

PN-AAA-794

REPORT TO U.S. AGENCY FOR INTERNATIONAL
DEVELOPMENT / COSTA RICA

53920

CENPRO

OCTOBER 1982

CENPRO: IN THE CONTEXT
OF AN EXPORT
DEVELOPMENT STRATEGY
FOR COSTA RICA

AD Arthur D. Little International, Inc.

Reference 88201

PART I

A DIAGNOSTIC ASSESSMENT OF CENPRO

AND

COSTA RICA'S EXPORTING ENVIRONMENT

PREFACE

The two sections of this report, "A diagnostic Assessment of Cenpro and Costa Rica's Exporting Environment," and "Framework for an Export Development Strategy in Costa Rica" were drafted separately to present the results of the two phases of the same study. The first part provides an assessment of exporters. The second phase seeks to establish some strategic guidelines for developing exports in Costa Rica in the context of the current crisis.

In order to insure that the results of this study provide a point of departure for Cenpro and USAID to support private and public efforts to develop Costa Rica's productive and export capacity, the approach adopted emphasized extensive discussions of the findings as a way to work towards a consensus. For this reason, a preliminary version of the reports presented here were circulated among Cenpro and USAID officials as well as other key representatives from the public and private sectors. This final version of the report incorporates the observations made during these discussions. We hope that the process of developing this final report has contributed to a favorable climate for the development of exports from Costa Rica.

I. INTRODUCTION

The Centro de Promocion de Exportaciones (Cenpro) was created in 1968 under circumstances vastly different from those which prevail in 1982. In 1968, the Costa Rican economy was performing relatively well. Its traditional exports of coffee, sugar and bananas supplied the country with an adequate inflow of foreign exchange while a strong import substitution policy (combined with the Central American Common Market initiative) provided a powerful incentive for the development of industries to serve domestic and regional markets. Not only did the high level of protection make non-traditional exports relatively less attractive outside the region, but the incentives and protection encouraged the development of industries which bore little relationship to Costa Rica's resource endowments.

In 1982, however, Costa Rica faces dramatically different circumstances. The government's policies of the last 20 years, combined with adverse trends in the international economy have gradually led the country into a severe crisis characterized by an overwhelming foreign debt, rising unemployment, very high inflation, and currency devaluations of as much as 700% during the past two years.

Cenpro was established in 1968 to expand non-traditional exports and promote foreign investment with a broad mandate for formulating the necessary policy recommendations to the public sector and providing a wide range of support services to potential exporters and investors. Until now, however, general Government policy emphasis has been on import substitution while manufacturers themselves have had relatively little interest in exporting outside the CACM. This has tended to relegate Cenpro to a somewhat secondary position, both in terms of Government policy making and the perceived needs of the private sector.

With the current crisis, the environment has changed dramatically. The Government has declared that export development is the nation's single most important priority. Major inflows of foreign exchange, as well as the saving of existing jobs and creation of new opportunities are essential to preserve and expand Costa Rican social and economic progress. Cenpro now finds itself at the center of this national emergency and must adapt its activities and organization to contribute more effectively and efficiently to overcoming the current situation.

In order to determine how Cenpro can best meet this challenge, the U.S. Agency for International Development (AID) has engaged the services of Arthur D. Little International, Inc. to undertake a study of Cenpro in the context of an assessment of what must be done to more effectively promote exports and investment. The following interim report represents the findings of our diagnostic assessment of Cenpro's operations, as well as the results of a survey to identify the perceptions of Costa Rican exporters regarding the exporting environment, policies, and programs. These findings, which have already been presented orally to the Director of Cenpro and USAID, will help focus our further research and the formulation of guidelines for an export and investment promotion strategy.

Diagnostic studies are by definition intended to identify problem areas where improvement should be possible. As a consequence, this report focuses more heavily on the shortcomings of Cenpro and the export environment than on successes. This does not mean that there are no positive aspects to the situation, but rather emphasizes these considerations which must be dealt with in order to insure an effective and efficient export development program.

II. DIAGNOSTIC OF CENPRO'S OPERATIONS

When Cenpro was established in 1968, it was given a broad mandate (1) to promote exports of non-traditional products and (2) to encourage foreign investment into the country. The program was established in recognition of the fact that Costa Rica's exports and foreign investment were largely limited to unprocessed agricultural commodities. The objective was to broaden the country's base of exports and foreign capital and increase the value added of its export production.

The law creating Cenpro gave it an impressive range of responsibilities with respect to both exports and investment. In the area of non-traditional exports, Cenpro's tasks included:

- promotion activities,
- market and production research,
- technical assistance to firms,
- public information and education,
- policy formulation, including recommendation of incentives,
- international representation,
- product identification for export programs.

Similarly, with respect to foreign investment, Cenpro was instructed to undertake several activities including the following:

- identification of investment opportunities in new lines of production for export,
- studies for potential investors,
- promotion and public information, and
- policy recommendations.

In our analysis of Cenpro's operations, we concentrated our attention on the nature and performance of Cenpro's activities, particularly in view of the circumstances and needs of Costa Rica's exporting community. Our concern was not only for the efficiency of those operations but also for their relevance to the real or perceived problems of exporters.

We have concluded from our analysis that Cenpro is a serious institution making a maximum effort to assist exporters as best it can. However, its

mandate is a general one which does not discriminate between exporting sectors with large potential and those with poor chances of success. Hence, Cenpro is required to work as a public institution whose services are available to all parts of the Costa Rican economy, meaning that Cenpro's limited resources are frequently stretched thinly across many sectors.*

One consequence is that the investment promotion and facilitation function has been widely neglected in recent years, to the point that very few of the mandated functions are being carried out. Only recently has the investment promotion function been elevated to the status of a section in Cenpro's organization.

Despite its dispersion across a large number of activities, sectors, and markets, Cenpro has enjoyed several successes. These successes have usually occurred in programs which have been clearly focused on one objective or else animated by an aggressive and innovative official. Examples of these more successful efforts have included:

- The "promotor viajero" program in which an individual promoter has been given the flexibility to seek out buyers for specific products with high potential in the most promising markets, regardless of location.
- Some trade missions focused on specific product areas which brought Costa Rican producers and foreign consumers together.
- Some overseas trade representatives who have been particularly entrepreneurial in representing Costa Rican products (for example, Cenpro's representative in Puerto Rico).
- The commercial information program which is generally considered of a high quality although very general.
- The administration of the CAT incentives** which appears to be efficiently managed.

In the above cases, the outstanding successes for Cenpro have usually depended on the effectiveness of a few key individuals. Herein lies Cenpro's principal problem, namely the lack of skilled, experienced,

* If not by its charter, certainly by its practice over the years.

** Certificados de Abono Tributario, the principal incentive for exporters, are a 15% tax credit on the ad valorem value of exports.

technically-trained personnel. We have concluded along with most outside observers that Cenpro generally does not have the personnel appropriate for the tasks it must undertake. Cenpro has a staff of approximately 80 individuals of which 26 are professional and 16 are technical assistants. Very few professionals have more than 3-4 years of experience as such. Most have received their academic training in international relations or business administration, but none have had industry-specific technical training or experience. However, because Cenpro's few successes may be clearly identified with the persons involved, the lesson to be learned is that the training and recruiting effort should have been aimed at reproducing the successful "model."

Cenpro's top executive posts and many of its overseas positions are filled by political appointees with no prior experience in export or investment matters. Turnover of staff is rapid because of low compensation and poor career possibilities. It is frequent that a university graduate will enter Cenpro, obtain useful experience and contacts, and leave at the end of two or three years for the private sector. The high turnover is also reflected in the lack of "institutional memory" on programs, results or even relationships with individual firms or associations.

Cenpro officials and certain outsiders claim that the organization suffers from a lack of sufficient budgetary resources. That fact notwithstanding, we believe that the budgeting process itself has more serious deficiencies than the amount of funding available. The budget process does not appear to be used in any way as a program review exercise.

Cenpro's budget is organized principally around existing posts (cargos) and offices rather than program objectives. There is little concept of program planning in the budget exercise or "zero-based" budgeting. Cenpro appears to have maintained a steady historical continuity in its budgeting with little effort at program evaluation or cost-benefit analysis. Budgets have been simply rolled over based primarily on the numbers of people employed. For example, half of Cenpro's budget goes to the support of its overseas offices, particularly Miami, Puerto Rico and Panama. There has been no recent attempt on the part of Cenpro to

evaluate the effectiveness or results of these offices, even though (1) they have been severely criticized by exporters as ineffective (with the exception of Puerto Rico) and (2) they account for half of Cenpro's total resources.

In the area of planning, Cenpro has recently initiated a planning unit designed to bring more rigor and regularity into the process. The results of the unit's work will not be known until some time in the future. In the past, there has been little planning of priority areas to be pursued over the long term. With this lack of clear planning guidelines, Cenpro's budget process by default has done little more than update the previous year's budget. As a result, programs have seldom been eliminated even when their effectiveness has been questioned, for example, certain trade fair programs, the permanent overseas offices, and assistance to sectors with no real export potential. Similarly organizational changes, which have been frequent in the past, do not seem to be guided by any results oriented strategy planning; they appear to respond more to personal idiosyncracies than any kind of objective analysis. The organization gets changed but the nature of the activities remain relatively constant.

We have also noted that Cenpro has made little effort to evaluate how the private sector uses its services and how effective these services are regarded. In view of the fact that Cenpro is an institution designed to assist the private sector, this lack of consultation with firms appears to be a serious deficiency in Cenpro's planning and budgeting. Interestingly, some of the programs which have gained favor among the private sector (such as the market information and promotor viajero programs) may not be effective in cost-benefit terms. Firms in need of help come to Cenpro, which in turn has an obligation to assist everyone regardless of their potential for favorable results on either the micro (enterprise) or macro (national) levels. Cenpro in turn has an implicit policy of first come, first served.

A related problem is that Cenpro has not made any concerted effort to build on successes or to minimize failures by modifying the programs or situation associated with failure. This lack of feedback in the system is related to poor planning, budgeting and the absence of any assessment of the effectiveness of programs.

It appears that the most serious problem facing Cenpro's effectiveness is not so much what they do, as what they do not do. First, Cenpro is not performing in any systematic way the policy formulation role it has been mandated to play. This is especially critical at the present time when the urgency of exporting has been widely recognized. Cenpro should be taking the lead in analyzing the problems of exporters and recommending how the nation can best pursue export and investment opportunities. The last successful policy formulating effort realized by Cenpro was the introduction of the CAT and CIEX incentives.

Several examples can be cited. There is no analysis of the costs and benefits which accrue to exporters by selling their products overseas. Exporters argue that the financial gain from exporting is so limited it often does not pay to export. Cenpro needs to verify this contention and if true, formulate and promote the policies required to remedy this situation. If the policy framework affecting the private sector is such that the "signals" received by firms discourage exports, all of Cenpro's activities are bound to be ineffective. It should be Cenpro's role to point out the impacts of existing policies and recommend modifications.

Second, Cenpro has not shown much selectivity among the sectors whose exports it promotes. Very little analysis has been undertaken of the product areas which have large scale potential for export sales. As a result, there is a lack of focus in Cenpro's assistance programs and the resulting dispersion means an unnecessary drain on the organizations limited resources.

Third, the attributes in the investment promotion area are almost non-existent. Without additional investment, and particularly in export-oriented industries, it will be almost impossible to increase the volume of exports enough to significantly alleviate the current crisis. (This conclusion will be quantified in the second phase of the study.) Cenpro has only two individuals working in the Investment Promotion Department and much of their activity has been dedicated to reviewing the laws related to immigration. Investment promotion has probably been ignored because there is no local constituency demanding this type of service.

This apparent disregard for investment promotion activities has been probably unintentionally reinforced by the lack of support for it, by most international donor agencies with which CENPRO has collaborated in the past.

Conversely many of CENPRO's less effective programs were created in response to initiatives of these donor agencies and not necessarily because of internally perceived needs.

Fourth and perhaps most important, Cenpro has no access to or influence on the top Government decision levels. Without such access and influence its work on policy formulation and obstacle alleviation will be of limited significance.

III. PERCEPTIONS OF THE PRIVATE SECTOR

To obtain an understanding of how firms perceive the investment and export environment, as well as the services provided by Cenpro, we undertook a survey of about 25 private firms in those industries generally regarded to have the greatest potential for non-traditional exports:

- processed foods,
- apparel,
- electronic component assembly,
- wood products,
- leather products.

The food processing and apparel industries alone represent 56% of all manufacturing employment and 54% of the value of output.* If exports are to be developed to any significant extent from existing industrial capacity, these two industries will have to play a major role. Furthermore, the five industries selected for the survey are likely to be the most successful exporters because they take the greatest advantage of factors such as low cost and skilled labor, available or potentially available raw materials, and market opportunities.

The survey included a wide range of firms in terms of size, sophistication and experience with exporting. It should be noted that the perceptions reported here do not necessarily reflect the conclusions of the consultants. Concerns expressed by private firms must be further analyzed to insure their accuracy, a task which is being carried out as part of the second phase of the study. Even if not all completely accurate, the perceptions of the private sector are an extremely useful tool in diagnosing the obstacles to be overcome as well as the users assessment of Cenpro.

The Exporting and Investment Climate

The consensus of the firms interviewed is that exports are essential, both from the national perspective and for individual enterprises to survive. Furthermore, it is generally believed that Costa Rica has a substantial export potential based on its natural resources (particularly

* 1975 Census of Manufactures.

agricultural) and its low cost and skilled labor force.

Despite this philosophical commitment to exporting and the belief that it should be possible, the majority of the firms have made only a marginal effort to develop exports. This is attributed to a number of factors which are summarized below.

1. Many interviewees perceive a strong anti-export bias in the existing commercial and financial policies. The argument is that because of these policies, exporting does not pay, despite the incentives provided by the CAT and CIEX mechanisms. One of the principle examples cited is the multiple exchange system under which exporters must purchase imported materials at a higher rate than the exchange rate for converting the export earnings.

In cases where the imported materials are not on the priority list, imports must be purchased at the free market rate (about 56 colones per U.S. dollar as of Sept.1,1982). The export earnings (which must be cleared through the Central Bank) are redeemed at the "interbank" rate of 40.25 colones per U.S. dollar for 95% of the earnings, and at the "official" rate of 20 colones per dollar for 5% of the earnings this implies an effective rate of about 39.23 colones per dollar. Even in the best cases where imports are purchased at the interbank rate, there is still a differential between the rate for imports and exports.

Another example given of the anti-export bias is the 4% tax imposed on all non-traditional exports. (The tax on traditional exports is considerably higher.) The historic view that exports should be tapped as an important source of Government revenue has not been reassessed despite the current crisis.

Part of the reason that firms may not find exporting attractive lies in the continual emphasis on import substitution related policies. The protection and incentives provided to industry would generally make the domestic and CACM markets appear much more attractive even when depressed.

Even though the firms interviewed are convinced that the policy environment is detrimental to exports, no one has done a quantitative analysis of whether this is indeed the case. This task is being carried out as part of this study.

2. The unavailability of working capital for exporters and the general inefficiency of Costa Rica's Nationalized Banking system are perceived to be additional major obstacles to exporting. Firms are unable to finance the materials or the labor required for export production. For example, one company indicated that it turned down a major order for shirts because it was unable to finance an additional shift.
3. Most private firms argue that Government bureaucratic procedures for exporting are too complex and time consuming. The most frequently cited problem areas are the Nationalized Banking System and the customs service. However, it is not clear whether this is a real obstacle or just a nuisance. There is some question as to whether firms would miss an opportunity for profit because of some paperwork requirements.
4. The difficulty of penetrating foreign markets is perceived by firms to be one of the major disincentives to exporting. Not only are most markets very competitive, but few Costa Rican firms know how to play the game. Identifying opportunities, understanding distribution systems, learning how to sell, coping with packaging, quality and regulatory requirements are all areas where most firms are still very weak.

Production management is a related problem. Firms produce too many different products, often of poor quality, and in inadequate volumes for effective foreign marketing. The firms interviewed are well aware of these obstacles and are looking for help to overcome them.

5. Some of the interviewees indicated that the lack of an "export mentality" is to blame for the inadequate level of exports. Because most firms were the product of import substitution,

managers have become accustomed to the safe domestic market where efficiency, cost, aggressive marketing and quality were less important.

6. Firms claim that the absence of traditional export finance facilities such as supplier credits and export insurance act as an added disincentive. It is argued that the lack of supplier credits places Costa Rica producers at a competitive disadvantage vis-a-vis their international competitors and the absence of export insurance places them at a risk in the event of non-payment by foreign customers.

Perceptions of Cenpro

Virtually all firms interviewed were familiar with Cenpro's activities. Most of these firms had participated in one or several of Cenpro's programs, either its commercial information program, its overseas fairs and exhibitions or its overseas offices. All exporting firms had been in contact with Cenpro to obtain the export tax credits under the CAT system.

While recognizing that Cenpro was working under severe strains, such as inadequate personnel and financial resources and too dispersed a mandate, most firms were nevertheless of the opinion that Cenpro could improve its effectiveness. We would summarize exporter views as follows:

- Lack of Influence in Government

Cenpro does not effectively represent the views and needs of exporters. Although Cenpro is the one institution which is intended to respond to both government and the private sector, most exporters do not see Cenpro as either understanding the realities of exporting or able to influence government policies.

- Lack of Focused Activity

Cenpro wastes a large amount of its resources on product areas and markets where Costa Rica has little potential for serious gains. Exporters believe that Cenpro has failed to identify for itself where the high pay-off areas are and as a result covers all sectors and markets as if they had equal potential.

- Lack of Sector Specialization among Promoters

Cenpro lacks effectiveness as promoter and market analyst because its personnel have little sector or technical specialization. Exporters see Cenpro personnel as either political appointees or recent university graduates who are unable to represent or fully understand production and marketing problems of sectors.

- Mixed Reaction to Fairs, Exhibitions and Missions

Exporters report very few concrete results from Cenpro-sponsored fairs, exhibitions or missions. These programs are frequently criticized as poorly organized and designed. However, most exporters feel that they serve an important purpose in educating the Costa Rican exporter about the realities of international marketing, quality standards, and competition.

- Ineffectiveness of Cenpro's Overseas Offices

With the exception of the promoter in Cenpro's Puerto Rican office, exporters were unanimous in their views that Cenpro's overseas offices were ineffective and wasteful. Most exporters believe that the resources spent on these offices could be far better used in other programs and that the information functions of these offices should be assumed by consular and embassy officials.

IV. EXPORTER RECOMMENDATIONS FOR GOVERNMENT POLICIES AND CENPRO ACTIVITIES

The exporters we interviewed made a series of recommendations, some which relate to broader actions by government and the private sector, and others relating specifically to Cenpro's role. We may summarize these suggested initiatives as follows:

Policy Suggestions

- An Emergency National Plan for Export and Investment Encouragement

In view of the crisis currently facing Costa Rica, the government should take a bold initiative to radically improve the exporting and investment environment. Those sectors with significant export and investment potential for earning major foreign exchange for Costa Rica should be designated for promotion.

Policies should be altered in a major way and all the country's institutions (in particular, the Nationalized Banking System, Costa Rica's foreign embassies and consulates, Cenpro and others) should be mobilized behind this plan.

- Policies Favorable to Exports and Investment

The Government should act forcefully to make it worthwhile for producers to export the country's products and for investors to invest in Costa Rica. Commercial and financial policies must be modified to remove the current anti-export and anti-investment biases. Some suggestions include: (a) a special exchange rate regime for non-traditional exports, (b) rights for exporters to retain a certain percentage of their export earnings in dollars to be used for future imports of goods, and (c) elimination of export taxes.

- Improved Financing for Exporters

Exporters see no possibility for improving export performance if firms cannot obtain working capital to do so. They argue that banks should be required to give preferential lending to private firms which export a significant percentage of their production.

- Structured Reforms and Technical Assistance

Many exporters argue that new organizational forms must be devised to bring producers together and consolidate their production so as to export in sufficient volume. They believe the government should encourage or help finance more private trading companies or export consortia to accomplish this objective. To do this, technical assistance should be contracted for these new groups to help them launch their new activities.

On Cenpro

- Represent the needs of the Export and Investment Community in Government Councils

Cenpro should capitalize on its unique position as a bridge between the public and private sectors and actively pursue policy analysis and recommendations. Cenpro is well placed to accurately represent to government decision-makers the basic requirements of exporters and investors. Most exporters believe this should be Cenpro's primary role.

- Place New Emphasis on Attracting Foreign Investors in Exporting Industries

Cenpro should place major resources behind efforts to bring in foreign capital into export industries. In many cases only major foreign investment can bring local production up to the competitive standards of international trade. An obvious target for this investment would be "maquila" industries, particularly in electronic component assembly. Costa Rica is well positioned to attract assembly operations, for example, by U.S. east coast firms.

- Assist in Organizing the Private Sector for Exports
 Cenpro should generate ideas and initiatives for organizing Costa Rica's private sector firms into export groups. Support should be given to the formation of sector-specific consortia, export management groups, or trading companies which could consolidate the production for export of Costa Rica's many fragmented firms. Cenpro could, in turn, assign its own "promotores viajeros" to these new institutions to work with them in contracting foreign buyers.
- Technical Assistance for Firms in Production and Marketing
 Cenpro should bring to firms or their associations, perhaps on a shared-cost basis, technical experts in both production and marketing. Cenpro's budget resources could be best spent on short-term technical consultants who have experience in production and marketing problems of specific sectors.
- Focused Effort on Only a Few Promising Sectors
 Cenpro should make a decision as to which export sectors hold out the greatest promise for Costa Rica's benefit. Its resources should be openly concentrated on this priority area. Its promoters should concentrate principally on those product areas and markets where significant export sales are likely.
- Reliance on Promotores Viajeros and More Aggressive Promotion Techniques
 Cenpro's promotion program must be more aggressive and flexible. A promotor viajero program for each major sector should replace Cenpro's current program which services virtually all sectors. For certain product areas, Cenpro should organize "reverse missions" to bring buyers to Costa Rica to see a wide range of producers.

- Transfer of Functions of Cenpro's Overseas Offices to Embassy and Consular Officials

Cenpro could free up a large percentage of its resources by transferring the information gathering and distribution functions of its overseas offices to Costa Rican diplomatic representatives abroad so as to allow Cenpro to concentrate on more aggressive marketing in many regions and markets.

- Simplification of Government Procedures (Tramites)

Cenpro should consolidate under its own roof and greatly simplify government procedures which currently discourage many inexperienced exporters from exporting. The number of steps, forms, and approvals needs to be reduced and physically concentrated in fewer offices. Cenpro should strengthen its work in this direction.

V. CONCLUSIONS

In order for Costa Rica to extricate itself from its current crisis, exports must be developed on a scale significant enough to help overcome the balance of payments problem, stimulate renewed economic growth, and create (as well as save) employment opportunities. Several conclusions have been reached during this diagnostic stage of the study which have important implications for the challenge to be faced:

- Manufacturers perceive a number of obstacles to exporting and believe that they need extensive support in the form of incentives, favorable policy framework, credit and technical assistance in order to export successfully. This suggests the need for an extensive support program of major proportions. In shaping this program, the following questions must be addressed: How can the necessary support be extended efficiently and effectively? What are the likely returns from a given level of effort in export promotion? What should the respective roles be for the private and public sectors?
- Cenpro officials and private manufacturers agree that Cenpro has not been as effective as it should be in carrying out its mandate. This raises questions for the future such as: Is it reasonable to expect Cenpro to stimulate a significant growth in exports when it has not done so in the past? What would have to be done for Cenpro to be effective and what level of resources would be required? How can Cenpro most effectively use its resources? Are other institutions better suited to carry out some of the required functions?
- Most of the emphases has been given to developing exports from existing manufacturing establishments. However, the question remains whether this is enough. What is the actual export potential from existing firms and to what extent will those alleviate the

balance of payments and employment problems? How much of this potential is likely to be realized and what will it cost? Can foreign investment in export industries be promoted? What would the cost and benefits be?

The strategic questions raised by these preliminary findings will provide the focus for the second phase of our study. We will seek to answer them, document the answers with the appropriate analyses, and incorporate the results into guidelines for a strategy for export and investment promotion.

PART II

FRAMEWORK FOR AN EXPORT DEVELOPMENT STRATEGY

IN

COSTA RICA

1. INTRODUCTION AND CONCLUSIONS

The purpose of this report is to provide the framework for establishing an export development strategy for Costa Rica. Building upon "A Diagnostic Assessment of Cenpro and Costa Rica's Exporting Environment" previously presented by Arthur D. Little International, Inc., this report suggests strategic options for a national export development program. By outlining the rationale and national benefits and costs associated with each strategic option, we hope to facilitate the discussion of alternatives and the achievement of a consensus regarding the strategy to be pursued. Once a consensus has been reached as to the objectives of an export development program and the appropriate strategic thrust to be adopted, it will be possible to further design the implementation strategy and programs. The latter tasks, however, would be outside the scope of the present study.

Our principal conclusion is that in order to significantly come to grips with the severe crisis being faced by Costa Rica, it is essential that an emergency export development program be adopted and implemented. This program requires carefully defined objectives and a well designed strategy which provides for the necessary policy adjustments and assigns responsibilities for implementing specific programs and activities.

Although a number of options exist, Exhibit I presents an outline for an emergency program for export development based on two possible strategic thrusts:

- Development of exports from existing industrial establishments;
- Promotion of foreign investment, with a short term emphasis on drawback and re-export industries, and a longer term effort to promote other foreign investment.

The export development program adopted could incorporate one or both of these thrusts. However, each thrust responds to different objectives. Export development from existing firms would primarily serve to alleviate the severe crisis being experienced by specific establishments, but would not have a major short term impact on the macro balance of payments and employment problems. If well implemented, the investment promotion thrust would be more likely to have a significant short term impact on the balance of payments and on the national economy.

It should be emphasized that there is no easy solution to the crisis being faced. The success of any strategy will require careful design and thorough implementation. Some of the principal aspects of a possible implementation program are presented in Exhibit II.

EXHIBIT I

FRAMEWORK FOR AN EXPORT DEVELOPMENT PROGRAM

Emergency Program for Export Development	
Objectives:	<ul style="list-style-type: none"> - Alleviate balance of payments crisis - Stabilize existing firms - Provide new source of growth
Policy Measures:	<ul style="list-style-type: none"> - Government commitment to exports - Appointment of extraordinary Authority - Clear definition of foreign exchange policies
Strategy:	<ul style="list-style-type: none"> - Two thrusts

	Support Existing Firms	Promote Foreign Investment
Objectives:	<ul style="list-style-type: none"> - Alleviate crisis at micro level - Generate foreign exchange 	<ul style="list-style-type: none"> - Short term alleviation of macro crisis - Provide new source of growth - Generate foreign exchange
Policy Measures:	<ul style="list-style-type: none"> - Remove anti-export bias 	<ul style="list-style-type: none"> - Define foreign investment and profit repatriation regulations
Programs:	<ul style="list-style-type: none"> - Policy research program - Priority financing for exports - Support for trading companies & export management groups - Technical assistance for export - Market information 	<ul style="list-style-type: none"> - Identification of key industries - Investment promotion program <ul style="list-style-type: none"> --short term focus--drawback --long term focus--agro and other investment - Assistance to firms in locating in Costa Rica
Key Institutions:	<ul style="list-style-type: none"> - Cenpro (policy research & market info.) - Private trading companies and associations 	<ul style="list-style-type: none"> - Cenpro - Zona Franca - Private trading companies

Cenpro would play a major role in an export development program. A policy formulation role involving a strong analytical capability and top level Government access would be particularly important. The institution could also have important responsibilities in the implementation of specific activities, particularly in the investment promotion area. However, Cenpro should only take on those activities where it can be most effective. Private sector and other public institutions, as well as individual enterprises, will also have to play a major role in the implementation of any export development program.

EXHIBIT II

IMPLEMENTATION OF THE EXPORT DEVELOPMENT PROGRAM

<u>P R O G R A M</u>	<u>T A S K</u>	<u>RESPONSIBILITY</u>
<u>Emergency Program</u>		
● Top level commitment	● Appoint special authority ● Clear policy statement	● Government ● Government
<u>Export Development-Existing Firms</u>		
● Policy analysis program	● Refocus Cenpro ● Provide top level access ● Provide technical assistance/training	● Cenpro/Government ● Government ● Cenpro/Donors
● Priority financing for exports	● Develop guidelines/export windows	● Central Bank
● Support for Trading Companies	● Provide seed money ● Provide technical assistance	● Govt./Donors/Priv.Sec ● Donors
● Technical assistance for export production & marketing	● Establish special fund ● Administer disbursement of funds	● Govt./Donors/Cenpro ● Cenpro or priv. assoc
● Market information	● Strengthen Cenpro capability	● Cenpro
<u>Foreign Investment Promotion</u>		
● Policy framework	● Define clear regulations	● Central Bank
● Drawback industry promotion	● Provide necessary commitment & resources ● Develop promotion activities ● Identify key industries ● Provide investment facilitation	● Government ● Cenpro/Donors/Zona Franca ● Cenpro ● Cenpro/Zona Franca/Trading cos.
● Long-term investment promotion	● Identify priority industries & oppor. ● Develop promotion activities ● Coordinate implementation of integrated projects	● Cenpro ● Cenpro/Zona Franca ● Cenpro/Zona Franca

2. THE PROBLEM

- Costa Rica finds itself in a crisis of major proportions characterized by:
 - Pressing foreign debt
 - Rising unemployment
 - Very high inflation
 - Severe strain on the productive sectors

- In order to alleviate the crisis, export promotion has been declared the nation's top priority.

- Given the magnitude of the crisis, exports must be developed on a large scale in order to have a significant impact.

3. PRINCIPAL FINDINGS*

- Existing export development efforts are largely oriented towards stimulating non-traditional exports from existing firms. (i.e., Cenpro, Banex, etc.)

- The effectiveness of these efforts has been constrained by:
 - An incentive system which makes it more attractive for firms to produce for the local market than to export. (See Exhibit III)
 - The limit placed on the potential for increased exports by the size of the industrial base and the level of capacity utilization (See Exhibit IV)
 - The difficulty of exporting for firms accustomed to operating in a protected market. Firms often lack the necessary marketing know-how, quality control, production efficiency, and export mentality to compete in export markets.
 - Obstacles perceived by potential exporters such as the lack of credit, high risk, inadequate information, tariff and non-tariff barriers in potential markets, and excessive red tape.
 - The high cost of providing firms with the extensive support required to develop exports, particularly relative to the limited volume of exports which can be expected from most firms. (See Exhibit V)

- Cenpro, the principal organization charged with developing exports, has not lived up to expectations because of:
 - A commitment to a very broad mission and a wide range of activities instead of concentrating on the most effective and necessary functions.
 - The failure to build on successful efforts such as the "promotor viajero" program, selected trade missions, commercial information, and some trade representatives.
 - The absence of a policy formulation function to provide the government with needed policy recommendations and analysis.
 - The lack of any significant activity in the investment promotion area.

- Little attention has been given to promoting foreign investment as a way of developing exports.. (The Zona Franca Program is the only significant activity in this area.) Not only is foreign investment not actively promoted, but it is discouraged by:
 - The constantly changing or undefined "Rules of the Game" involving foreign exchange rates and controls, capital registration, etc.

* See "A Diagnostic Assessment of Cenpro and Costa Rica's Exporting Environment", Interim Report presented to AID by Arthur D. Little International for a more detailed presentation of findings.

- The potential for attracting foreign investment to Costa Rica is significant and particularly in drawback industries (See Exhibit VI). Furthermore, this investment would generate substantial national benefits in the form of employment, foreign exchange and demand for other goods and services. (See Exhibit VII.)

EXHIBIT III

UNIT COSTS AND PRICES FOR LOCAL AND EXPORT SALES
(Colones per Unit)

A. COMPANY X - LADIES GARMENTS

COSTS

Local Market

● Local raw materials	¢ 33 ¹
● Imported raw material	¢ 132
● Import tariffs	--
● Labor, overhead & other costs	¢ 151
Production cost per unit	¢ 316 (a)

Non-Regional Exports

● Production cost (a)	¢316
● Packaging & local transport	¢ 30
● Export tax	¢ 19
Unit cost for exporting	¢365 ²

PRICES

Local Market

● Sales price	¢ 800
● (-) 8% sales tax	¢(-)64
● (-) 10% consumption tax	¢(-)80
Income from local sale	¢ 656
Net profit	¢ 108%

Non-Regional Exports

● Sales price FOB (US\$12)	¢470
● CAT	¢ 51
Income from export sale	¢521
Net profit	42% ²

¹Materials purchased locally but processed from imported raw materials.

²Excludes the cost of developing foreign markets which is impossible to assign on a unit basis. However, this cost would reduce profitability.

Source: Arthur D. Little International, Inc. based on interviews with selected firms. A more detailed presentation of the analysis can be found in Appendix I.

EXHIBIT III

UNIT COSTS AND PRICES FOR LOCAL AND EXPORT SALES
(Colones per Unit)

B. COMPANY Y - CONFECTIONARY PRODUCT

COSTS

Local Market

● Local raw materials ¹	¢1.18
● Imported raw materials	¢0.06
● Import tariffs	--
● Labor, overhead & other	¢1.51
Production cost per unit	¢2.75 (a)

Non-Regional Exports

● Production costs (a)	¢2.75
● Packaging & local transport	¢0.14
● Export tax	¢0.17
● International transport	¢0.92
Unit cost for exporting	¢3.98

PRICES

Local Market

● Local sales price	¢ 4.0
● Distribution	¢(-)0.2
● Consumption tax	¢(-)0.4
● Sales tax	¢(-)0.2
Income from local sale	¢ 3.2
Net profit	16%

Non-Regional Exports

● Sale price CIF (US\$.10)	¢3.9
● CAT	¢0.3
Income from export sale	¢4.20
Net profit	6% ²

¹Materials purchased locally but processed from imported raw materials or affected by price controls. The prices paid for these "local materials" are 15-30% above world market levels.

²All of the profit is derived from the CAT. Without this, the product would be exported at a loss.

Source: Arthur D. Little International, Inc. based on interviews with selected firms. A more detailed presentation of the analysis can be found in Appendix I.

EXHIBIT IV

A. MAXIMUM NET EXPORT POTENTIAL OF NON-TRADITIONAL PRODUCTS FROM EXISTING INDUSTRIAL CAPACITY, 1980
(Thousands of U.S. Dollars)

	<u>Non-Regional Exports</u>	<u>Industrial Production</u>	<u>Capacity Utilization, %¹</u>	<u>Maximum Potential Increase in Exports</u>	<u>Import Component %</u>	<u>Potential Net Increase in Exp⁴</u>
Food & Kindred Products	31,100	398,500	70	119,600	28	86,100 ⁴
Textiles, Apparel & Leather	13,200	88,700	58	37,300	46	20,100
Wood & Furniture	5,100	61,800	66	21,000	31	14,500
Paper & Printing	3,500	63,600	66	21,600	68	6,900
Chemicals, Rubber & Plastics	27,100	146,800	75	36,700	70	11,000
Non-metallic Minerals	600	33,100	47	17,500	23	13,500
Basic Metals	1,500	4,500	64	1,600	68	200
Machinery	22,800	89,500	64	32,200	58	10,300
Other Industries	7,500	9,000	59	3,700	61	1,400
TOTAL	112,500	895,500	67	291,200	56	164,000

¹Based on firm estimates of optimum capacity. Full capacity utilization, however, is virtually impossible. From Instituto de Investigaciones en Ciencias Economicas.

²From Instituto de Investigaciones en Ciencias Economicas.

³Reflects maximum potential net foreign exchange earnings. However, this level is highly theoretical since: 1) much of the unused capacity is likely to be inefficient; 2) many small firms are unlikely to be able to export; 3) many products are not suitable for non-regional exports.

⁴Food products represent the bulk of potential exports. However, only 8% of current production is currently exported outside the region, indicating that developing this potential will be very difficult.

Source: Banco Central and Instituto de Investigaciones in Ciencias Economicas.

EXHIBIT V

BENEFITS AND COSTS OF DEVELOPING EXPORTS FROM EXISTING CAPACITY

BENEFITS

COSTS

At firm level:

- | | |
|---|---|
| <ul style="list-style-type: none">● Large scale investment in capacity not required● Fuller utilization of capacity● Provides alternative markets● Provides technical & marketing know-how● Provides easier access to credit● Facilitates purchases of imported materials● Survival of current crisis | <ul style="list-style-type: none">● Investment in export marketing● Painful streamlining● Profit margins reduced (Exhibit I)● Greater risk● Additional costs of exporting |
|---|---|

At support program level:

- | | |
|---|--|
| <ul style="list-style-type: none">● Ability to build from existing activities● Supports existing firms | <ul style="list-style-type: none">● Costly technical assistance in export marketing and production for large number of firms● High level of support per unit of foreign exchange generated● Difficulty of developing exports in small and import substitution oriented firms.● Export financing |
|---|--|

At national level:

- | | |
|---|--|
| <ul style="list-style-type: none">● Generates foreign exchange● Increased tax revenues● Some increase in demand for local materials● Saves existing jobs● Improves efficiency of industry | <ul style="list-style-type: none">● Net foreign exchange benefits reduced by high import component● Implicit subsidy for imports on priority list● CAT & CIEX● Significant outflow of foreign exchange (for equipment & materials) before any inflow● Priority access to credit for exporters● Limited potential for new investment & growth● Large investment in technical assistance would only produce results slowly |
|---|--|

EXHIBIT VI

POTENTIAL FOR FOREIGN INVESTMENT

A. EXPORT PROCESSING¹

- Value of assembled products imported by the U.S. where Costa Rica has a competitive advantage²
 - \$1.4 billion in 1980 assuming wage rates of \$.60/hr.³
 - \$779 million in 1980 assuming wage rates of \$1.00/hr.
- The principal opportunities are in:
 - Electronic tubes, transistors and other components
 - Radio and television
 - Office machines
 - Watches, clocks and photographic equipment

B. OTHER EXPORT INDUSTRIES

- Costa Rica's resources, particularly agricultural, political stability, geographic location and labor, provide opportunities in:
 - Agro-industry and food processing
 - Fresh fruits and vegetables
 - Other export oriented industries
- However, near term investment in opportunities other than drawback industries is limited by:
 - Inadequate integration of agriculture and industry
 - The long gestation period required to develop these projects
 - The high level of investment required
 - Extensive infrastructural requirements
 - Greater risk aversion by investors

¹ Drawn from Richard Bolin and Carl Goderez, "Survey of the Industrial Estate/Export Processing Zone Development Program in Costa Rica".

² Compares total delivered cost from Costa Rica with costs from principal LDC's for 120 product categories.

³ In May, 1982, the total cost of unskilled labor for electronics assembly was estimated at \$0.45 (assuming exchange rate of ¢38).

EXHIBIT VII

NATIONAL BENEFITS OF DRAWBACK INDUSTRIES

A. APPAREL MANUFACTURER (ONE PLANT)

<u>Foreign Exchange</u>	<u>Inflow</u>	<u>Outflow</u>
Initial Investment	\$ 150,000	(If company leaves)
Guarantee on Equipment	\$ 100,000	(If company leaves)
Raw Materials	--	On consignment--No outflow
Value Added	\$ 1,000,000/yr. ¹	--

Employment

500 Employees at Optimum Capacity
Payroll=\$550,000 or \$22 million colones

Other Benefits

Social Benefits (Payroll Tax) - \$230,000 or ¢9.2 million
Overhead (utilities, maintenance, administrative salaries = \$220,000
Multiplier Effect = ¢33 million/year in induced demand from payroll
only (assumes 1.5 multiplier)

B. INVESTMENT PROMOTION--50 DRAWBACK PLANTS²

Net Foreign Exchange Inflow³

Initial Investment	= \$ 7,500,000 (One-time)
Guarantees	= \$ 5,000,000 (One-time)
Value added	= \$ 50,000,000 (Annual)

Employment

Jobs	= 25,000
Payroll	= \$ 27,500,000 or ¢1.1 Billion

Other Benefits

Social Payments	= \$ 11,500,000 or ¢460 Million
Overhead	= \$ 11,000,000 or ¢440 Million
Multiplier (Payroll)	= ¢ 1.65 Billion

¹Value added is 20% in terms of dollars. Prior to the devaluation it was 40%. Value added would be higher for electronics plant.

²At the end of 5 years, assuming 10 new plants per year. The numbers presented here are conservative since they are based on apparel manufacturing. Most of the drawback firms are likely to be in electronics which requires a higher level of investment and involves a greater value added.

³Excludes profit repatriation which tends to be minimal in the case of drawback firms because transfer payments limit the profits earned by the drawback firms. If the strategy was to promote joint ventures, locally retained profits would increase the benefits of drawback firms.

Source: Arthur D. Little International based on selected interviews.

4. AN EMERGENCY PROGRAM FOR EXPORT DEVELOPMENT

- The magnitude of the current crisis requires an emergency program for export development.
- If export development is to be it's top priority, the government must insure that all its policies and actions are consistent with the export strategy adopted.
- The recommended strategy incorporates two principal thrusts: (See Exhibit I)
 - Development of exports from existing firms.
 - Promotion of foreign investment in export industries.
- Each of the two thrusts is aimed at different objectives and requires different types of initiatives.
 - Exports from existing firms must be developed as the basis for the stabilization (or even survival) of these establishments, and for maintaining the level of employment. This would help alleviate the problems at the firm level but would only partially resolve the macro crisis. Furthermore, significant results are unlikely in the short term.
 - Investment promotion would significantly address the objectives of quickly improving the balance of payments, creating new sources of employment and stimulating the national economy.
- Implementation of the strategy would involve: (See Exhibit II)
 - Top level government commitment to the emergency program, possibly with the appointment of an extraordinary export development authority.
 - Policy review to insure that the "signals" received by existing firms and potential investors are consistent with strategy objectives. No export development program can be successful without addressing the policy framework.
 - Restructuring of Cenpro in order to provide:
 - Policy analysis and formulation
 - Analysis and identification of priority sectors for export development
 - Investment promotion
 - Support for private sector initiatives, such as trading companies,

cooperative export associations, trade associations, and export credit institutions.

- Funding of technical assistance for export production and marketing.

- More detailed recommendations for the two strategic thrusts are presented below.

5. EXPORT DEVELOPMENT FROM EXISTING FIRMS

- The purpose of this strategic thrust is to take the steps needed to stimulate and facilitate exports from establishments which were created as a result of import substitution policies and have been primarily oriented towards the local and regional markets. It should be emphasized that implementing this thrust will be difficult and costly, and is unlikely to show any dramatic results in the near term. However, the thrust is essential to alleviate the crisis being experienced at the firm level.

- This thrust involves three principal types of initiatives:
 - Formulation of an appropriate policy framework
 - Establishment of credit, exporting and marketing mechanisms
 - Extensive technical assistance in export production and marketing

- The Government must play a crucial role in:
 - Insuring that policies are conducive to export development
 - Insuring that export firms benefit from priority access to credit
 - Helping to create the appropriate channels and mechanisms for export development

- The Government should not play a direct role in marketing specific products; the private sector must assume responsibility for these initiatives.

- Specific programs should include:
 - Creation within Cenpro of a major economic policy analysis capability designed to assess:
 - 1) The economics of exporting for Costa Rican exporters;
 - 2) The implications of Costa Rican policy and foreign economic developments;
 - 3) Emerging opportunities for Costa Rican exports and identification of priority industries
 - 4) Opportunities generated by the Caribbean Basin Initiative and the formulation of programs for taking advantage of them.
 - 5) Long-term structural and organizational needs of the export sector; and
 - 6) The cost effectiveness of ongoing export development efforts
 - Formulation of Government guidelines to the national banking system to give priority access to available financing to exporting firms, particularly in priority industries.

- Supporting the development of new trading companies or export management groups.
 - Establishment of a fund to provide technical assistance in export marketing and production. This fund could be administered by Cenpro for use by firms and trading groups to pay for technical assistance services.
 - Assessment of new opportunities for traditional exports, including new markets, marketing approaches or further processing.
-
- Since these programs are difficult and costly, implementation of the strategic thrust should be carefully designed to insure that the benefits exceed the costs. Hence, Government incentives and support efforts should not exceed the net foreign exchange generated from the exports developed. Similarly, marketing support should not cost more than the export sales.

6. FOREIGN INVESTMENT PROMOTION

- The purpose of this strategic thrust is to quickly and significantly alleviate the macroeconomic crisis currently affecting Costa Rica. Furthermore, it will provide a new basis for long-term economic growth.
- The short term focus should be on attracting drawback and reexport firms. This is the only type of investment which can be expected to be placed quickly and on a large scale, and subsequently have an immediate and substantial impact on the economy.
- Projects based on local natural resources should be promoted as a longer term strategy. Most of these projects would require extensive study, careful preparation and a wide range of prerequisites such as infrastructure, development of agricultural production, etc., such that they could not be expected to come on stream in the short term. Even though some projects could be started quickly (decorative plants, some food processing) the cumulative impact would not be sufficient.
- Implementation of this thrust requires:
 - Immediate clarification of regulations with respect to capital registration, exchange rate conversion and profit repatriation. It is not necessary to provide additional incentives; however, it is essential to make the rules of the game clear and consistent and to commit to these rules.
 - A vigorous promotion effort to attract carefully targeted drawback industries based on potential and national benefits. This requires a strong research effort supporting a promotion program.
 - Development of effective and practical mechanisms for controlling drawback firms.
 - Initiation of a program to attract investment based on local natural resources.
 - Assistance to facilitate establishment in Costa Rica by specific firms.
- The potential results of implementing this strategic thrust are substantial in terms of the opportunities for attracting investment and the national benefits. However, it should not be interpreted that the achievement of these results would be easy. Implementation will require a strong top level and national commitment to the strategy, modification of existing policies to conform with the thrust, and a vigorous and effective promotion effort.

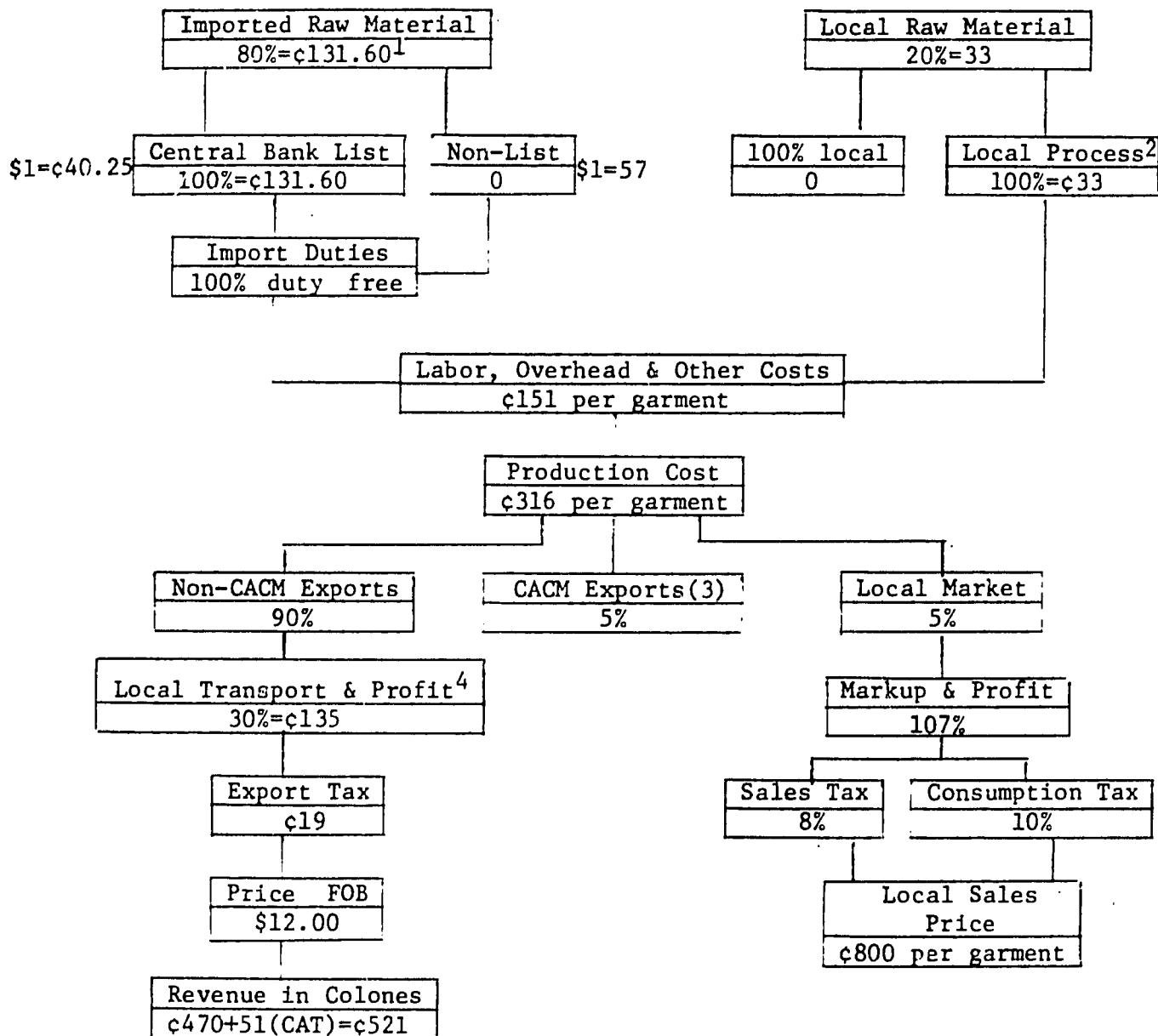
7. THE ROLE OF CENPRO

- As the Government's principal institution responsible for promoting exports and investment, Cenpro must play a central role in the implementation of any strategy.
- Cenpro must be refocused and strengthened to provide the following:
 - Policy formulation and analysis, with access to top levels of Government policy making.
 - Well defined strategic objectives such that its programs and resources will be focused on achieving them.
 - A strong planning and analysis capability to insure that its own activities and programs, as well as those being provided by other institutions are effective in achieving strategic objective and the most efficient use of available resources in cost-benefit terms.
 - A strong investment promotion capability and program which to date has been almost non-existent in Cenpro.
- Cenpro should not take on activities which can be better performed in the private sector or in other institutions. Examples would include:
 - Marketing of specific products;
 - Export credit programs;
 - Free zones and industrial parks; and
 - Technical assistance in export marketing and production.
- Implementation of these recommendations for Cenpro would involve:
 - Government commitment to Cenpro as the principal formulator, coordinator and advocate of export development policy and programs.
 - Establishment of a staff capability, attached to the Board, for assisting in policy formulation.
 - Strengthening of the Board of Directors by appointing the extraordinary export Authority as Chairman, eliminating the opportunity for members to delegate attendance at meetings to juniors, and insisting that the Board actively manage Cenpro.
 - Strengthening line planning and analytical capabilities with improved recruiting practices and provision of technical assistance.
 - Establishing a major initiative and providing technical assistance to develop an investment promotion program.
 - Reassessing current export promotion activities in terms of their contribution to the export development strategy adopted and their cost effectiveness.

APPENDIX I

THE RELATIVE ATTRACTIVENESS OF EXPORTING

A. COMPANY X--LADIES GARMENTS



¹ Indicates cost per garment (example item)

² Locally processed with imported materials. These purchases are 10-20% more expensive than imported materials.

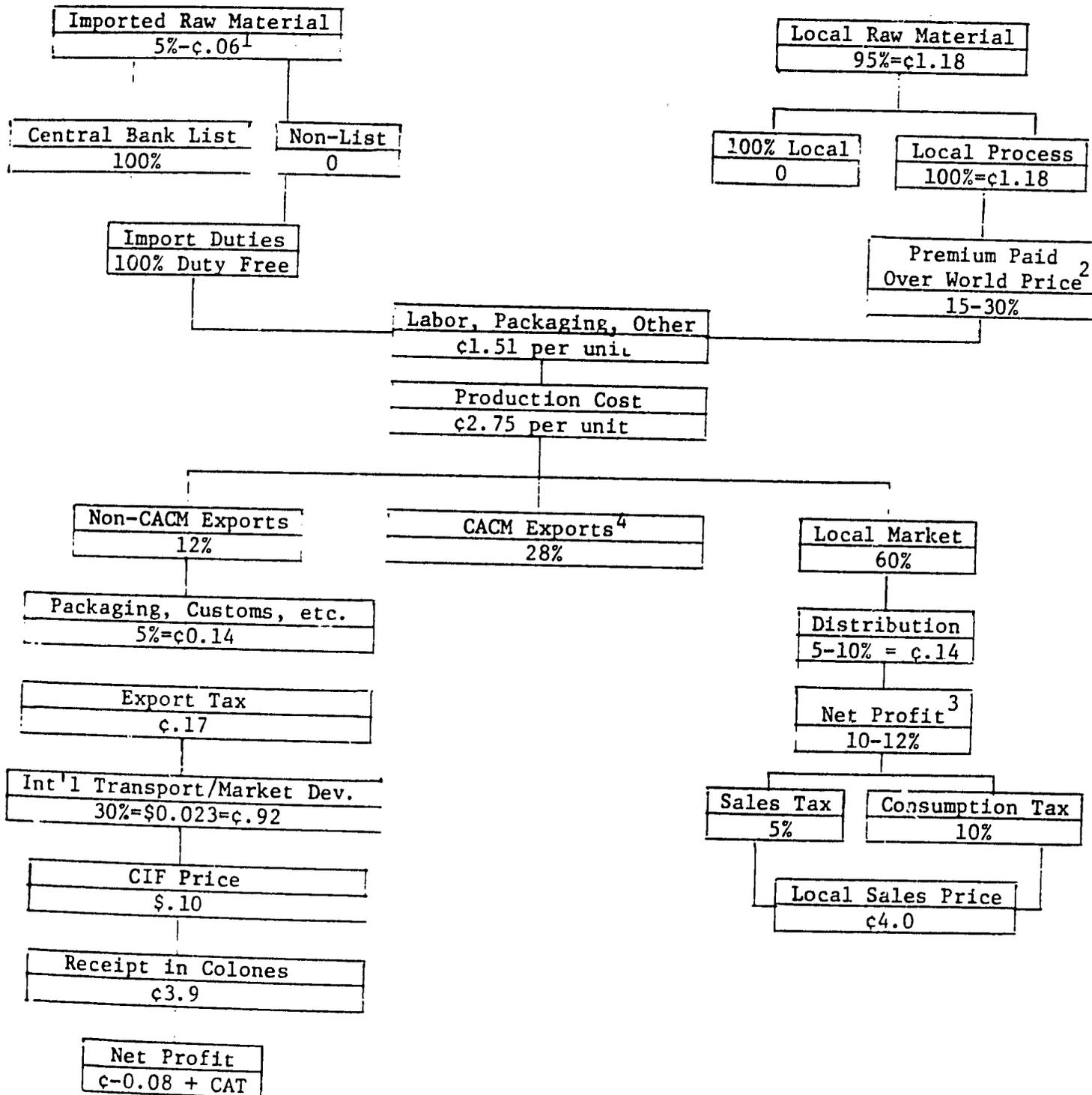
³ CACM exports would incur additional transportation costs relative to domestic sales but would not pay taxes. These sales would be as profitable as local sales.

⁴ Excludes cost of developing foreign market.

APPENDIX I

THE RELATIVE ATTRACTIVENESS OF EXPORTING

B. COMPANY Y--CONFECTIONARY PRODUCT



*Footnotes attached.

-
- ¹Indicates unit price for a product sold both in export and local markets.
 - ²Intermediate materials with imported component as affected by price controls (e.g., flour & sugar)
 - ³Local sales were more profitable before the economic crisis.
 - ⁴CACM exports are slightly more profitable than local sales because of savings in distribution and sales and consumption taxes. These more than offset higher transportation costs.

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