

## SUMMARY

1. Since its last trade policy review in 2007, Costa Rica has continued to liberalize its foreign trade regime, chiefly through participation in preferential trade agreements, while at the same time maintaining a proactive policy of attracting investment based on the Free Zone Regime (RZF) and other incentive schemes. Thanks to this strategy, it has been able to diversify its production and export platform to cover higher technology products and services, and has facilitated the integration of the Costa Rican economy in a number of global value chains.

2. The RZF has played a significant role in attracting foreign investment, boosting export performance and creating more and better jobs. However, linkages between domestic and export-oriented activities still need to be strengthened. Reforms are also needed to increase competitiveness and improve the business climate. In particular, infrastructure needs to be improved, electricity tariffs and fuel prices reduced, and the gap between educational opportunities and market demand narrowed. On the macroeconomic front, fiscal consolidation is essential. The recent opening up to competition of various services subsectors that were previously State monopolies is a positive move towards increasing the economy's competitiveness and efficiency, as are the reforms introduced in trade-related areas such as the competition regimes, standardization, protection of intellectual property and government procurement.

### The economic environment

3. The Costa Rican economy grew at an annual average rate of 3.2% between 2007 and 2012, chiefly thanks to the strong performance of domestic demand. At the same time, per capita GDP rose to US\$9,665 in 2012. Costa Rica was able to cope with the effects of the global economic crisis of 2008-2009 by expanding public spending while maintaining financial stability. However, the country's fiscal position has deteriorated since then, and today, fiscal consolidation is one of the keys to its macroeconomic stability. Monetary policy has been directed towards consolidating the low inflation rates maintained since 2009, while exchange-rate policy has been based on the exchange-rate band system. The Central Bank has intervened on the exchange market to defend the band floor in the wake of the strong capital inflows over the past few years.

4. The current account of the balance of payments showed a deficit throughout the period under review owing to the deterioration of the trade balance, which was offset by the surplus in the capital and financial account resulting from strong foreign investment flows. Diversification of Costa Rica's foreign trade continued, and today, services exports account for a third of foreign sales. The main goods exported are manufactures, in particular micro-processors and medical equipment. Bananas continue to dominate agricultural exports, although other, non-traditional products have been gaining ground. Approximately 75% of Costa Rica's imports are manufactured goods. The Costa Rican economy is closely linked to that of the United States, which accounts for approximately 40% of trade in goods and foreign direct investment (FDI) flows to Costa Rica. The European Union, the countries of the Central American Common Market (CACM) jointly, Panama, Mexico and China are also important partners. Further diversification of Costa Rica's foreign trade markets would open up opportunities and improve sustainability. The fact that Costa Rica is a net recipient of FDI has contributed significantly to its economic growth and to growth in exports.

### Trade and investment policy framework

5. Costa Rica has maintained an open trade and investment regime, which it considers essential to achieving its economic growth and development objectives. Its foreign trade policy is directed towards expanding its trade platform through stronger multilateral rules and new bilateral agreements, and by introducing the domestic reforms needed to be able to take full advantage of those agreements.

6. As a founding Member of the WTO, Costa Rica participates actively both in the regular work of the Organization and in the negotiations under the Doha Development Round. It has also taken part in the negotiations to expand the coverage of the Information Technology Agreement (ITA). During the period under review, Costa Rica maintained a steady flow of WTO notifications, and brought a new case under the dispute settlement mechanism as complainant in relation to certain safeguard measures adopted by the Dominican Republic.

7. Costa Rica is a member of the Central American Common Market (CACM) together with Nicaragua, Guatemala, Honduras and El Salvador. The CACM countries have harmonized some 93% of their common external tariff, strengthened Central American investment regulations and taken steps to facilitate trade among them, such as the simplification of customs and transit procedures, and the harmonization of technical regulations and sanitary and phytosanitary measures.

8. One of the central pillars of Costa Rica's trade policy is the expansion of its network of regional and bilateral agreements, not only with its traditional trading partners in the Americas, but also with countries of Europe and Asia. New agreements to which Costa Rica is a party have entered into force since 2007: between Central America and Panama; between Central America, the United States and the Dominican Republic (CAFTA-DR); and between Costa Rica and China. Other agreements are either about to enter into force (Central America-Mexico, Costa Rica-Peru and Costa Rica-Singapore), going through the legislative process (Central America-European Union and Costa Rica-Colombia) or about to be signed (Costa Rica-European Free Trade Association). The agreements in force at the beginning of 2013 covered some 68% of Costa Rica's exports and 76% of imports.

9. Costa Rica has relatively few restrictions on foreign direct investment. They concern the energy, mining and fishing sectors as well as a number of services sectors: communications, advertising, transport, certain professional services, and certain recreational and sporting services. Since 2007, the insurance sector and certain telecommunications services have been liberalized. At the same time, a Supreme Court resolution lifted restrictions on foreign investment in Costa Rican airlines. Costa Rica is working on various projects to improve the business environment, including the streamlining, simplification and automation of procedures.

#### Trade policies by measure

10. Since its last review, Costa Rica has introduced measures to modernize its trade regime and facilitate trade. These include the computerization of customs procedures, the reduction of formalities and documentation, the upgrading of border posts, the launching of an authorized economic operator scheme, and amendments to its customs legislation. The tariff is the main trade policy instrument and all of the rates are *ad valorem*. The average applied MFN tariff remained unchanged during the review period, and stood at 6.9% in 2013. The average tariff for agricultural products (14%) is higher than for other products (5.5%). Costa Rica bound its entire tariff schedule, and the average bound rate (44.1%) is significantly higher than the applied rates, somewhat undermining the tariff regime's predictability.

11. Almost all imports originating in the CACM countries enter Costa Rica duty free. In addition, Costa Rica grants tariff preferences to imports from the countries with which it has free trade agreements.

12. Costa Rica applies domestic taxes in a non-discriminatory fashion to domestic and imported products with the exception of the Institute for Municipal Promotion and Support (IFAM) tax, which concerns only imported beer. The import permits applied to certain products, relate mostly to the protection of health, public security, and the environment.

13. Costa Rica is not a frequent user of trade defence measures. Between 2007 and 2013, it applied only a couple of anti-dumping measures. It has harmonized its trade defence legislation with the relevant Central American regulations.

14. Costa Rica has a sound legal and institutional framework for the development and application of technical regulations and sanitary and phytosanitary (SPS) measures, and has steadily been notifying these measures to the WTO. It has made progress in harmonizing technical and SPS regulations with its CACM partners, and has reached agreements on the equivalence of SPS inspection systems with other trading partners.

15. Certain exports (such as coffee, bulk sugar, fish, molluscs and crustaceans) are subject to authorization for reasons of public health, environmental protection or quality assurance. The exportation of various species of wood logs is prohibited. A tax is applied to exports of coffee, live cattle and bananas. It might be worth reconsidering the rationale for these taxes to see

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whether their maintenance is justified. Until 2010, bananas were subject to a minimum export price for competition policy reasons.

16. In 2010, Costa Rica amended its Law on the Free Zone Regime (RZF) in order to bring it into conformity with the WTO Agreement on Subsidies and Countervailing Measures before the end of the extension period granted for that purpose (31 December 2015). The main change was the elimination of export requirements for the companies benefiting from the RZF and of the restrictions on domestic sales. Costa Rica is also working on reforming the Inward Processing Regime in order to meet its WTO commitments.

17. Costa Rica maintains a number of other tax and financial incentive programmes to stimulate various productive and social activities. It would be worth assessing the impact of these programmes in order to rationalize the tax exemptions, particularly in view of the pressing need to consolidate public finances.

18. The State continues to play a leading role in the economy through State enterprises operating in key sectors such as electricity, basic telephony, the administration of ports and railways, and the financial sector. A State enterprise (RECOPE) has a monopoly on the importation, refining and wholesale distribution of crude oil and its derivatives: it has been notified to the WTO as a State trading enterprise. Other State trading enterprises are expected to be notified in the near future. It might be worth evaluating the costs and tax burden of some of the services provided by State enterprises with a view to minimizing their impact on the economy's competitiveness.

19. In 2012, Costa Rica amended its legislation on competition policy so as to tighten control on anti-competitive practices. In particular, these reforms included the introduction of a prior notification obligation for mergers, increased investigative powers for the competition authority, and application of the regulations to providers of public services under concession that are not established by law. However, this does not include the State monopolies created by law. A number of sectoral regulations were also introduced to regulate competition in the markets supervised by the regulatory bodies of the financial and telecommunications sectors. As of the middle of 2013, prices of regulated public utilities and rice were subjected to official control.

20. Costa Rica is neither a party nor an observer to the WTO Plurilateral Agreement on Government Procurement. During the period under review, Costa Rica reformed its legal framework for government procurement, *inter alia* to include changes in the types of procurement; to introduce framework agreement contracts and electronic auction; to automate procedures; and to stiffen the administrative penalties for acts of corruption. Changes were also made to the procurement regimes of State telecommunications and insurance companies in response to the recent opening up of these areas to competition. Costa Rica applies preferences for domestic products and small and medium enterprises when it comes to government procurement, subject to certain conditions. By law, the participation of foreign bidders is subject to reciprocity, but in practice, this condition is not applied.

21. Since its last review, Costa Rica has introduced reforms aimed at modernizing its intellectual property system to accommodate technological progress and to meet the country's international commitments. Legislative reforms have covered practically all intellectual property rights as well as the enforcement regime. 2008 saw the enactment of the Law on the Protection of Plant Varieties, and in 2011, Costa Rica accepted the Protocol amending the TRIPS Agreement in respect of paragraph 6 of the Doha Declaration on the TRIPS Agreement and Public Health. But in spite of the changes made, there would appear to be room for a more efficient enforcement regime, particularly as regards copyright.

## Sectoral policies

22. In 2012, agriculture, forestry and fishing accounted for 5.7% of GDP and for 13.4% of employment, while generating 37.5% of goods exports. Although the average tariff protection level for the agricultural sector (WTO definition) is 14%, for some products (meat, dairy, potatoes, onions, sugar and rice) the tariffs are well above the average. Rice production also receives government support under a policy which maintains market prices at levels exceeding Costa Rica's WTO commitments, a policy which has not led to any increase in productivity. In May 2013, the Government issued a decree providing for the elimination of price fixing for rice as from March 2014. The marketing of some products, such as sugar and alcohol, is handled by State enterprises.

23. The manufacturing industry contributed 15.4% to GDP and accounted for 11.3% of employment in 2012. At the same time, it accounted for 60% of goods exports. Manufacturing activities in the free zones continue to act as a magnet for FDI and play an important role in generating exports (more than 70% of exports of manufactures in 2012). However, the links between these zones and the rest of the economy remain fairly limited. Companies operating under the ordinary regime contribute 82% of manufacturing value-added; their products go chiefly to the domestic market, and in some cases, receive higher-than-average tariff protection.

24. The State-owned Costa Rican Electricity Institute (ICE) controls most of the generation and distribution of electricity, and is exclusively responsible for transmission. The private sector is allowed to participate in the generation of electricity up to a limit of 30% of the national installed capacity. By law, the State has a legal monopoly on the importation, refining and wholesale distribution of hydrocarbons. Electricity tariffs and fuel prices are regulated, and the fact that they are among the highest in the region has an impact on the competitiveness of the Costa Rican economy.

25. The services sector accounts for 62.7% of GDP and 67% of employment. Services exports have been extremely dynamic (in particular computer services and other business services), and this has led to a surplus in the trade balance in services. In fact, the services market regime is currently more open than the commitments adopted by Costa Rica under the General Agreement on Trade in Services (GATS), which are limited to a few sectors. Costa Rica accepted the Fifth Protocol of the GATS on financial services, but has not assumed any commitments in telecommunications. Although a number of services subsectors that were previously State monopolies were opened to competition during the review period, the State continues to be very present in certain services market segments. The recent opening up processes should be pursued and consolidated in order to ensure development in conditions of effective competition.

26. With the end of the ICE State monopoly on mobile telephony, Internet and private networks in 2009, the telecommunications sector has become highly dynamic. The opening up of the sector was accompanied by the introduction of a new legal and institutional framework, and the involvement of private operators has generated market competition and led to a more diversified supply of services and lower rates.

27. The most significant change in the financial sector was the termination of the State monopoly of the National Insurance Institute (INS), the enactment of new legislation and the creation of a regulatory authority for the sector. Although as a result, new participants entered the market and the total premium production increased, the INS still holds more than 90% of the industry's earnings. Foreign insurance companies may participate in the Costa Rican market by setting up as joint stock companies or through branch offices. There are no restrictions on foreign capital participation in insurance companies. Insurance contracts may be concluded with foreign insurance companies to cover risks that are expressly established in an international agreement between Costa Rica and the country of origin of the companies in question.

28. The banking sector in Costa Rica continues to be dominated by the State banks, which own approximately 65% of total banking assets. Foreign banks may establish a presence in Costa Rica through subsidiaries set up as joint stock companies, but not through branch offices. There are no limits on foreign capital in private banks incorporated in Costa Rica. Once established, the foreign banks are granted national treatment. However, there are still certain regulatory asymmetries

between the private banks, domestic and foreign, and the State banks - for instance the private banks must pay a "bank toll" to be able to receive current account deposits, and they have no deposit insurance. The State banks, for their part, are subject to government procurement rules. During the review period, a number of reforms were introduced to discourage offshore banking operations and to improve the supervision of the banking sector.

29. In the transport area, Costa Rica still faces problems relating to the quality of its ports and roads, which service 97% of its total export volume. In order to upgrade its infrastructure and improve efficiency, Costa Rica entrusted private companies with the construction, maintenance and operation of ports and airports, which by law must remain under State ownership. Cabotage services are restricted to vessels registered in Costa Rica. The air transport regime in Costa Rica is relatively open, and since 2007, 100% foreign-owned Costa Rican companies may provide air transport services for people, cargo and mail. During the period under review, Costa Rica concluded new bilateral air transport agreements, some of them with countries outside of its traditional market, the Americas. The market for ground handling services is open to foreign investors, and there are no restrictions with respect to computer reservation systems, sale and marketing of air transport services or repair and maintenance of aircraft.

30. The tourism sector, although somewhat affected by the global financial crisis, has recovered considerably since 2010. Revenue from tourism activities accounts for 14% of total exports of goods and services. The sector depends heavily on tourists from the United States. During the review period, new laws were introduced to promote rural community tourism, to regulate the certification of corporate social responsibility in the tourism industry, and to impose a fee on all passengers entering the country by air. A study commissioned by the Costa Rican Tourism Institute concluded that the effect of the fiscal cost of the different exemptions granted to the tourism industry was more than compensated by their beneficial impact on investment.