

Working paper No. 92. Costa Rica. Foreign Direct Investment and Multinational Enterprises: Effects on the Local Economy, Employment and Skills Training.

Executive Summary

Foreign Direct Investment (FDI) inflows to Costa Rica showed high growth rates during the 90s, with the highest levels in 1990 (60,5 per cent), and 1998 (50,3 per cent). This trend, however, slowed down in 1999 as the increase was significantly lower than that year, and in 2000, FDI inflows diminished by 35 per cent.

According to World Bank data, the percentage of FDI as a part of the GDP in Costa Rica is among the highest in the world (between 5 and 6 per cent), and is the highest of the group of the six emerging economies in Latin America (Costa Rica, Chile, Colombia, Brazil, Argentina and Mexico). Multinational enterprises (MNEs) like Intel Corporation, Abbott laboratories, Procter & Gamble and Phillip Morris have installed their centers of operations in Costa Rica.

The high FDI inflows to Costa Rica can be seen as a result of the country's explicit policy to attract investments, which ECLAC has deemed as successful, considering in particular that it did not only respond to a temporary trend of deregulation, privatization and liberalization. Costa Rica's strategy to attract FDI was initially based on a plan to develop the country's competitive advantages that identified the priorities to which investments should be directed: high technology, pharmaceuticals, tourism and environment. The strategy comprised of three schemes of FDI incentives – Export Contracts, Export Processing Zones and Active Improvement (*Perfeccionamiento Activo*) – with various degrees of tax exemptions. The system also benefited from the support of a vast commercial infrastructure that was created by the Government and funded by international cooperation to offer free services to the new exporting sector. Starting in the mid-90s a more active policy to encourage FDI was put into practice in order to attract investments mainly from enterprises in the field of high technology and activities requiring a highly skilled workforce. This policy had three approaches: developing science and technology, increasing productivity and quality, and strengthening education.

Although the high incidence of FDI has contributed to Costa Rica's economic growth, its effects have not translated into an improvement of the internal economy due to poor linkages between FDI and local activities. Actually, in spite of the country's economic development during the 90s, important problems persisted in the area of employment, though less serious than in other Latin American countries. The average underemployment rate remained at a relatively high level – 12,5 per cent – during the period 1994-2000, revealing that almost one third of the workforce did not enjoy appropriate working conditions. In addition, 52 per cent of the workers were not educated or had only low-level instruction. Data on labour market behaviour shows that the process of employment deterioration persists, implying that the formal sector of the economy has not been able to generate enough employment thus pushing people to engage in informal economy activities, which have increased at an average annual rate of 2,5 per cent.

The sectors that have mostly contributed to employment growth are agriculture and tourism, and more specifically the activities within those sectors that were targeted by the policies to attract FDI. However, the growth of employment in tourism does not have a

substantial impact on the general employment situation as it only accounts for 7,2 per cent of the total labour force.

Employment in EPZs maintained a good growth rate during the 1990s, providing jobs to about 34 thousand people in 2000, and companies located in EPZs have been very dynamic in creating employment during the recent years. However, the employment generated by EPZ firms again only represents 2,5 per cent of the total economically active population.

In general, the effect of FDI on employment at the national level has been minimal, accounting for 7,6 per cent of the total. A study on direct employment creation published by the Ministry of Foreign Trade showed the distribution of employment generated by FDI during the period 1985-1999 to be as follows: 68 per cent in the industrial sector, 16 per cent in agriculture and 4 per cent in tourism. Taking into account that only 14,5 per cent of the country's labour force works in the industrial sector, it is understandable that FDI's contribution to employment growth has not been very significant.

With regard to working conditions, it has been observed that multinationals in Costa Rica not only apply high standards in their own operations but also establish high standard requirements on the entire supply chain. These companies generally offer better wages than national enterprises, even though differences depending on the grade of the employee can be observed. Thus, incomes of employees with low-level instruction are equal or lower in MNEs than those in local enterprises, while the incomes of highly skilled workers can be up to 60 per cent higher in MNEs. Health services provided to employees in local enterprises are considerably less developed compared to those in multinationals.

In the area of skills development, efforts have been made since the 1970s to improve the education system as well as vocational training in order to prepare the labour force for the twenty-first century. Even though Costa Rican workers' appropriate academic basis to acquire the knowledge, abilities and competencies required by MNEs has always been considered as one of the advantages the country offers to multinational investment, there is still room for improvement in this area. In particular, it would be necessary to integrate and coordinate the tasks of the various institutions that carry out skills training and development programmes to avoid duplicating efforts. MNEs play an active role in this field in collaboration with local institutions.

There is a wide range of initiatives aimed at building or strengthening the linkages between multinational and local enterprises in order to achieve a better harmonization among productive activities. Most of these programmes seek to enhance the management capacity of Costa Rican economic actors, in particular micro, small and medium enterprises, to enable them to satisfy the needs of MNEs so that the benefits of FDI spread to the entire Costa Rican society. The various projects are starting to show good results, but to assure their maximum efficacy, it is essential to achieve a better coordination among them.