

# Costa Rica: Trade Brief\*

## Trade Policy

Overall, Costa Rica has been improving access to its market since 1995, particularly with respect to goods. Its relatively open trade regime is reflected in the 55<sup>th</sup> rank (out of 125 countries) on the latest most-favored-nation (MFN) Trade Tariff Restrictiveness Index (TTRI). As of 2007, the country's MFN applied simple tariff average was 5.5 percent and the import-weighted tariff mean is 4.4 percent, both of which are lower than Latin America and Caribbean (LAC) region or upper-middle-income country averages. While the maximum tariff rate is relatively high at 112.5 percent (applicable on refrigerated chicken products), less than 2 percent of items in Costa Rica's tariff schedule have applied tariff rates exceeding 15 percent, as opposed to comparator countries' average shares of 15–19 percent. With a frequency ratio of only 1.6 percent (1999), nontariff measures are rare. MFN duty-free imports accounted for 26 percent of all imports in 2007. Restrictions still remain in several services sectors, as the government retains monopoly rights on insurance, telecommunications, and energy distribution. Its overall GATS commitment index is one of the lowest in the world, suggesting ample room for further multilateral liberalization in the services sector. The negotiations for the recently agreed Dominican Republic–Central America Free Trade Agreement (DR-CAFTA) with the United States provided the impetus for the implementation and lock-in of a number of domestic policy and regulatory reforms

## Market Access

According to the latest Market Access TTRI (including preferences) Costa Rica's exports face lower tariff barriers in international markets than those from an average LAC or upper-middle-income country. Its rest-of-the-world applied tariff average stands at 0.7 percent, and is lower than the LAC and upper-middle-income group averages.<sup>1</sup> Almost two thirds of exports were MFN zero-duty in 2006, a much higher proportion relative to its comparators. The country is a Generalized System of Preferences (GSP) beneficiary with a number of industrialized countries, and enjoys further preferential access to the United States under the Caribbean Basin Initiative (CBI). It is also a member of the Central American Common Market (CACM) and holds free trade agreements (FTAs) with Mexico, Panama, and Chile. The share of exports going to FTA partners is 54.7 percent, higher than the LAC regional average. Its most important trade arrangement, however, is the DR-CAFTA with the United States, although Costa Rica is the only signatory that has not yet started its implementation as approval of 10 pieces of legislation related to the agreement is still pending. On market access, DR-CAFTA consolidates and expands the current access Central Americans have to the U.S. market, while extending broadly reciprocal access for U.S. goods to their own markets. The decision to make the provisions of the agreement apply multilaterally among Central American countries and the Dominican Republic will deepen regional integration efforts and facilitate the

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\*As of April 2008. See the World Trade Indicators 2008 database at <http://www.worldbank.org/wti2008>.

<sup>1</sup> After the DR-CAFTA with the United States was agreed in April 2006, pre-CAFTA preferential tariffs that the United States imposed on Central American cotton exports were reduced significantly, in many cases to zero, but the UNCTAD Trade Analysis and Information System (TRAINS) database used for the Market Access TTRI and Market Access Overall Trade Restrictiveness Index (OTRI) still reflects 2006, pre-CAFTA preferential tariffs. Thus, the relative standing of Central American countries and the LAC region on market access is expected to improve once the 2007 effective tariffs are taken into account in the next update of the trade restrictiveness indices. Note that estimates of the value of U.S. preferences in the WTI database rely on national data for 2006 and thus reflect the post-CAFTA preferences, although their impact on trade flows will become apparent only in later years.

creation of a Central American Customs Union. A majority of the voters in a referendum held in October 2007 supported the agreement, but its implementation is pending National Assembly's approval of several pieces of legislation that the government believes will be approved within 2008, despite strong opposition from some congressional representatives and labor unions in the public sector. The real effective exchange rate appreciated by 2.3 percent in 2006.

### **Behind the Border Constraints**

Costa Rica's Doing Business overall standing improved only slightly to 115<sup>th</sup> in 2007 from 117<sup>th</sup> (out of 178) in 2006. Its governance indicators are also better than the regional averages. Regarding trade facilitation, port inefficiency, limited capacity, and poor quality roadways, are significant constraints to the country's trade activity and it is ranked 72<sup>nd</sup> (out of 150) in the 2006 Logistics Performance Index, in line with its regional and upper-middle-income comparators' averages. Here, its weakest indicators were quality of transport, information technology (IT) infrastructure, and logistics competence. Regarding telecom and IT infrastructure, Costa Rica's per capita rates for Internet users (27.6 percent in 2006) were above the regional and income-group comparators' averages while its telephone and mobile phone usage rate (64 percent) fell below comparator averages. Secondary school enrollment improved significantly from 57 percent in the late 1990s to 85.8 percent in 2006.

### **Trade Outcomes**

Costa Rica's real growth in trade was 9.7 percent in 2007, higher than that of LAC and the upper-middle-income country group (7.5 percent and 8.3 percent, respectively), but slightly lower than the 11 percent experienced in 2005–06. The country's trade integration, measured by its trade share in GDP, reached 104.6 percent in 2007, up from the early 2000s average of 91.5 percent. While greater than the LAC regional average, it remained lower than for the upper-middle-income country group. Traditional exports (coffee, bananas, meat, and sugar) accounted for less than 11 percent of total export in 2007 as the economy has highly benefited from the dynamic re-export industry (free trade zones), which accounted for more than half of total exports and were mostly led by technology manufactures. In 2006, Costa Rica's top exports included microcircuits (14.7 percent of merchandise exports), bananas, machine parts, and medical instruments. The services share in total exports stood at 27.3 percent in 2007, with the most important services export being tourism, with a 15.7 percent share (in 2006) in total exports.<sup>2</sup> The country's main trading partners were the United States and the European Union.

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<sup>2</sup> Tourism share in total exports in about 15 percent in 2007 according to national sources.