observations**

Since its first Trade Policy Review in 1995, Costa Rica has improved access to its already generally open market, particularly for goods; however, restrictions remain on a few service sectors. Since 1995, the average tariff has fallen five percentage points, to 7%, and the use of non-tariff trade barriers has been limited. Costa Rica has followed a two-pronged liberalization strategy leading to both new multilateral and regional commitments. Over the period under review, an export-oriented strategy, based on tariff and other fiscal concessions, underpinned a swift shift towards manufacturing and sharp export expansion, which in turn has contributed to rapid but variable economic growth.

Since 1995, however, growth in Costa Rican per capita disposable income has only been moderate, reflecting in part the weak linkages so far established between domestic- and export-oriented activities. These and certain other activities are favoured by the existing incentives structure at the expense of other areas, including the production of traditional agricultural export-goods. Moreover, the State maintains a dominant position in a number of key services, in some of which inefficiencies have arisen over time as regulations have failed to keep pace with technological and market changes. Further improvements in resource allocation would thus be aided by a more uniform treatment of all activities, enhanced internal competition, and addressing existing shortcomings in the services sector. The considerable achievements of the last six years bode well for Costa Rica's ability to meet these challenges and, ultimately, reach and sustain faster gains in living standards.

Economic Developments

Between 1995 and 2000, real GDP grew at an annual average rate of 4.7%. Growth was particularly strong in 1998 and 1999, when GDP rose at an annual average rate of just over 8%. This resulted in good part from major construction projects undertaken in free zones and, subsequently, sharp export increases from the new facilities. Economic growth fell sharply in 2000 as construction ended and exports contracted, but was expected to rebound somewhat in 2001. Per capita GDP stood at close to US\$4,100 in 1999. In per capita terms, real GDP grew at an annual average rate of 2.2% over 1995-2000, while disposable national income grew at only 0.5%, the difference being mainly explained by profit remittances associated with free zone activities.

Since Costa Rica's previous Review, persistent deficits in Central Government and Central Bank operations have kept the public fiscal deficit consistently high. In part as a result, total public debt is high, having reached the equivalent of 54% of GDP at the end of 2000. The public deficit has traditionally been financed through the issuance of domestic debt, putting pressure on domestic interest rates and contributing to the relatively high cost of credit. The authorities have succeeded in reducing the inflation rate, which fell from 23% in 1995 to 10% in 2000.

Exchange rate policy has sought to maintain the external competitiveness of domestic goods through daily adjustments of the exchange rate on the basis of the differential between inflation in Costa Rica and its main trading partners. Since 1995, the current account balance has registered important deficits, over 1995-97 due mainly to the trade deficit and from 1998 to the widening of the factor services deficit: the latter resulted from the sharp increase in profit remittances associated with the expansion of free zones activities. Deficits were partly covered by foreign direct investment

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inflows. The balance of trade in non-factor services has traditionally been positive mainly due to tourism exports. The structure of merchandise exports has changed substantially due to the expansion of electronic components and the stagnation of agricultural exports. The share of agricultural products in total exports dropped from 68% in 1995 to some 30% in 1999.

Trade Policy Framework

Since Costa Rica's previous Review, no major changes have been introduced to the trade and investment regimes. Main responsibility for trade policy implementation remains with the Ministry of External Trade. Trade policy has sought to promote and consolidate Costa Rica's integration into the world economy. Between 1995 and 2000, as a proportion of GDP, trade in goods and services rose from some 78% to 97%.

Since its accession to the GATT in 1990, Costa Rica has participated actively in the multilateral trading system. Costa Rica is a founding member of the WTO, the Marrakesh Agreement Establishing the WTO having become an integral part of its legislation. It subsequently signed the Ministerial Declaration on Trade in Information Technology Products (ITA), and ratified the financial services protocol to the GATS; it also participated, but did not make an offer, in the basic telecommunications negotiations. On the other hand, Costa Rica's commitments under the GATS are relatively limited; in general, for the sectors included in its Schedule, only market access and national treatment for consumption abroad were bound.

Costa Rica has used the multilateral dispute settlement mechanism to protect its trade interests. In part due to the ensuing benefits, both the authorities and the public at large hold a positive perception of the multilateral trading system and its impact on small countries. Multilateral commitments have proved a key catalyst for domestic reform in the past.

Costa Rica has also increasingly participated in preferential trade arrangements. It is part of the Central American Common Market, has subscribed bilateral free trade agreements with Chile, Mexico, Panama and the Dominican Republic, and is negotiating another with Canada. It also participates in the Free Trade Area of the Americas process. Costa Rica benefits from various GSP schemes and the U.S. Caribbean Basin Initiative. Its major trading partners are, in decreasing order of importance, the United States, the European Union, Mexico and Central American countries, Costa Rican exports entering those markets mostly under preferential conditions. Costa Rica joined the Cairns Group in 1999.

Market Access for Goods

Access for imported goods into Costa Rica's market has improved since its previous Review. Between 1995 and 2000, the average MFN tariff decreased from almost 12% to 7%. At 15% and 6%, average tariffs are considerably higher for agricultural than industrial products. As part of its market access commitments under the WTO Agreement on Agriculture, Costa Rica established tariff quotas for various agricultural products, (e.g. certain dairy and poultry products), although in almost all cases the filling levels have been low. Tariff reductions under preferential agreements have also contributed to greater access to Costa Rica's market.

Costa Rica bound all but five tariff lines at the WTO, most at a maximum ad-valorem rate of 45%; exceptions include mostly agricultural products, for which bound rates are in some cases as high as 233%. Closing the wide margin between applied and bound rates would further increase the predictability of market access conditions.

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Imports are subject to domestic taxes applied uniformly with respect to their origin and in accordance with the national treatment principle, except for a few beverages. In addition, the domestic commercialization regime for alcoholic beverages discriminates between most imported and domestic products.

The use of non-tariff trade barriers appears limited. Costa Rica maintains various import restrictions and prohibition, generally for health, security or environmental reasons. No anti-dumping or countervailing duties were applied between 1995 and 2000, although four anti-dumping investigations were initiated. Likewise, with the exception of special safeguard measures applied to rice and beans under the WTO Agreement on Agriculture, no safeguard measures were taken.

Other Measures Affecting Trade in Goods

There are no estimates of the global impact of programmes to promote production and exports, although their number and diversity raise questions about their effectiveness and the economic distortions they might induce. To promote exports, Costa Rica maintains various special import regimes, notably the free zone regime. Export subsidies granted through a tax credit mechanism (Certificados de Abono Tributarios) were eliminated in late 1999 although some benefits are still being paid. In addition, production, particularly by small and medium size firms, is supported through a plethora of relatively minor programs, including fiscal incentives and concessional credit schemes.

As at early 2001, Costa Rica maintained a tax on banana exports; taxes on coffee and meat exports were eliminated in 1999. From May 2000, Costa Rica has applied quantitative restrictions to coffee exports, retaining 20% of its export supply. The European Union grants Costa Rica's banana exports preferential market access through tariff quotas. Canada and the United States apply import quotas to its textile and apparel exports under the WTO Agreement on Textiles and Clothing.

Competition legislation adopted in the mid 1990s has resulted in an increasing number of actions by the competition authorities. However, competition remains restricted in a few but important areas. For instance, in practice the external and internal commercialization of domestically produced sugar is controlled by a cartel. Likewise, the State holds a monopoly on the importation, refining and wholesale distribution of crude oil, fuels derived from oil, asphalt and naphtha. The State also regulates the price of several goods and services, including public services and the marketing of various agricultural products such as bananas, coffee and sugar.

The Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement) became part of Costa Rica's legislation through its ratification of the Marrakesh Agreement. Subsequently, Costa Rica has enacted or amended related domestic regulations to harmonize them with its international obligations and thus facilitate their application. Those changes were notified to the Council for Trade-Related Aspects of Intellectual Property Rights in late 2000.

Sectorial Policies

Since its previous Review, Costa Rica has promoted the expansion of export-oriented manufactures through special fiscal regimes, notably of electronics under the free zone regime. However, despite efforts to generate linkages between export-oriented activities and the rest of the domestic industry, spillovers have so far been limited. Moreover, fostering those activities disadvantages other industries not enjoying the same privileges. Apart from the special fiscal regimes, measures to promote industrial production have focused on small and medium size enterprises.

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In spite of its decreasing share in GDP, agriculture remains an important sector because of its contribution to employment and export earnings. A small number of agricultural products for domestic consumption are protected through higher than average tariffs and safeguard measures. Agricultural production in general benefits from other support measures, including fiscal incentives and specific financing programmes. Notwithstanding such support, and in spite of the traditionally high productivity of Costa Rica's producers, its two major agricultural exports, banana and coffee, have come under considerable pressure in recent years. This reflects both adverse international market conditions as well as competition for factors of production, particularly land and labour, from other sectors.

No major changes affected the services sector between 1995 and 2000. Tourism remains a main magnet for foreign exchange and investment, but long-standing inefficiencies in some other service areas impose unnecessary costs on other activities. The State retains monopoly rights on insurance, telecommunications and energy distribution. Notwithstanding growing private participation in the banking industry, state-owned banks, favoured by current regulations, still dominate the industry. Faced with vocal opposition from interest groups, the Government was unable to pass legislation it considered of prime importance to modernize key service activities, notably telecommunications. Pressure for reform arises from the widening gap between decades-old legislation, changing technology and new market imperatives. WTO services negotiations could give new impetus to the reform process but this would require building up wider public awareness of the need to improve the quality and reduce the cost of bank, insurance, telecommunications and energy distribution services.

TRADE POLICY REVIEW BODY

COSTA RICA

Report by the Government of Costa Rica (Part II)

Economic and Trade Policy Environment

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

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

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

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

Foreign trade in services also expanded over the past six years, albeit to a lesser extent than that in goods, from 15.6 per cent of GDP in 1995 to 19.1 per cent in 2000. In this connection, tourism generated appreciable revenue that enabled the country to post successive surpluses in the balance of payments services account over the past six years. This sector accounts for almost 62 per cent of domestic output and is concentrated mainly in the spheres of trade, real estate, business and rentals, as well as in transport and storage, education, hotels and restaurants, construction and the health sector.

Yet despite the satisfactory results of the policies to attract investment and to integrate Costa Rica's economy into the international market, public finances continue to show a major imbalance. In terms of revenue, the enactment of the Code of Tax Standards and Procedures (*Código de Normas and Procedimientos Tributarios*), the expiry of the Tax Credit Certificates (*Certificados de Abonos Tributario*) and efforts to improve tax collection started to yield encouraging results in late 2000.

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These policies have been matched by a process of financial engineering whereby domestic debt was replaced with external debt so as to alleviate domestic interest payments. The public sector deficit for the 1995-2000 period has remained close to 3 per cent of GDP, whilst domestic debt absorbed a third of the country's output this past year.

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

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