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## **Abstract**

Public-private collaboration in productive development policy in Costa Rica frequently takes the form of policy co-governance: an autonomous institution in charge of policy for a particular economic sector is created, with a board of directors comprising representatives from both the public and the private sectors, often with the public sector in a minority position. This paper analyzes five cases of co-governance: tourism, fisheries, rice, coffee, and the attraction of foreign direct investment (FDI). When co-governance has been used in conjunction with market discipline and as a means to discover and remove obstacles to higher productivity, as in tourism and FDI attraction, PDPs have been quite successful. When, on the contrary, it has been used to shield producers from market discipline or to allow unsustainable use of natural resources, as in rice and fisheries, they have turned into failures. Coffee stands in between, with considerable social achievements but only modest competitiveness achievements.

**JEL Classifications:** F210, L520, O250, O430

**Keywords:** Foreign direct investment, FDI, Industrial policy, Sectoral planning, Economic growth, Institutions, Economic growth

## **1. Introduction**

Following the crisis of the 1980s, Costa Rica's economic policy, much like that of the rest of Latin America, shifted from inward-looking protectionism to export promotion and integration with the global economy. In Costa Rica, the public and the private sectors have been deeply engaged in policy design or implementation, and their cooperation frequently takes the form of co-governance, in which an autonomous institution in charge of policy for a particular economic sector is created, with a board of directors comprising representatives from both the public and the private sectors, often with the public sector in a minority position.

This paper analyzes five cases—tourism, fisheries, rice, coffee, and the attraction of foreign direct investment (FDI)—in which vertical productive development policies (PDPs) have been implemented within a framework of public-private collaboration. These cases encompass two success stories (tourism and FDI), one case that we would suggest is a social but not necessarily a productive success (coffee), and two cases that are, in our opinion, outright failures (fisheries and rice).

## **2. Tourism**

Costa Rica has succeeded in creating a world-class international brand in tourism, based on the country's natural environment, its democratic institutions, and its history of peace. Locally captured value added is high, there are many small and medium-size operators, and the industry is distributed throughout the country.

Lately, conflicts have arisen in some local communities regarding the use and availability of water. Environmental groups have objected to some projects, and development has taken place without adequate planning and infrastructure. Moreover, the industry has become more diversified, and some authors worry that the country might be at risk of losing its unique brand and veer toward undifferentiated mass tourism (Pratt, 2002). Despite these challenges, the industry has shown great resilience, visitor levels have returned to pre-crisis levels,<sup>1</sup> and new hotels are being built.

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<sup>1</sup> According to ICT data, 2.1 million tourists visited Costa Rica in 2008. By 2011 the number was 2.2 million.

## 2.1 Overview of the Tourism Cluster

The private sector in the tourism cluster has four salient features:

- Many types of operators, including hotels, local and international airlines, ground transportation companies, restaurants, tour operators, nature guides, car rental agencies, and around them, complex supply chains. Generally, they are well organized and, for the most part, prosperous.
- Heterogeneous operators, ranging from very small to very large, from rural community tourism, to top-of-the-line international hotel chains, from exclusive independent boutiques to mass-market-oriented, all-inclusive resorts, from rough adventure to ultimate comfort.
- Ubiquity: While rice, fisheries, and coffee are naturally confined to certain geographical areas, tourism is all over the country: on both the Pacific and the Caribbean coasts, in the humid tropical forest and in the dry tropical forest; at the beaches and in the mountains, in rural and urban areas.
- Well-organized participants, including two umbrella organizations that are the main voices of the sector:
  - The Costa Rican Chamber of Hotels (CCH), whose membership includes the largest international hotel chains as well as many local, independent hotels. The CCH is a very influential organization, even though only 239 of Costa Rica's nearly 4,500 hotels are affiliated with it, and;
  - The National Chamber of Tourism (Canatur), with a more numerous and heterogeneous membership: travel agencies, hotels, restaurants, regional chambers, tour operators, mass media, rental car agencies, and many more. In alternate years, the CCH organizes the National Hospitality Congress, and Canatur hosts the National Tourism Congress. Each becomes the high point of the public-private dialogue process of the year. Other smaller organizations represent the interests of particular sub-sectors within the cluster.

The Costa Rican Institute for Tourism (ICT) is the public sector organization directly responsible for tourism policy. An executive president (CEO and chairperson) and a six-member board of directors, half of which are appointed by the cabinet at the beginning of each

presidential term for eight-year terms, govern the ICT. Its members include political appointees as well as representatives of the industry, who are frequently appointed as CEOs. The board operates with considerable independence, as the law states “the members of the board will discharge their duties with absolute independence from the executive branch.”<sup>2</sup> However, implementation of current tourism policy requires the cooperation of a wide swath of Costa Rica’s public sector, including organizations in charge of transportation, energy, telecommunications and water infrastructure, training, environmental regulations, construction permits, and many others.

The ICT was created in 1955 by Law 1917 with a simple goal: to increase tourism in Costa Rica, as part of a wave of old-style industrial policy interventions. It was granted the authority to build and operate tourist facilities and to set and supervise prices charged for tourism services. However, tourism and the ICT gained prominence in Costa Rica much later, when the country shifted to an economic strategy that promoted integration into world markets rather than import substitution industrialization. The ICT was assigned the roles of promoter of private sector development, coordinator of sectoral dialogue, and administrator of tourism development incentives.

In 1985, the Law on Tourism Incentives (Law 6990) created an income tax credit equal to 50 percent of investments in certain tourism activities, subject to approval by the Tourism Regulatory Commission. This commission was abolished in 1992. While the incentives were justified in terms of national competitiveness, perhaps their role can be better understood as compensating for information asymmetries: when they were created, the tourism industry was already starting to take off, but no international hotel chains were operating in Costa Rica. With these incentives in place, local entrepreneurs were able to lure these chains into the country. From this standpoint, they can be considered a success, as currently many different chains operate in the country and build new hotels without fiscal incentives.

Law 8694 of 2008 boosted the ICT’s resources with the creation of a US\$15 tax levied on all tourists arriving by air. The proceeds from this tax are to be used exclusively for promotion and marketing (Article 2). This tax solves a “free rider problem”: if promotion of Costa Rica as a destination were left to private operators, none of them would reap the full benefits of such

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<sup>2</sup> Law 1917, Article 20.

promotion, and even those who spent nothing on it would benefit. Consequently, the level of investment would be suboptimal.

Although tourism was already a growing industry in the 1980s, it came of age in the 1990s. In 1991, the number of tourists coming to Costa Rica surpassed half a million.<sup>3</sup> By 1999, the country welcomed over a million tourists, and that number surged to 2 million by 2008. Total revenues contributed by the industry increased from US\$719 million in 1997 to \$2.174 billion in 2008 and, after a moderate contraction in 2009 and 2010, reached US\$1.975 billion in 2011. Tourism as a share of GNP peaked at 7.9 percent in 2008, and has declined since then, mostly due to the rapid growth of the business services industry. Investment in projects that were awarded ICT's classification as a tourist attraction grew steadily after 2004 and reached US\$696 million in 2008. Following a dip in 2009, investment accelerated, reaching US\$233 million in 2011, near 2007 levels. From 1995 to 2011, the number of available hotel rooms grew from 25,329 to 44,307, while the number of hotels grew from 1,599 to 2,476. The average number of rooms per hotel remains at 17.9, indicating a high percentage of small and medium-size businesses in this segment of the industry. The ICT (2007 and 2010) indicates that tourism benefits all regions of the country.

## **2.2 Institutional Arrangements and Current Policy**

Costa Rica's tourism development policy can be divided into three stages:

- Spontaneous takeoff in the late 1970s to early 1980s, which capitalized on previous investments in environmental protection and human development.
- Incentive-based growth in the mid-1980s and early 1990s, which attracted international chains, including some first-tier players.
- Promotion-based development after 1992, when major tax incentives were abolished.<sup>4</sup>

The National Sustainable Tourism Plan lays out Costa Rica's current long-term tourism policy and establishes three key strategic pillars: differentiation, new products, and growth. It proposes four elements as the cornerstones of the country's brand: nature, coasts, culture, and

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<sup>3</sup> Unless otherwise indicated, all data from ICT's Anuarios Estadísticos, 2005–2011

<sup>4</sup> Promotion was part of the policy package all along but became the main component once fiscal incentives were abolished.

sustainability, and defines four norms to guide activities: innovation, authenticity, sustainability, and improvement of current products.

The elements of the plan are a compromise between different visions of the sector. It proposes a diversified portfolio that will include large beach and sun projects but will emphasize authenticity, differentiation, the relationship with nature, and local culture, in which local small businesses will continue to play a central role. To deliver these products, the plan projects a need to increase the country's logistical and tourism capacities and emphasizes land use planning and zoning regulations.

Interaction between the public and the private sectors has been frequent and intense, and the industry has had considerable input in defining the promotional campaigns run by the ICT in its target markets. In the 1980s, an "industry competitiveness" exercise took place under the auspices of the INCAE Business School (INCAE), which appears to have had a long-lasting effect in terms of creating a shared vision regarding the foundations of Costa Rica's country brand and competitiveness in the tourism sector.

In the National Sustainable Tourism Plan, now in its third iteration, consultation and consensus are frequently mentioned, but the process was not documented. However, in the course of this study it was possible to reconstruct the process that led to the latest version of the plan. A draft of the first two chapters (Assessment and Vision) was prepared by the ICT and then submitted to a discussion group convened by Canatur. Some niche and regional chambers were also consulted. Finally, a two-day meeting, with the participation of an estimated 50 industry representatives, was held and consensus was reached. Based on that consensus, the ICT prepared a second version of the first two chapters, and presented it to its board for approval. Once approved, the operational portions of the plan were prepared, and the results were presented at the National Tourism Congress.

This is an interesting process in many ways. First, it was clear that the government went to great lengths to listen to the concerns of the private sector. Second, the issue of who actually represents the private sector was left to the sector's umbrella organization, Canatur, to sort out. Any organization that felt excluded had to raise the issue with Canatur, not with the ICT. Finally, the mandate (assessment and vision) was conceived jointly, but the programmatic portion—the technical details—were worked out by the ICT and presented to the industry's Congress once they were nearly finalized. In other words, the public sector consults, avoids the political

problems associated with picking and choosing participants within the private sector, and reserves for itself considerable leeway to adjust and fine-tune the final plan. Once the plan is adopted, an annual meeting with the private sector is scheduled to revise and update it.

Other mechanisms for cooperation are also in place. The most prominent is the regular appointment of private sector representatives either as ministers of tourism or as members of the ICT board. Sector appointees and political appointees are rotated on a fairly regular basis as heads of the ICT, and the private sector is nearly always represented on the board.

This form of cooperation raises several issues. First, the government has complete discretion as to whom it appoints. Whether the appointees represent a particular vision or subsector of the industry or are widely recognized as industry leaders with a comprehensive understanding of it is always an open question, and between these two extremes the government can choose as it wishes. Second, when active members of the sector are appointed to political positions, issues of conflict of interest, or at least the appearance of it, are likely to arise. Critics of the ICT accuse it of being nothing more than a tool in the hands of large-scale developers.

There is broad cooperation at the operational level, including joint public-private working groups on tourism promotion, sustainability certificates, water management certificates, security, and education. Cooperation also takes places on an ad hoc basis. For example, when the government was attempting to persuade airlines to schedule regular flights to the Daniel Oduber Airport in Guanacaste, private hoteliers financed a bond to guarantee to the first airline that decided to use the airport—Continental—that any losses incurred as a result of the new route would be covered by them, not the airline. The new route was a success, and the guarantee was never called. Finally, there are frequent, informal consultations, and on critical issues, higher authorities are normally available to the heads of Canatur and CCH and to the managers of large or important projects.

While some nongovernmental organizations (NGOs) are part of Canatur, such organizations are, for the most part, excluded from the policy dialogue and process. Local communities have a well-defined mechanism of participation, if not in the broader policymaking process, at least in the approval or rejection of particular projects, as community town meetings and consultation with local communities are mandatory elements of environmental impact studies. Moreover, organized communities can and have taken to the streets and to the courts and have delayed some projects for years.

Tourism policy in Costa Rica has a clear mandate: to promote the development of the sector and to increase the number of tourists arriving in the country. In a narrow sense, policy governance is simple: the ICT leads public policy for tourism, but it is empowered to foster a dialogue within the sector and to promote Costa Rica as a tourist destination, using special, earmarked taxes for this purpose. The private sector is involved in consultation processes, but it also has a say in defining the ICT's policies and actions through its representatives on the ICT board, participation in working groups, or more directly when sector representatives are appointed as ministers of tourism.

However, current policy, as expressed in the Sustainable Tourism Plan, calls for broad public sector interventions. Implementation of the plan requires the cooperation of authorities that deal with zoning regulations, fresh water supply and sewage disposal, logistics and transportation infrastructure, security, training and education, energy, telecommunications services, compliance with environmental standards, and others. When considered from this broader perspective, policy governance is particularly poor, because the ICT does not have the formal or informal authority required to align all (or any) of the relevant public sector entities with the National Sustainable Tourism Plan.

### **2.3 Policy Outcomes and the Role of Cooperation**

Tourism developed spontaneously in Costa Rica, capitalizing on the country's investments in environmental protection and human resource development. The public sector did not choose it as a winner, but was quick to support it once it revealed itself as a potential winner. Fiscal incentives played a critical role in bringing international hotel chains to Costa Rica, and their success is evident in the fact that after they were discontinued, international brands and investment have continued to flow into the country.

A sector-wide tax is used for international promotion and private sector representatives are part of the ICT's marketing committee. This arrangement, similar to the investment boards proposed by Romer (1993), has been quite successful.

An intensive dialogue between the private and public sector has been a constant in sector policy and has used a variety of channels, including formal and informal consultations, private sector representation on the board and on several ICT working committees, and the frequent appointment of industry leaders as CEOs of the ICT. Although cooperation has been close, the

public sector has retained control over policy, and while some important players may have privileged access to public authorities, small operators of all kinds are prosperous and well organized and their voices are part of the policy process. Moreover, while fiscal incentives and tax exemptions were once quite generous, the sector continued to thrive after they were discontinued and has always been subject to market discipline. Public sector incentives have been properly aligned as well: both the ICT and its CEO have no other mission than to foster the development of tourism. Looking ahead, the main challenges are the shift from a narrow, vertical policy that capitalized on previous investments to a broad policy that will require the cooperation of vast swaths of the public sector, and managing growth while preserving the unique characteristics of Costa Rica's brand of tourism.

### **3. Fishing**

The fisheries sector is a story of failure: productivity has not increased, poverty among fishermen is endemic, natural stocks are being depleted, and even the ocean floor is being damaged by the use of wasteful and outdated fishing techniques.

#### **3.1 Overview of the Fisheries Sector**

The main features of the private fisheries sector are the following:

- Many types of operators: fishing fleets, from international industrial to local artisanal, intermediaries who collect fish from different parts of the coast to sell it for local consumption or for export, and exporters of canned, fresh, and frozen fish and seafood.
- Socioeconomically heterogeneous operators: from prosperous industrial-scale operators to poor artisanal fishermen.
- Geographic concentration: mainly along the Pacific coast.
- Unorganized small producers, with little voice and impact on the policy process.

The main public sector institution that oversees fisheries is the Costa Rican Fishing Institute, INCOPECA. While several ministers sit on its board of directors, the fisheries sector is not a high priority for any of them. Formally, INCOPECA is under the direction of the Ministry of Agriculture, whose main priority, not surprisingly, is agriculture, not fisheries. Many other entities have responsibilities regarding the sector, including the National Animal Health Service (SENASA), the Coast Guard, the Ministry of Environment and Energy (MINAE),

Customs, the Institute of Social Welfare (IMAS), and the Costa Rican Oil Refinery, which provides subsidized fuel. A multi-institutional commission, created by executive decree in 2010,<sup>5</sup> was given a mandate to coordinate activities on the seas, including fishing. However, it has never been convened.

Sustainability and sector development were the justifications for the creation of INCOPECA by Law 7384. However, production was dwindling and poverty was widespread among fishermen. Unlike in tourism, in which the PDP supported a winner, in fisheries the PDP aimed to save a loser.

INCOPECA's primary responsibilities include coordination of the fisheries and aquaculture sectors, promotion of their development, and the conservation and sustainable use of marine resources. It is in charge of proposing a National Fishing and Aquaculture Development Plan to the Ministry of Agriculture, monitoring the industry, issuing fishing licenses, promoting fish consumption, and regulating the consumption of marine products.

Law 8436 bestowed new responsibilities on INCOPECA, such as the monitoring of scientific research (Articles 17-22), the development of coastal communities (Article 3, clause o), and the supervision of community projects carried out by beneficiaries of economic subsidies. It also provided additional financial resources to INCOPECA, granting it 20 percent of all payments received for licenses, registrations, and fines imposed on foreign vessels.

Coastal fish and shrimp were the predominant landings before the 1970s. Later, pelagic fish species and shrimp species from deeper waters began to dominate. By the mid-1980s, coastal water species had dwindled, and dolphin, tuna, sharks, billfish, and other deep-water species became the main landings.

National fleet landings grew steadily, from 10,000 metric tons (MT) in the early 1980s to 27,000 MT in 2001, while annual reported landings of the international fleet were in the 3,000-6,000 MT per year range. Thus, at its peak in 2001, total fish landings were around 32,000 MT. Additionally, tuna captures reported by the international fleet (not landed in Costa Rica) amounted to between 20,000 and 30,000 MT per year.<sup>6</sup>

The decline in many of the fish populations was already taking place in the 1980s, but fishermen were constantly shifting toward other species so that total landings remained high or

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<sup>5</sup>Executive Decree N° 36005 MP-MINAET-MAG-SP-MOPT-TUR-RE.

<sup>6</sup> See <http://www.incopesca.go.cr>.

even increased until 2001. However, the ratio of coastal to deep-water landings shifted from 3:2 to 1:4, masking the decline in coastal landings (Mug-Villanueva, 2002).

In 1960, the trawling fleet had six boats. That number increased to 35 by 1980 and to 70 by 1989 (Alvarez and Ross, 2010), but declined to just 23 boats currently operating on a part-time basis. Similarly, shrimp landings had reached 500 MT by 1960 and increased to 4,500 MT by 1985, but fell to less than 1,000 MT in 2008 (Araya, 2007), and the number of shrimp exporting companies fell from 17 in 1999 to 7 by 2008.<sup>7</sup>

Fish-exporting companies have seen a similar evolution, falling from 35 companies in 1999 to only 27 by 2008 (INCOPECA). By 2001, seafood exports were close to US\$134 million. A steady decline in seafood exports followed, falling to only US\$77 million by 2007. The total value of fisheries production (including tuna landed by the international fleet) was US\$299 million in 2001, but by 2007, it had further declined to US\$187 million (IICE-UCR, 2010).

Although there has been a significant decrease in the number of fishing boats, it has not been sufficient to produce a recovery of the fish stocks. While small and medium artisanal fishermen reaped few benefits from the boom years, they have clearly felt the impact of the collapse of most fish stocks.

### **3.2 Institutional Arrangements and Current Policy**

Fisheries policy is vertical but wide: it requires the participation of sanitation, trade authorities, police, welfare, energy, and public training institutions to fully carry out its mandate. However, INCOPECA has neither the informal leadership nor the formal authority over the institution in charge of those policies.

INCOPECA has not fulfilled its legal obligation to develop a National Plan for Fishing and Agriculture<sup>8</sup> due to a lack of the resources required to fulfill this regulatory role. Only 14 inspectors are available to enforce regulations in at least eight ports that operate 24 hours a day. Moreover, most of the catch is captured beyond 40 miles from the coastline, but INCOPECA does not have a single boat able to sail in those waters.

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<sup>7</sup> See <http://www.incopescas.go.cr>.

<sup>8</sup> Article 5, Law 7384.

A resource that could potentially support INCOPECSA is the revenue received from licenses and permits. However, these fees have been set at very low levels, and the board has rejected any increases above adjustments for inflation, notwithstanding a specific order from the General Audit Office to do so.<sup>9</sup>

INCOPECSA's supreme governing body is its board of directors, made up of four representatives from the public sector representatives and seven from the private sector.<sup>10</sup> Thus, the private sector has such tight control of the board that the public sector representatives frequently do not come to board meetings.

The public sector members are the chairpersons of the board and CEO, appointed by the Cabinet, the Ministers of Agriculture and of Science or their representatives, and a representative of the government, also appointed by the Cabinet. The private sector members are three representatives of local fishermen's associations, three representatives of the fisheries industry, and one representative of the export sector. The Cabinet, from short lists submitted by the private sector, appoints all representatives. Artisanal fishermen, by far the most numerous, are seldom represented on the board, which is dominated by the sector's largest players.

NGOs are usually quite critical of INCOPECSA's performance but support some institutional activities, particularly those seeking to promote the sustainability of fishing practices. However, their involvement in the policymaking process is quite limited. Regional and global organizations, such as the Food and Agricultural Organization (FAO), the Organization of the Fisheries and Aquaculture Sectors in Central America (OSPESCA), and the Inter-American Tropical Tuna Commission (IATTC), influence policy development at INCOPECSA through regional collaborative agreements.

INCOPECSA's goals are broad and vague. They encompass resource protection, the development of coastal infrastructure, aid programs to fishermen, training programs, the development of a national fleet, the development of industrial processes, the strengthening of seafood commerce, and others. The institution spreads itself among a great number of activities within a reduced budgetary framework.

With no plan, no participation of political authorities, no outside supervision, and weak representation of the majority of fishermen, decision making is casuistic and probably influenced

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<sup>9</sup> Contraloría General de la República-Report. DFOE-PGA-86/2006.

<sup>10</sup> As regulated by Article 7 of Law 7384.

by short-term considerations rather than guided by long-term resource sustainability criteria. The weak presence of government representatives at board meetings cedes the initiative to the private sector. Private sector representatives propose most of the subjects discussed at the board meetings.<sup>11</sup> Rather than designing a mechanism that would allow it to extract useful information and to implement productivity-enhancing policies, the public sector surrendered policy management to the upper echelons of the private sector.

Policies and regulations are seldom implemented. Illegal fishing by national and international vessels is loosely controlled. The potential for large-scale, unregulated, and unreported fishing is high, and INCOPECSA has not implemented any study or process to monitor the availability or conservation status of key fish stocks. No statistics on fisheries have been produced in the last five years and, consequently, policy and management decisions are made in an information vacuum.

### **3.3 Policy Outcomes and the Role of Cooperation**

Overall performance of the sector has been poor: landings have been reduced by half, and the average income of artisanal fishermen has grown only 8 percent during the last decade (Alvarez, 2009). Most of the fish stocks have dwindled and, in the last decade, imports of fish from Asia and the United States have grown from almost none to 4,000 MT (OPESCA, 2009).

The connection between policy, goals, and activities is seriously hampered by the work of the board of directors. Its composition is a clear breach of the principle of neutrality insofar as members of the regulated sectors are members of the regulatory body. Public sector representatives are seldom present at the board meetings, which means that the private sector representatives on the board are the de facto decision makers. It would appear that successive administrations over the past two decades have simply ceded policy to private sector actors.

The administration of a common good demands a delicate balance between promoting the activity and regulating the use of the resource. By withdrawing from the policymaking process and relinquishing policy control to a small but economically important subsector within the fishing industry, the public sector has all but guaranteed that such a balance will not be achieved and that the result will be overexploitation, or destruction, of the commons.

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<sup>11</sup> This is evident in the analysis of the minutes of the meetings of the Board of Directors from 2006–2011.

In the 18 years since its inception, INCOPESCA has not been able to either prevent the overexploitation of fish stocks or significantly increase productivity and income for most fishermen. This is not the result of inept administration or even of inadequate resources, but rather the inevitable result of a deeply flawed institutional design.

The main source of profits for at least part of the fishing industry lies not in what the policy does but in what it fails to do: enforce the rules. This enables overexploitation, the use of illegal gear, banned activities (shark finning), and so forth.

## **4. Rice**

The rice industry is also a story of failure. A very heterogeneous sector, with both large and prosperous producers and small, poor, and poorly organized ones, has been able to establish a system of rules and incentives that predominantly benefits large, prosperous producers. Rice is an important item in the budget of the poorest Costa Ricans, and the main result of the policy currently in place is to make this staple more expensive for them.

### **4.1 Overview of the Rice Sector**

Currently, 1,490 farmers and 13 agro-industrialists, operating 17 processing plants, are registered with the National Rice Corporation (Conarroz), while COMEX reports 144 importers, 13 of which have no contingent quota assigned. In addition, the production chain includes exporters, retailers, and seed, chemical, and equipment suppliers.

Conarroz is the primary institution in charge of rice sector policy. The National Groundwater, Irrigation, and Drainage Service (SENARA) and the Ministry of Foreign Trade have a direct influence on sector activities. The Ministers of Agriculture and Livestock (MAG) and of Economy, Industry, and Commerce (MEIC) have a permanent seat on the board of directors of Conarroz, which has 11 members. The remaining members of the board are four representatives of agro-industry, five representatives of rice farmers, and an auditor elected by the General Assembly who has no voting power. Equity among market participants was put forth as the primary justification of the PDP, while increasing productivity was a secondary consideration. The need to protect and promote domestic rice production was also used to justify the need for government intervention.

Law 8285 of 2006 created Conarroz. Its main objective is to establish a system of relationships between rice farmers and agro-industrial companies that guarantees the rational and equitable participation of both sectors in this economic activity and fosters competitiveness and development of rice production while ensuring the availability of rice for local consumption.

Under Law 8285, purchases from farmers are audited, and farmers are prohibited from selling on behalf of another person or from reporting planted areas owned by someone else. Rice processors are required to pay producers no later than eight days after delivery of the product and are charged interest if payment is delayed. Likewise, agro-industrialists must submit a sworn statement to the Corporation detailing purchases, sales, prices, and inventories for the month being reported. They are also required to receive all of the rice offered to them, with some exceptions having to do with quality, market conditions, and processing capacity. Therefore, the majority of rice sales are guaranteed to the farmers. If there is excess production, surpluses can be exported (as long as at least three months of domestic supply is assured). When there is a shortfall, imports are allowed once Conarroz informs MAG or MEIC of supply needs, either of which must then issue a decree.

By law, MEIC can set maximum prices at different stages along the value chain (retail, wholesale, and exporters) based on technical information submitted by Conarroz. The profit margin between agents of the value chain of rice is determined by the price fixed by the MEIC: from 10 to 24 percent for the industrialist, depending on the milled rice quality (percent whole grain),<sup>12</sup> 5 percent to wholesalers, and 7 percent to retailers. The producer margin varies from 20 to 40 percent depending on the scale of the planting, the production region, and the technology used. Prices have consistently been set above the international price and are thus considered a subsidy by the World Trade Organization (WTO) well in excess of the maximum agricultural subsidy allowed for Costa Rica under its WTO obligations.

When national production is below national consumption (as it normally is) the law authorizes the Corporation to import at zero tariff. Import quotas are allocated to industrialists in proportion to their historical market share. Since the sale price remains at the fixed, above-international-market level set by MEIC, importers make a substantial profit selling in the local market. Anyone who pays the 35 percent tax is free to import.

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<sup>12</sup> This figure is higher (24 percent) for the category of greater presence in the domestic market (80/20).

Domestic production has seen important variations in the last few years. The sown area grew from 47,252 hectares in 2006–2007 to 81,022 hectares in 2010–2011, while the number of farmers increased from 970 in 2008–2009 to 1,490 in 2010–2011. These increases were due mainly to the National Food Plan of 2008. This plan promoted rice production as part of a Food Safety Policy, which aimed to cover 80 percent of local consumption with domestic production. Together with the price-setting mechanism already described, this encouraged even cantaloupe growers to switch to rice production. In October 2011, the industrial sector refused to purchase all of the domestic production, alleging that inventories were excessive and that the higher price with regard to the imported husk rice made the activity unfeasible.

A high-level commission, named by the Executive branch, was created within the framework of Conarroz, and an agreement was reached to reduce the number of hectares from 81,000 to 60,000 and to lower the self-supply goal to 60 percent of domestic consumption. Some 100 farmers are expected to leave the sector.

According to Conarroz data, rice production in 2010–2011 was 290,474.70 MT of paddy rice, with a planted area of 81,792.5 and an average yield per hectare of 3.58 MT. This contrasts with 7 MT in the United States and 8 to 9 MT in Egypt and Australia, with the differences mostly due to natural conditions.

According to SEPSA (2006), under domestic prices all domestic producers are profitable, with profitability varying from 20 to 51 percent of revenues per hectare. However, when international prices are used, only large-scale producers under the irrigated sowing system are profitable. In this case, the producers from the Chorotega region included in the study showed lower production costs per MT than in the United States. Even though local agricultural yields are lower, the difference in price is attributable to private direct subsidies granted to producers in the United States. This means that without subsidies, Costa Rica's large producers could be competitive with U.S. producers in terms of yield.

In terms of area, rice farming in Costa Rica is dominated by upland rice (72 percent), while low-risk, irrigated rice represents 28 percent of the total area planted. Rice production is highly concentrated: 18 percent of producers contribute more than 80 percent of national production. These producers, with medium-size and large farms between 50 and 200 hectares, have nearly a 4.8 MT per hectare yield. In contrast, small and medium producers, which account for 82 percent of the total number of rice producers, contribute only 22 percent of total

production. These producers own farms that are between 10 and 50 hectares, have close to 2 MT yields per hectare (MAG, 2012), and some of them do not reach 2 MT per hectare.

According to data from COMEX for the period 2010–2011, four industrial rice companies dominated 72 percent of the local grain market. Two are cooperatives sharing 17.6 percent of the market, and one—Coopeliberia—represents 88.8 percent of this percentage. There are 144 importers of milled rice and 12 of paddy rice. In both cases, the market is highly concentrated. In the case of paddy rice, 72 percent of the import quota goes to three agro-industrialists, and in the case of milled rice, nine companies account for 69.7 percent of total imports. Of the 12 industrial companies, five are among the major importers of hulled rice.

#### **4.2 Institutional Arrangements and Current Policy**

Rice policy is a narrow, vertical PDP. As explained in a previous section, Conarroz' objectives include equitable relations between market participants, productivity increases, and ensuring the availability of rice for domestic consumption. The corporation has been for the most part successful in preventing social conflicts between market participants, but it has failed to improve sector productivity or promote technological innovation.

In order to promote domestic rice production, Costa Rica relies on high (35 percent) import tariffs and a system of prices set by the Ministry of Agriculture at the wholesale and retail levels, based on technical production information submitted by Conarroz. When local production is not adequate to satisfy local demand, industrialists are allowed to import rice at zero tariff and sell it at the previously fixed price, even though international prices are well below domestic prices. Importers are thus guaranteed a hefty margin. Large, highly productive local producers would be profitable even at world prices. Small, low-productivity producers, however, are barely profitable, if at all, even at the elevated domestic price.

As in fisheries (formally) and tourism (informally), in this PDP, cooperation between the public and private sectors has taken the form of co-governance: a specialized institution has been created to manage sector policy, with a board of directors that includes representatives of both the public and the private sectors but in which the private sector is in complete control.<sup>13</sup> Private sector participation on the board is defined by law and, as in the case of fisheries, the public

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<sup>13</sup> Something that might be perfectly fine when the institution is funded by the private sector, but hard to justify when funding comes from tariffs that allow overpricing of a basic component of the diet of the poor.

sector is in the minority. The rules for the selection of private sector representatives are clearly defined, and rice is a priority sector for both the Minister of Agriculture and the Minister of Economy.

The General Assembly is Conarroz' supreme governing body. It is made up of 16 producer representatives, 13 agro-industrialist representatives, and the Ministers of Agriculture and of Economy. The board of directors is made up of four agribusiness representatives and five producer representatives appointed to two-year terms. In addition to the Ministers or Deputy Ministers of Agriculture and Livestock, the Minister of Economy and Commerce (MEIC) also participates. The law also created a forum for public-private dialogue and negotiation: the National Rice Congress, formed by representatives of producers and agro-industrialists, with the participation of public authorities.

The three main instruments of sector policy are the (very high) external tariff, the allocation of tariff-free import quotas (to ensure the availability of rice for local consumption plus a small quota set in CAFTA-DR), and internal price setting. In theory, the government could liberalize internal prices at any or all stages in the production and commercialization chain, and it could also unilaterally reduce the import tariff. Also in theory, the organization of Conarroz looks very similar to that of ICAFE (discussed below), and a fair representation of all segments in the production chain seems to be ensured by law. In practice, however, the situation is quite different.

All non-vertically integrated rice producers are dependent on agro-industrialists to sell their crops, and while the law minutely regulates the relationship between producers and processors and virtually guarantees that crops will be sold, the reality is that processors can refuse to buy the entire crop—as they did in October 2011, claiming excess inventories—and in so doing, inflict considerable damage on small producers.

Despite clear violations of its international obligations regarding agricultural subsidies, the government has been loath to liberalize domestic prices, and in fact has not done so. Every time it has made an attempt, producers and industrialists have announced and carried out protests, and the government, unwilling to see social peace disturbed, has systematically given in to those protests. It should be noted that these protests are legitimized because they are made to defend small peasant farmers who would not remain in the market if international prices prevailed in the local market. These producers have not been presented with a credible

alternative—which could be an exit strategy—to the current price support system. Therefore, they are more than willing to defend it, even if most of its benefits accrue to large producers and it does not make small producers prosperous. In short, the public sector does not exercise its authority, and small producers have been manipulated by large producers into becoming stalwart defenders of a policy that keeps them, at best, in a very precarious economic situation.

Both the MAG and the MEIC must submit an annual report, including sector policies, to the General Assembly. However, in the opinion of key informants interviewed, the report that is normally sent provides no more than a general outline, with little impact on the actual programs adopted by the board of Conarroz.

Conarroz also produces an annual report, but decision making seems to be oriented by strictly political, not technical criteria, and the report does not undertake a serious evaluation of the current policy and its impacts. Despite this, at a technical level, the MAG, the MEIC, and, more recently, COMEX have tried to document concerns about the price distortions and international treaty violations brought about by the current policy.

#### **4.3 Policy Outcomes and the Role of Cooperation**

Conarroz has a dual mandate: to guarantee equitable relationships among all market participants and to foster sector growth and productivity. In practice, it has done little to increase productivity, and it has used the equity mandate to justify highly distorted prices for rice in Costa Rica, well above international prices.

Most domestic rice producers would not be profitable at international prices and remain in the market only because high tariffs and high prices set by the public sector protect them from competition. Some large producers would be competitive at international prices, because even though their yield per hectare is lower than that of the United States (the main source of Costa Rican rice imports), their costs are also lower. However, 18 percent of all producers (medium and large) are responsible for 80 percent of rice production. Large producers also tend to be vertically integrated and participate in rice imports, and tariff-free rice is sold at the same price as tariff-paying rice, and the importers pocket the difference under rules that make the largest companies the biggest winners. Thus, the benefits from high domestic prices accrue disproportionately to a small number of producers that do not need them, but poor consumers mainly pay the cost of high domestic prices, as rice is an important budgetary item for them.

Policy design achieves goals that are very different from those stated in the law creating Conarroz and the current policy framework. This is not a failure of policy administration, but rather of policy design: both the policy mechanisms and the governance rules are skewed in favor of large producers and industrialists. These results may be surprising, given that Conarroz' organization and the rules regarding margins along the production chain resemble those of ICAFE, which have achieved very different results.

There are two key factors that explain the striking differences in performance between rice and coffee, despite the formal similarities between ICAFE and Conarroz. First, Costa Rican coffee is internationally competitive, and only those that succeed in the marketplace can make profits. The regulatory system ensures—or at least tries to ensure—that profits are equitably distributed among market participants. The situation is almost exactly the opposite of that in the coffee sector: most Costa Rican rice producers are not internationally competitive and, due to natural conditions, cannot aspire to become so. A price and import system that makes them privately profitable creates benefits that accrue mostly to large, prosperous, vertically integrated producers and which are paid by all consumers, with a particularly negative impact on the poorest of them. It is true that these producers would be competitive at international prices. What the current system does is turn normal profits into extraordinary profits, created by policy, not by success in the marketplace.

Second, in coffee, small producers are well organized and almost as productive as large producers. The contrary is true in rice: small producers are not organized and their productivity is low, which means they are poor and have little influence in the policymaking process.

## **5. Coffee**

Coffee production in Costa Rica dates back to the 19th century. It was the country's first successful export crop, and a high number of small producers participated in the industry. Early on, coffee became a heavily regulated activity: the Defense of Coffee Institute was created in 1933. It was later renamed the Costa Rican Coffee Office in 1948, and in 1985 became the Costa Rica Coffee Institute (ICAFE). Its mission was to promote the activity and ensure equitable relations between producers, processors, and exporters, “not based on the economic rules of supply and demand, but through a public process of mediation ... where, although the price of

coffee is determined in international markets, it is datum for the determination of the agents in the coffee industry” (Aguilar, Barboza, and León, 1982: 132).

Coffee policy can thus be viewed as social policy with a productive development component, rather than as a pure PDP. The public sector’s intention was neither to support an incipient sector that had already demonstrated a competitive advantage—as in the case of tourism—nor to rescue a failing sector, such as fisheries. Rather, it was to ensure that the income created by Costa Rica’s (at the time) most successful export sector was equitably distributed and, almost incidentally, to promote the activity.

### **5.1 Overview of the Coffee Sector**

Four different types of private agents participate in the coffee sector: growers, millers, toasters, and exporters. In some cases, producers are vertically integrated into milling, toasting, or exporting. Currently, there are 50,631 coffee growers (down from 76,163 in 2000). Of these, 92 percent have less than 5 hectares and represent 44 percent of the planted area. Six percent have between 5 and 20 hectares, representing 21 percent of national planted area, while the remaining 2 percent have plantations over 20 hectares, representing 35 percent of the planted area.

There are 172 millers (up from 97 in 2000), 57 percent of which qualify as small (with an output of less than 3,000 bushels) and process 3 percent of the coffee produced; 38 percent are considered medium-sized (between 3,000 and less than 7,000 bushels) and process 52 percent of the harvest; 5 percent are large millers (more than 7,000 bushels) and process 44 percent of the harvest. There are 57 toasters and roasters registered, six more than a decade ago. About 16 percent are cooperatives. Finally, there are 336 exporters, 7 percent of which are cooperatives, which place coffee with importing companies and/or roasters in consumer markets and which capture the bulk of national production. Most exporters are small-scale (70 percent), and 95 percent of firms use futures markets for coverage.

Most participants in the coffee market belong to one of several organizations. The three most important ones are the National Chamber of Exporters of Coffee, the National Chamber of Coffee Growers, and the National Chamber of Coffee Producers, Millers, and Processors.

The National Chamber of Coffee Growers<sup>14</sup> comprises 33 coffee-producing firms (including farmers and coffee processors), which represent about one-fifth of all producers registered with ICAFE.<sup>15</sup> Its main objectives are to monitor national coffee policy and to defend and promote the interests of the sector.

The National Chamber of Producers, Millers, and Processors was created in 1979 and brings together 23 roaster companies that offer the product (gold bean, roasted and packaged) to national and international consumers. According to ICAFE records, at the moment, the chamber includes 40 percent of all roasters.

A second group of organizations includes the International Coffee Week Association (SINTERCAFE), Specialty Coffee Association of Costa Rica (SCACR), the National Federation of Coffee Cooperatives RL (FENAC-Café, RL), and the Women in Coffee Alliance of Costa Rica (WCACR).

The Costa Rican Coffee Institute (ICAFE) is the main public sector organization in charge of coffee sector policy. It is an autonomous institution, with a board of directors that includes both private and public sector representatives. Other government agencies that have an impact on coffee sector performance include the Ministry of Transportation, the Ministry of the Environment, and the National Bureau of Immigration. The latter is particularly important because most seasonal workers on coffee plantations are immigrants from Nicaragua and, to a lesser degree, from Panama, who are granted temporary work permits. ICAFE also provides information for national accounting purposes and guides decision making in economic and trade policy, together with the Central Bank of Costa Rica, COMEX, and other agencies involved in the sector.

The main concern that led to the formulation of detailed regulations for the coffee sector and the creation of organizations charged with applying them was equity. It was feared that, in the absence of such regulations, processors and exporters would ignore the interests of the many small producers. Productivity was also a consideration, although a secondary one.

Law 2762 of 1961 on Coffee Producers, Processors, and Exporters defined the rules governing the relationship among sector participants. Law 6988 of 1985 created ICAFE. This

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<sup>14</sup> <http://www.cafedecostarica.com/Coffee-Community/es/national-coffee-chamber/>

<sup>15</sup> In an interview, the Executive Director of ICAFE quoted a higher number of members. The text data is displayed on the website of the Chamber.

legislation sets profit margins for millers (who obtain coffee from producers) and exporters (who obtain it from millers). Millers are permitted a 9 percent margin, exporters a 2.5 percent margin, and the rest, after costs have been deducted, accrues to producers. ICAFE estimates that producers receive 80 percent of the international reference price. Additionally, the regulations define payment procedures and times.

Implementation of these regulations requires detailed record keeping, and ICAFE has developed the operational capabilities to achieve this. No market participants appear to be interested in liberalizing the operation of the sector. All market participants must register with and be authorized by ICAFE and are bound by the rules established by law or by regulations issued by ICAFE. There is no “opting out.” ICAFE is funded by a 1.5 percent tax on the FOB value of coffee exports.

When considering volume produced, Costa Rica ranks 15th among coffee producers. Brazil, Vietnam, Indonesia, Colombia, India, and Ethiopia lead the ranking. In Latin America, Mexico, Honduras, Peru, Guatemala, El Salvador, and Nicaragua also ranked above Costa Rica in terms of volume produced. Production has fallen significantly since 2000, when it reached 3.6 million “fanegas” (agricultural unit of capacity). By 2009 production, had declined to 1.9 million fanegas, recovering slightly to 2.1 million, in the 2010–2011 harvest.

In Costa Rica, 92 percent of producers have less than 5 acres and deliver less than 100 bushels of coffee a year. Their plots represent 44 percent of the total growing area and 41 percent of national production. Medium-sized producers, defined as those with 5 to 20 hectares each, represent 6 percent of all producers and 21 percent of total planted area and contribute about 24 percent of national production. Finally, large producers, accounting for 2 percent of producers and 35 percent of the cultivated area, provide 35 percent of total production. Clearly, on a per-acre basis and in stark contrast with rice, small producers are almost as productive as medium and large producers.

On the industrial side, in 2010–2011, small millers processing less than 3,000 bushels processed 3.3 percent of the harvest; medium-sized millers represented 37.5 percent of all millers and processed 51.9 percent of the harvest. The remaining 5.2 percent of millers, the largest ones, processed 44.8 percent of the harvest.

Prices for berries delivered by producers have been trending upwards, going from CRC 16,774 in 1994 to CRC 93,084 in 2010. Average prices for exported coffee declined from 1994

to 2001 and have shown an upward trend since then. Costa Rica sells a significant and increasing portion of its harvest on the international market, with price differentials related to quality. On average,<sup>16</sup> between 2006 and 2010, Costa Rica obtained an additional \$16.7 per 46 kg bag. Among 13 leading coffee-producing countries, Costa Rica ranks third in terms of price per kg. exceeded only by Kenya and Colombia (ICAFFE, 2012).

It should be noted that Costa Rica sells mostly products with low value added. Green coffee represents 99 percent of total exports by volume, with roasted coffee representing 0.9 percent of exports and coffee extracts, essences, and concentrates representing 0.1 percent. However, in recent years the volume and share of roasted coffee have increased, indicating greater specialization in the sector. The main export destinations are the United States (56 percent of Costa Rican exports), Belgium and Luxembourg (11 percent), Germany, and Italy.

## **5.2 Institutional Arrangements and Current Policy**

The coffee PDP is vertical and narrow: inputs supplied by the broader public sector are already largely in place, which is not surprising given coffee's long history in Costa Rica. This PDP places great emphasis on the detailed regulation of the relationships between market participants in the coffee sector, to the point of making coffee the most highly regulated economic activity in the country. A democratic and clearly defined governance structure, adequate funding, meticulous record keeping and administrative independence and skill have enabled the PDP to fulfill its role with great legitimacy, very little conflict between market participants, and the general acquiescence of all agents in the coffee sector.

The PDP has taken the form of co-governance. Policy implementation is delegated to an autonomous institution, governed by a board with public and private sector representatives, on which the public sector is in the minority. Unlike other sectors, the rules for the selection of private sector representatives are defined by law and rigorously enforced, so that fair representation of all market participants is ensured. The existence of strong private sector organizations at all levels of the production chain, including cooperatives that bring together small producers, facilitates this participation and makes coffee the most democratic PDP in terms of private sector participation among the five cases under study.

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<sup>16</sup> The behavior of the FOB export price obtained by Café de Costa Rica with respect to the average price of the first and second positions of futures contracts traded on the Intercontinental Exchange (ICE).

ICAFE governs itself with considerable independence from political authority. Unlike the rice and fisheries sectors, small producers are well represented, and the legal framework is designed to guarantee them a considerable share of the sector's earnings. The National Coffee Congress appoints ICAFE's board of directors, following detailed sector representation rules. Both the Congress and the board are organized along democratic principles, and all participants in the coffee industry are represented. The Congress comprises representatives of producers (the number of delegates varies: one for every 1500 farmers recorded by each coffee region), nine representatives of the processors, six representatives of the exporters, two of the roasters, and one representative from the executive branch.

The board is composed of nine members and eight alternates, namely: five and four alternate are from the productive sector, covering all of the coffee electoral regions, a representative and a substitute for the exporters, millers, and roasters, and finally, the Minister of Agriculture or another representative of the executive branch with equal or higher rank, appointed by the Governing Council and a deputy. The board, in turn, appoints its president and an executive director.

ICAFE has administrative autonomy, but it is subject to the rule of law and must follow the General Law on Public Administration. It is accountable to the General Audit of the Republic (GCR). As established by the Organic Law of the GCR (Law 7428 of September 7, 1994), the General Law on Internal Control (Law 8292 of July 31, 2002) and related regulations, ICAFE has an Internal Auditor that follows the guidelines set by the GCR and reports directly to the Board of ICAFE. The auditor carries out surveillance, monitoring and control of the situation and progress of the institute (Article 125 of the Regulation). ICAFE publishes an annual financial statement in the official Gazette as well as an annual report of its activities. At the close of each fiscal year, a financial report is prepared and presented to the National Coffee Congress and certified by an external auditor. In general, the reports published are complete but descriptive, with no results-based evaluation of ICAFE's activity.

### **5.3 Policy Outcomes and the Role of Cooperation**

ICAFE is a well-funded organization that has exhibited the organizational and technical capabilities required to fulfill its main responsibilities: to administer a system that regulates the relationships between coffee sector participants with the aim of ensuring fair and equitable

participation in the sector's profits by producers, millers, roasters, and exporters. From this point of view, ICAFE has been quite a success. The fact that the public sector has only a marginal participation in running the organization has not hindered its effectiveness, as ICAFE has proven itself capable of enforcing the laws governing the sector. Two key success factors are that small producers are numerous, well organized, and well represented at all levels of ICAFE's organization, and that they are almost as productive as larger producers.

However, ICAFE or, more generally, Costa Rica's coffee sector PDP, can also be seen as a missed opportunity. While the country has produced high-quality coffee, it has not aggressively sought price differentials based on quality, nor has it climbed up the value chain. Most Costa Rican coffee is sold as dry but otherwise unprocessed grain. Although producers of high-quality coffee are increasingly able to obtain a price premium and small-scale efforts to sell processed, packaged coffee have proven successful, this has been the result of private initiatives rather than broad efforts coordinated by ICAFE.

One perspective is that Costa Rica has been able to grow high-quality coffee and to ensure equitable relationships among market participants, and that this coffee is bought at relatively good prices by foreign importers. But Costa Rica has done very little to actually sell coffee, let alone high value-added, branded, consumer-ready coffee. Given the high level of organization of producers, including small producers, and the demonstrated capabilities of ICAFE, this seems to be a missed opportunity. Climbing up the value chain could, however, disrupt the current arrangements, and would require a less regulated, more innovation- and initiative-inducing market. Costa Rica has done well with the current PDP. To do better, it might need to redefine the current model.

## **6. FDI Attraction**

After the economic crisis of the 1980s, Costa Rica shifted from an "import-substitution and industrialization" economic strategy to one that emphasized integration into the global economy, via exports and the attraction of FDI. Like many other countries, Costa Rica's first priority in the aftermath of the crisis was employment creation. However, unlike most other countries, Costa Rica has been able to systematically climb up the value-added chain and to move from (cheap) labor-intensive exports to increasingly complex and knowledge-intensive exports, fueled by the country's very successful FDI attraction programs.

FDI attraction was entrusted to the Costa Rican Investment Promotion Agency (CINDE), a private organization that collaborates closely with COMEX and the Export Promotion Agency (Procomer) of the government of Costa Rica.

## **6.1 Overview of Foreign Direct Investment**

Although multinational corporations (MNCs) are the target of Costa Rica's FDI attraction programs, they did not play a significant role in their design. Once established in Costa Rica, however, they do have an interest in policy continuity, and they convey their concerns and preferences to the government, either directly or indirectly, via CINDE and other channels.

CINDE, on the other hand, is probably best characterized as a quasi-public entity: it is formally private but fulfills a public role and is recognized as the country's FDI attraction agency. A third and frequently overlooked private sector segment is free-zone operators and their association, AZOFRAN. While they have not played a role in the design of the FDI and export-promotion policies, they do play a role in the stability of free zone legislation.

The organization directly responsible for trade policy and FDI is the Ministry of Foreign Trade (COMEX), created by Law 7638 in 1996. This law also created Procomer, an export promotion agency that works under COMEX but has an independent board of directors and private sector-like rules of operation.

The Customs Service, part of the Ministry of Finance, plays a crucial operational role. Other entities are involved on an ad hoc basis. These include the Costa Rican Power Institute (ICE), which was crucial in building power lines without which Intel's plants in Costa Rica could not operate; and the Ministry of Transportation, which has on occasion built small infrastructure projects specifically tailored to the needs of free-zone exporters.

Like the Costa Rica Tourism Board (ICT), COMEX lacks formal authority over those public agencies whose cooperation it needs to fulfill its mandate. Unlike ICT, however, the interventions that COMEX requires tend to be "surgical," and COMEX has had enough high-level political support to ensure they are delivered, although not always as quickly as desired.

Costa Rica's policy of integration into the global market has been broadly justified with standard economic arguments: there was recognition of both the limitations of the local market as a basis for economic growth and simultaneously of the gains from trade that a small economy

like Costa Rica could realize if it abandoned its inward-looking economic policies in favor of an outward-looking policy.

Now, as this policy has been implemented through various legal instruments, formal justifications have been given in each one of them: presidential decrees reducing tariffs, laws setting up fiscal incentives for non-traditional exports to third markets (that is, markets outside Central America), for tourism, for the creation of public institutions in charge of trade policy, for special importation regimes for exporters, and, finally, for the creation of free zones, or special processing zones for export-oriented companies initially, and for all companies that comply with certain requirements today (in order to comply with WTO regulations).

Delving into the details of each of these instruments would take us too far afield. Suffice it to say that the country recognized the need to compensate for its previous anti-export bias and to jump-start export-oriented activities. At the same time, it recognized the need to create permanent institutions in charge of trade policy, which it achieved by transforming a project ascribed to the Office of the President into the Ministry of Trade, and to create special processing zones for exporters that would offer fiscal incentives, mechanisms to expedite what could otherwise be paralyzing red tape, and the infrastructure required for the operation of companies with exacting needs in terms of access to transportation, telecommunications, energy, and other public services. This was achieved through the creation of free zones.

To promote integration into the global economy and to promote exports, Costa Rica has adopted a number of laws that, while not directly regulating CINDE's FDI attraction activities, provide the institutional and regulatory framework without which those activities would be fruitless.

### *6.1.1 Tariff Reductions*

Tariff reductions began in 1986 and became steeper by 1988. Since then, Costa Rica has signed free trade agreements with countries that represent more than 80 percent of its external trade, setting tariffs at zero, with a few exceptions that will be phased out over time.

### *6.1.2 Fiscal Incentives for Export Promotion*

Fiscal incentives for export promotion, known as CATs, became important in 1984, when an emergency law provided exporters of nontraditional goods with tradable certificates equivalent

to 20 percent of their sales. While these are no longer available, they played an important role in jump-starting non-traditional exports.

### *6.1.3 Free Trade Zones*

Law 7210 of 1990, amended in 1994, 1998, and 2010, created free trade zones. Initially, only export-oriented firms could apply for this support. The main purpose of the 2010 amendment was to make the regime legal according the WTO, with no special provisions for exporting firms.

### *6.1.4 WTO and Free Trade Agreements*

As part of its efforts to insert itself into the global economy, Costa Rica joined the WTO in 1995 and has signed free trade agreements with Central America, Mexico, Canada, the United States, Chile, the Caribbean, China, Panama, and the Dominican Republic. Agreements with Peru and Singapore have been negotiated and are pending legislative action. Negotiations of an Association Agreement with the European Union have been completed and the text is in the process of review. Agreements with Canada, the European Free Trade Association, and an update of the treaty with Mexico are being negotiated.

Total exports of goods and services were estimated at slightly more than US\$1 billion in 1980, and reached almost US\$16 billion by 2012. Traditional exports, which comprised over 55 percent of total exports in 1980, had declined to 7.9 percent in 2012 (COMEX, ND). This surge in exports has been driven largely by Costa Rica's success in attracting FDI, which rose from US\$52.7 million and 0.9 percent of GDP in 1980 to US\$2.5 billion and 5.3 percent of GDP by 2011, well above the OECD average for most developing countries.<sup>17</sup> High-tech exports represent 40 percent of manufactured exports, one of the highest percentages in the world.<sup>18</sup>

## **6.2 Institutional Arrangements and Current Policy**

CINDE, in tandem with COMEX, has been a high-performance organization, in a context in which much of the public sector can be described as anything but. Three factors may explain this. First, while CINDE is currently a highly specialized institution, with a relentless focus on attracting high-tech FDI organized around a few well-defined clusters, it was not always so.

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<sup>17</sup> Source: COMEX, op. cit.

<sup>18</sup> Source: COMEX, using World Bank data.

CINDE enjoyed the benefit of a generous budget, private sector rules, and a creative board of directors that allowed it to explore many different areas of action before discovering its competitive advantage. Second, CINDE is part of an organizational network that includes COMEX, Procomer, international FDI attraction agencies, multilateral trade organizations, multinationals, and companies that provide services to multinationals, which makes it a very attractive career option, in stark contrast to most of the rest of the public sector. A young professional who starts his career at COMEX, CINDE, or Procomer will work with outstanding senior professionals, has a good chance of becoming a trade expert after a few years, and will have strong career prospects. Third, CINDE, COMEX, and Procomer share a common vision of foreign trade policy, which allows exceptional coordination among them, not because there are hierarchical lines of control but because of that shared vision.

While in its early days CINDE undertook many different activities with varying degrees of success, its most enduring role was that of a think tank and lobbying organization. CINDE collaborated with public authorities to design the instruments required to make the new policy of global integration and trade promotion a success, drafting the relevant legislation and then steering it through Congress until it was finally approved.

Gradually, as the legal and institutional pieces of the puzzle were put in place, CINDE shifted its focus to providing services that the public sector probably should have provided but was not prepared to provide: lab services, market intelligence, funding for new projects, and national competitiveness strategy design in collaboration with INCAE and Harvard University, training of the diplomatic corps in business and FDI attraction issues, and training of local businesses to help them increase their technological capacity and quality and take advantage of trade opportunities.

CINDE has transferred most of these functions to public agencies and now focuses on two tasks: FDI attraction and post-investment services to multinational corporations that set up operations in Costa Rica. This is by far the deepest case of cooperation of the five case studies presented in this paper: it has involved policy design, policy implementation, support from the private sector (CINDE) in operational tasks that the government was not prepared to undertake directly, and specialization according to institutional competitive advantage.

But this is only one part of the cooperation. More players have been involved, and the way that they cooperated warrants explanation. In the early stages, the United States Agency for

International Development (USAID) was a major player, providing funding and political support. USAID engaged the Costa Rican private sector through carefully selected leaders, and developed a pro-growth economic transformation agenda that was fully embraced by Costa Rican business leaders, academics, and policy makers. It became a Costa Rican project, an unorthodox, pro-growth project in the midst of economic stabilization. This seminal collaboration planted the seeds for today's successful collaboration between CINDE, potential MNC investors in Costa Rica, and the Costa Rican public sector.

The final aspect of the cooperation model is cooperation between CINDE and the MNCs. CINDE is organized around three services:

- Information services: while CINDE actively tries to convince MNCs to invest in Costa Rica, it starts by providing accurate, complete, and timely information to facilitate the MNCs' decision making.
- Facilitation services: CINDE works side by side with potential investors from the moment the investment decision is made to the moment the project is in operation.
- Post-investment services: once a company is established in Costa Rica, CINDE is available to it, free of charge, to advise on anything from navigating government regulations to ensuring that potential workers have the required qualifications.

Today, CINDE is a small organization with a well-defined organizational structure. A board of directors defines strategy, while an executive director and several area managers implement it and tend to day-to-day business. However, most decisions affecting FDI in Costa Rica are made outside of CINDE, and what is remarkable is how successful CINDE has been in influencing those decisions, from the approval of crucial export-promotion legislation to the most recent modification in the Free Trade Zones legislation.

CINDE's success (and that of its allies) is that it has been able to create a mindset, a conceptual framework, regarding a) the importance of FDI for Costa Rica's development; b) the type of FDI that Costa Rica should seek, and; c) the incentives and requirements that need to be met in order to succeed in attracting the type of FDI that the country wants. It is not a stretch to say that all institutions and a high percentage of decision makers and opinion leaders directly involved in trade and FDI concur with the broad outlines of this framework.

Nonetheless, hard challenges lie ahead. For example, Costa Rica will need to upgrade the quality of its primary and secondary education, particularly in mathematics, science, and

languages, and to increase the amount, quality, and relevance of the training offered by vocational high schools. This will require commitment and participation by the Ministry of Education, an entity that has not been directly involved in trade or FDI attraction policy and whose priorities are not necessarily aligned with the country's needs in this area. It will also require more and better-trained engineers, scientists, statisticians, and mathematicians, which will require the cooperation of Costa Rica's public and private universities, over which CINDE has little influence.

The challenge, then, is to be able to set a broader national consensus on FDI attraction policy, one that goes beyond the specialists and dedicated institutions. And influencing decisions on such a wide and large scale is something that goes well beyond what CINDE has done so far.

### **6.3 Policy Outcomes and the Role of Cooperation**

Cooperation took place, initially, between two actors who did not have a direct financial stake in FDI policy—USAID and an elite group of Costa Rican businessmen—and not between multinationals and the Costa Rican government. Second, cooperation was eventually established between COMEX, a public entity, and CINDE, a private entity fulfilling a public role but with the flexibility to make quick decisions, plus the budget and mindset required to evolve as an institution.

Third, coordination among policy participants, so often a thorny and seemingly unsolvable problem in public policy, was achieved not on the basis of hierarchy, mandates, or controls, but of a shared vision of foreign trade policy that was the result of a long, deep, and continuous process of dialogue, cooperation, and interaction between the public and private sectors. The private sector participants were the spokespersons for a clearly defined vision of what Costa Rica's economic development should be. Fourth, this shared vision has brought about remarkable policy stability for more than 30 years. Fifth, cooperation has taken also the form of a flow of key personnel between COMEX, CINDE, and in some cases, multinational corporations. It is not infrequent for former Ministers of Trade to become chairs of CINDE's board of directors, and some senior personnel have moved from CINDE to work in multinational corporations, further reinforcing a common vision or mindset. Sixth and finally, cooperation has been organized around instruments and services that alter relative prices but do not insulate beneficiaries from the discipline of market competition.

## **7. Public-private Collaboration in Costa Rica: Some Preliminary Lessons**

In Costa Rica, public-private collaboration often takes the form of co-governance. The law defines the broad policy outlines. A specialized entity is created for the purpose of implementing the policy, and that entity has a board of directors with both public and private representatives, with the private sector often in the majority. In the extreme case, one could argue that the public sector forfeits its rights and duties as policymaker, and simply outsources policy management to autonomous institutions run by the private sector.

Two of the cases under study can be considered failures. In the case of rice, the current policy's main effect is to increase prices to consumers and rents accruing to the large, vertically integrated producers, while small, low-productivity producers receive neither the tools required to move out of rice and into a more productive activity for them, nor those that they would require to become more productive. Similarly in the case of fisheries, under current policy a relatively large number of artisanal producers merely scrape by, while larger, industrial vessels, many of them foreign and paying small fees for licenses, are allowed to over exploit—and deplete—valuable fish stocks.

Coffee is a success from several standpoints. First, Costa Rica has continued to be a successful coffee exporter and has been able to climb up the value chain, sell at better prices, and differentiate its product. Second, relatively prosperous small and medium-size producers produce a significant portion of the coffee harvest. However, as perhaps was to be expected by a policy borne out of considerations of equity rather than productivity, Costa Rica has for the most part remained at the low end of the coffee value chain, and exports of roasted, let alone branded, coffee are at best incipient.

Tourism is a success. After decades of growth and pioneering policies first in eco-tourism first and later in sustainable tourism, Costa Rica remains a prime tourist destination and an attractive destination for industry investors. Small and medium-size businesses comprise most of the sector, which creates revenue for a wide variety of businesses throughout the country.

FDI attraction is also a success. Foreign direct investment has grown exponentially, to the point that Costa Rica's net inflow of FDI as a percentage of GDP is one of the highest in the world, and its manufactured exports are among the most knowledge-intensive.

## **7.1 Shared Shortcomings**

These five cases have some shortcomings in common, despite their varying degrees of success. They are elucidated in the following subsections.

### *7.1.1 Difficulty Mobilizing the Rest of the Public Sector*

All of the cases studied are “vertical” policy cases. At different points and for different purposes, however, in all cases, instances can be found in which there is a need for a broader public sector intervention or, at least, an intervention by an entity outside the vertically defined policy process. In no case have effective mechanisms for the deployment of the rest of the public sector been devised. It would seem that the price paid for the creation of a specialized institution, run in large part by the relevant segment of the private sector, is that the institution is largely on its own when it comes to achieving its policy objectives, which are not seen as collective public sector goals, but rather as isolated institutional goals.

### *7.1.2 Less than Perfectly Open, Transparent Dialogue*

A feature shared by all five cases is permanent dialogue between the public and the private sectors. However, the degree to which the dialogue is organized according to well-publicized rules and is open to all interested parties varies considerably from one sector to another. Transparency and access to files documenting the dialogues and the agreements reached, if any, also vary considerably from one sector to another.

In short, there is a quite a bit of leeway for public authorities in deciding whom to invite to participate in the process, and to interpret the results of the interaction. This probably comes in handy for political authorities and, if done skillfully, can preserve the legitimacy of the process, but it is less than perfectly transparent.

### *7.1.3 Weak Accountability*

It can be argued that accountability is weak in the Costa Rican public sector, in the sense that policy generally lacks well-defined, measurable goals and efficiency metrics. Consequently, it is difficult to evaluate whether policies are reaching their goals at a reasonable cost. In the case of public-private collaboration on productive development policies, accountability is further weakened by a lack of transparency: given informal and discretionary dialogue processes, with

no registration of agreements, it becomes impossible to determine if agreements were fulfilled and hard to evaluate if policy goals have been met.

#### *7.1.4 No Performance-related Incentives for Public Sector Officials*

In none of the cases we studied are there performance incentives for public officials tied to policy outcomes. This has not prevented some of them from performing outstanding work.

## **7.2 Failures**

Two failures, rice and fishing, have a few suggestive features in common, described in the following subsections.

#### *7.2.1 Many Small, Low-productivity Producers, with No Independent Political Voice*

In both cases, a few quite large producers coexist alongside a large number of very small, frequently poor producers who lack the organization required to balance the power exercised by the few large producers. Moreover, policies—particularly subsidies—are justified on the small producers' behalf but are designed in such a way that small producers receive only a small proportion of the benefits from them.

#### *7.2.2 Isolation of Market Discipline or Breakdown of Market Mechanism*

In the case of rice, high tariffs and the ability to import rice without paying the tariff and to sell it as if the tariff had been paid are the key to large profits. Producers who are able to secure duty-free import rights will become profitable because the tariff allows them to overcharge consumers. In the case of fishing, the (private) profit-maximization rate for any individual producers leads directly to overfishing, depletion and, potentially, extinction of valuable species. As private prices are very different from social costs, reliance on price mechanisms to determine the amount of fish captured leads to socially undesirable results.

#### *7.2.3 The Public Sector Forfeits its Role*

At both INCOPECA and Conarroz, public sector representatives are a minority on the board of directors. Ministers who sit on those boards can be and are easily overruled, when they attend at

all. For all intents and purposes, policy making has been outsourced to the very sector the PDP was supposed to foster and regulate.

### **7.3 The Successes**

The success cases also have quite a few features in common, which are described below.

#### *7.3.1 Subject to Market Discipline*

In tourism, FDI attraction, and coffee, producers compete in an open market. Incentives and rules may make their jobs easier or Costa Rica a more attractive FDI destination. But in the end, either these producers find, capture, and retain customers in an open, competitive market, or they fail. In all of these cases, then, public policy has been a means to identify, support, or strengthen market competitive advantages, not to create private profits in the absence of such advantages.

#### *7.3.2 Either Homogenous in Size, or Well Organized and Competitive*

In the case of FDI, most companies that operate within special regimes are large, technologically advanced companies. From a broad perspective, they are quite homogeneous. This is not the case in tourism or coffee, but small tourism operators and small coffee growers are highly organized (the latter even vertically integrated into processing and exporting, to some degree). Thus, they have a voice and they are instrumental in ensuring that policy delivers results that benefit the sector as a whole, rather than just a few powerful producers.

#### *7.3.3 Organizational Focus and Incentive Alignment*

The only purpose of ICT is to develop tourism. CINDE is entirely focused on attracting a specific type of FDI. In contrast, INCOPECA, and even ICAFE, have many different goals—some productive, some social, and others even further afield. With focus comes incentive alignment within the public (or in the case of CINDE quasi-public) organizations in charge of policy: the path for a successful career for anyone working at ICT or CINDE is to be successful at doing what the organization is meant to do.

### **7.4 Some Preliminary Lessons**

The first lesson is quite obvious. When a PDP creates mechanisms that allow private producers to turn a profit isolated from market discipline, it will result in rent creation, not productivity

enhancement. Similarly, when market prices are relied on in a market where private and social costs are severely misaligned, the results will be private profits but at a cost to society that decreases social welfare.

The second lesson is that when dealing with sectors that are heterogeneous in the sense of having a few large, high-productivity agents and many small, low-productivity agents, it behooves the public sector either to help organize and educate the small producers, so that they have a significant voice in the policy process, or to ease them out of the sector. Otherwise, there is a considerable risk that policy will be justified using the small producers, but designed to benefit mostly the bigger ones, at considerable social cost.

A third lesson is not quite as obvious from the preceding analysis and requires some context. The Costa Rican coffee sector benefited from extensive public sector investments in road infrastructure dating back to the 19th century. High-tech manufacturing benefited from investments in human capital formation that have also roots in the distant past, and tourism benefited from education, infrastructure, and environmental protection. In other words, the success cases are vertical, even narrow PDPs that capitalized on previous, very broad public policies and made them the foundations of competitive advantage in the contemporary economy. The lesson seems to be that just as supporting sectors that have already revealed some signs of competitive advantage generally is a wiser course than picking winners, capitalizing on “social stocks” created by earlier policies (infrastructure, human capital, and natural capital in the case of Costa Rica) is likely to yield results faster than policies that require the creation of those stocks from scratch. The corollary is that those pre-existing stocks will always be finite. At some point, either they need to be increased or the limits of growth will be reached.

Herein lies a fourth lesson that may be derived from the Costa Rican experience: even if vertical, narrow PDPs are quite successful, sooner or later, the ability to mobilize the rest of the public sector has to be acquired. Otherwise, the stocks on which the vertical policy is founded will be exhausted, and further growth will be severely constrained.

A fifth and final lesson has to do with the overall architecture of public-private cooperation. It is one thing for the public sector to organize itself in such a way that it can learn and elicit information from the private sector and engage with it in order to develop and implement policies that help a country discover its competitive advantages, strengthen them, and increase its overall productivity. It is another thing entirely when the public sector forfeits its

responsibilities and simply hands policy, or policy management, over to the private sector. This is unlikely to be a good idea under any circumstances, but particularly so if the policy framework insulates producers from market discipline, or if producers operate in a setting in which there is a wide gap between private and social costs. In these cases, an increase in private rents, rather than an increase in social productivity, is the more likely policy outcome.

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