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Resilience of Foreign Direct Investment: A Case Study of Costa Rica's IPA during the COVID-19 Pandemic

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Abstract

Facing a world of continuous, overlapping disruptions, countries recognise resilience as imperative for securing a sustainable and inclusive future. For developing countries, such as Costa Rica, foreign direct investment has positively impacted economic growth, total exports, and the number of people employed. Costa Rica has undergone an important structural transformation in the last three decades, having gone from an import substitution model to a development model oriented to promoting exports and attracting foreign direct investment. The efforts made to achieve greater international insertion of its economy have allowed the country to diversify its exportable offer, position itself as an attractive destination for investment in search of efficiency, and integrate its exports into global value chains, ultimately becoming more resilient to external shocks. During the pandemic of COVID-19 Costa Rica's Investment Promotion Agency (CINDE) reached record numbers in investment projects and job creation; the paper focuses on the years 2020-2021 and the attraction of foreign direct investment to Costa Rica.

Keywords: Economic Resilience, Foreign Direct Investment, Investment Promotion, Pandemic

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1. Introduction

According to the United Nations Conference on Trade and Development (UNCTAD) report from 2021, there was a substantial decline of 35% in global foreign direct investment (FDI) flows, dropping from \$1.5 trillion in 2019 to \$1 trillion in 2020. In the case of Costa Rica, there was a 38% decline in FDI attributed to pandemic-related factors. These findings are consistent with recent studies that highlight the substantial negative impact of the COVID-19 situation on greenfield FDI in both the manufacturing and services sectors of host countries (Hayakawa et al., 2022).

Interestingly, despite the overall decrease in FDI, Costa Rica stands out as an exceptional case. The country achieved record-breaking numbers during 2020 in terms of investment projects and job creation within the multinational environment and by 2021 it had already recovered its FDI previous record inflows. Many factors contribute to this story of success, some of which will be further analyzed.

Faced with the uncertainty generated by recent world events (COVID-19 pandemic, container crisis, substantial increase in transportation time and costs, among others), companies have rethought their strategy and have once again set their sights on relocation of their businesses. Greater emphasis has been placed on installing or relocating operations in areas closer to the final consumer market for their goods and services. But these decisions are complex, with various reasons that influence the internationalization of companies. Among the motivations for foreign investment are: having access to new technologies, promoting technologies or a brand in new markets, having access to scarce natural resources (minerals, oil), having access to cheaper resources than in the country of origin (labor), follow a competitor (contact in multiple markets), avoid high tariffs, take advantage of opportunities for better production conditions and take advantage of better access to final markets (Dunning, 2000 and 2001).

In addition, the country to which they decide to move must meet certain conditions such as availability and cost of human capital, shorter transportation and energy times and costs, legal certainty, among others. One of the conditions considered in this decision to relocate operations is the difference in the time zone between the country receiving that investment and that of the foreign company's headquarters. The impact of time zone on international trade and foreign investment flows has been widely studied (Bista and Tomasik, 2019; Nakanishi, 2019; Christen, 2017; Mandal, Prasad and Bhattacharjee, 2017; Stein and Daude, 2007), and it has been shown that the time difference has a negative effect on international trade, both for services and goods. Additionally, Stein and Daude (2007) found that this time difference most negatively affects foreign direct investment flows towards destinations with a wide difference between their longitudes and those of the countries of origin of that investment. Countries have no control over their time zone (longitude) or geographic location (latitude), but they can take advantage of them.

This is the case of Costa Rica, which is in a strategic location and with a similar time zone with respect to its largest trading partner: the United States, which represents around 80% of the foreign direct investment that arrives in the country and the destination of 43% of exports of goods (Central Bank of Costa Rica, 2023). Additionally, more than 15 free trade agreements have been signed to give preferential access to 59 trading partners (COMEX, 2023). The country has had a wide diversification of exports in both the services and goods sectors. According to the Atlas of Economic Complexity, Costa Rica is ranked 47th out of 133 in its ranking, while in 1995, it was ranked 72nd (Atlas of Economic Complexity, 2021). This improvement is mainly due to the diversification of its exports. Thanks to greater sophistication and added value, service exports increased their importance in the services export matrix from 9% in 1999 to 71% in 2022 (TRADEMAP, 2023), thus showing great resilience in the first year of the pandemic (Chacón and Zolezzi, 2022).

In terms of goods, the country has had a very important conversion. The relative share of exports of primary goods has decreased significantly, representing 67% in 1986 and 10% in 2022; medical devices were the main industrial export product in 2022 (PROCIMER, 2023).

Due to a change in its economic policy more than 30 years ago, and its strategic location, Costa Rica's economy is more resilient to external shock and disturbances than before. Resilience is a concept that has been previously used in ecology and psychology, it is used to describe how an entity or system responds to shocks and disturbances, and now it has been extended in diverse contexts, such as a perceived attribute of an object, entity, or system and, normatively, as a desired feature that should somehow be promoted or fostered (Martin & Sunley, 2015). One of the imperatives for local economic research is to understand how responses and outcomes during a period of crisis and recession shape and are shaped by longer term processes of change and adaptation (Martin, Sunley & Tyler, 2015). The COVID-19 pandemic was defined as a global health crisis and the greatest challenge we have faced since World War Two (UNDP, 2021) and not only tested health care but also most economies in the World were negatively impacted.

The objective of the paper is to show the case of Costa Rica and how this greater sophistication of its exports of goods and services has been largely due to the arrival of new foreign companies and the expansion of new operations of foreign companies already established in the country. The research gap that we want to address with this paper is to show how the attraction of FDI during a period of crisis can show the resilience of an economy using Costa Rica's case study as an example.

The rest of this paper is organized as follows. Section 2 examines the case of Costa Rica; Section 3 focuses on the methodology used and Section 4 finishes with the discussion and conclusions.

2. Case study: Costa Rica

Costa Rica has undergone an important structural transformation in the last three decades, having gone from an import substitution model to a development model oriented to the promotion of exports and attraction of foreign direct investment (FDI). The efforts made to achieve greater international insertion of its economy have allowed the country to diversify its exportable offer, position itself as an attractive destination for investment in search of efficiency, and integrate its exports into global value chains.

Currently, foreign trade and foreign direct investment constitute a driving force of the Costa Rican economy. In 2022, exports of goods reached US\$15,58 billion and, although the country continues to be characterized by successful performance in agricultural exports, medical devices currently constitute the main exported goods. Foreign sales of these products grew by 33% between 2020 and 2021 (growing around US\$1.3 billion in a single year). The second most important sector for Costa Rica is the agricultural sector, which grew by 6% (US\$169 million), followed by the food industry with 26% (US\$430 million), and third is the chemical and pharmaceutical sector, which grew by 10% (US\$73 million) (PROCOMER, 2023).

In general, the importance of time zone in foreign investment flows and international trade has been studied (Bista and Tomasik, 2019; Nakanishi, 2019; Christen, 2017; Mandal, Prasad and Bhattacharjee, 2017; Stein and Daude, 2007). For example, Christen (2017) concluded that time zone differences significantly increase transportation costs (a factor that discourages trade in both goods and services between countries). This negative effect on foreign direct investment is seen in a greater proportion when the destinations have a greater difference between longitudes of the country of the parent company. To explore the Costa Rican case, it is important to highlight that the largest trading partner is the United States. This represents 70% of the arrival of foreign direct investment flows to Costa Rica (CINDE, 2022).

With a workforce of 2.3 million Costa Ricans (approximately 55.69% of the total population) (INEC, 2023), the country also stands out for being number one in human capital in Latin America (WEF, 2019); This ranking highlights the measurement of the general level of skills of the workforce, the quantity and quality of education and life expectancy (IMF, 2019). There is also a 98% literacy rate: only 2% of the population over 15 years of age does not know how to read or write. The highly trained workforce arises from a high percentage of school enrollment in the Costa Rican population; specifically, 82% at the secondary level and 58% at the tertiary level. This is also due to a high effort from part of the Government of the Republic since 6.7% of the GDP is allocated to public spending on education (World Bank, 2022).

Costa Rica, with low export volatility, has ensured business continuity and stability. Considering the reports made by UNCTAD on Global Trade as of the third quarter of 2022, Costa Rica had an Export Volatility Index of 0.10 on average. Export volatility tracks export performance across the last 6 months to identify volatility patterns, a greater score implies higher export vulnerability (UNCTAD, 2022). In Costa Rica, the most complex

goods in the Country Complexity Index are medical instruments and devices. Thanks to greater sophistication and added value, services exports increased their importance in the services export matrix from 9% in 1999 to 71% in 2022 (CINDE, 2023), thus showing great resilience in the first year of the pandemic (Chacón and Zolezzi, 2022).

The COVID-19 pandemic was not easy for anyone, but Costa Rica has shown resilience since the beginning of the pandemic and further strengthened it during 2021 and 2022, specifically in the attraction of FDI. This has been a key factor in ensuring business continuity and achieving successes with new record figures from the over 400 multinational companies that the Costa Rica's private Investment Promotion Agency, CINDE, has attracted and continues to support. One of the highlights of 2022 was the country's performance in attracting greenfield investments, reported by FDI Intelligence, an international publication. In a study by fDi Markets analyzing 95 countries, Costa Rica came first with a score of 12.7 points, meaning Costa Rica attracts near 13 times the amount of new FDI that could be expected given the size of its economy (FDI Intelligence, 2023).

Regarding the sanitary measures taken by Costa Rica itself during the COVID-19 pandemic, the Government of the Republic categorized companies under the Free Zone Regime as an exception to export licenses. These licenses sought to combat the Costa Rican shortage of some medical protection items such as different presentations of ethyl alcohol and masks. For the benefit of Costa Ricans and manufacturing companies, medical industry exports and their operation within free zones were not affected by this restriction (Presidential House of Costa Rica, 2020). That is, Costa Rica not only declared the manufacturing of medical devices as an essential activity, but also maintained its product diversification. In general, Costa Rica was favored by the increase in demand for medical devices during 2020; mainly by the United States (ECLAC, 2020).

The Ministry of Science, Technology and Telecommunications (MICITT for its acronym in Spanish) of Costa Rica, with financing from the Inter-American Development Bank (IDB), promoted the Innovation and Human Capital Program for Competitiveness (PINN for its acronym in Spanish) to develop scholarships that would help innovate the skills of Costa Rican students and professionals according to the demands of the labor market. In February 2020, the MICITT with the collaboration of CINDE held a new initiative through this program to identify the digital and technological skills required by people aspiring to work in sectors such medical devices (Torricco, 2021). The country was able to quickly recognize the sectors whose demand could benefit from the emergence of the pandemic and with this information acted proactively to train people to promote employment in the country.

CINDE, as mentioned before was designated Costa Rica's Investment Promotion Agency, it was founded in 1982 as a private, non-profit, non-political organization dedicated to promoting foreign direct investment in Costa Rica. In 1984 the organization was declared of public interest by the Costa Rican government; to date it has worked alongside 10 different government administrations. Ranked in 2017, 2018, 2019, 2020, and 2021 as the world's top institution in attracting FDI, by the International Trade Center. The

organization aids potential and existing investors during the whole investment lifecycle, its team of well-prepared professionals will assist a company in their site selection due diligence process. CINDE has extensive experience in strategic sectors such as Corporate Services, Digital Technologies, Life Sciences, Advanced Manufacturing, Light Manufacturing, Tourism Infrastructure and Food Industry. The organization provides services to companies that wish to invest in projects with high-added value activities in the country.

In 2011 a private-public alliance was established between CINDE with the ministry of foreign trade (COMEX) and the exterior commerce promotor (PROCOMER), resources destined to this alliance have shown positive results in several indicators such as jobs, new investments, and reinvestments. Having this alliance has provided the organization with more resources and has been able to increase the impact of the sector on the Costa Rican economy. CINDE's services are available through all the steps of the investment project; from the initial and exploratory stage until after the establishment, when the company starts its operation in the country. Companies may continue to use these services throughout their entire lifespan in the country.

CINDE has cultivated, over many years, a sterling reputation as one of world's highest-performing investment agencies, but on May 3 of 2023, the Costa Rican government decided to put a halt on the funding for CINDE which terminated a trilateral agreement between CINDE, the country's Ministry of Foreign Trade (COMEX) and the Trade Promotion Agency of Costa Rica (PROCOMER, a government organization which promotes Costa Rica exports). CINDE lost 73% of its total budget without the agreement in place. Both COMEX and PROCOMER provided these funds (which amount to around US\$6.3 million). The rest of the funds come from contributions made by private enterprises.

CINDE's former responsibilities under the agreement will now fall on PROCOMER. CINDE will remain active as an FDI attractor, but now without direct government support. CINDE's current mission is to position Costa Rica as a sustainable country, highly connected with the global economy, reliable to investors, fostered by its growth in modern, high-tech, and knowledge-intensive industries that drive national employment and promote productive linkages. Further, CINDE's current vision is to contribute to the country's economic and sustainable development, economic impact, and social progress by attracting foreign direct investment and nurturing the right investment climate to do so.

3. Methodology

To show Costa Rica's resilience during the COVID-19 pandemic, we resort to a variety of sources confirming the maintained growth of its product exports, the importance of the markets it is closest with, low export volatility, increased sophistication of general exports, and FDI projects and employment. For the last point, the paper uses information compiled by CINDE.

As a way of monitoring CINDE's support to companies, the Investment Advisory Department delivers a form that must be filled out by the enterprise's point of contact. In this form, companies agree to be counted in the aggregate statistics generated for FDI in their respective categories (new project or reinvestment). These forms also help CINDE keep track of the companies' legal names and IDs which are later used to get anonymized employment data.

The Social Security Fund (CCSS, for its acronym in Spanish) collects data on reported salaries and employment per company for all those who comply with the mandatory social charges. Thanks to an agreement CINDE has with this entity, it is possible to obtain employment information for each sector. To maintain privacy and follow Costa Rica's data protection legislation, all data is anonymized by CCSS, however, data points are linked to relevant general information like company sector, regime, country of origin, and others. To calculate job creation and net general employment, first the change of employment by anonymized entity is calculated (in this case, September 2022 minus September 2021). The net general employment corresponds to the sum of all changes, while job creation sums only the net employment of companies with an increase for the corresponding period. For September 2022, the database included more than 400 CINDE-supported foreign companies with a total of more than 179,000 employees. The company sector classification answers to the operations established in the country instead of the companies' final product i.e., a pharmaceutical manufacturing company with customer support operations in Costa Rica will be classified as Corporate Services.

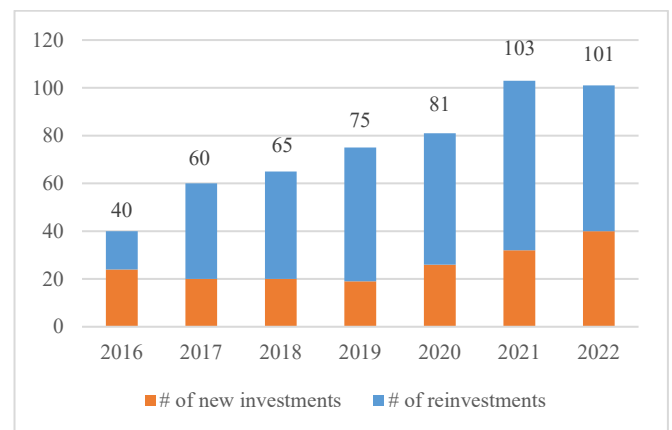


Figure 1. Number of new investments and reinvestments per year, 2016-2022. Source: CINDE, 2023.

During 2021 and 2022 record numbers in investments and job creation were reached. For example, in 2021 the highest number so far of confirmed projects was reached in 2021 with 103 new investment and reinvestments, and for 2022 this number was 101(Figure 1). The continuity in providing services by CINDE resulted in the confidence by investors in Costa Rica, whether for the beginning of operations or as a continuity with reinvestments. Since 2017, the number of investments has grown around 18%.

Job creation has also been on the rise (Figure 2): in 2022, for the fifth consecutive year, Costa Rica saw a record in direct job creation, with 25,330 Costa Ricans employed in the sectors of services, life sciences, manufacturing, and tourism infrastructure. Compared to 2018, the employment level has grown around 67%. Costa Rica's value proposition, consisting of people, planet, and prosperity, has proven that Costa Rican talent remains the number one reason for investors to choose Costa Rica.

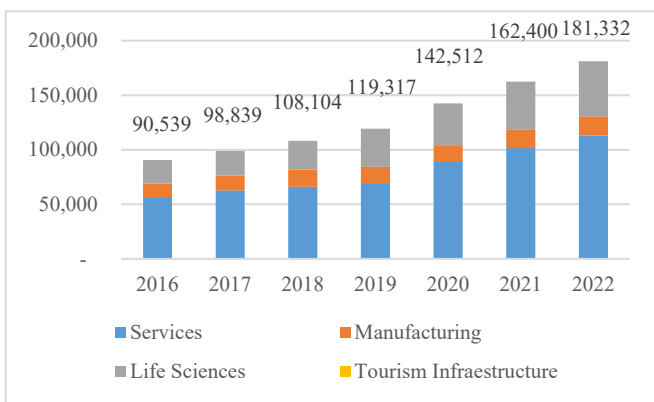


Figure 2. Number of jobs per year, 2016-2022. Source: CINDE, 2023.

4. Discussion and Conclusion

Resilience is not a fixed trait but a dynamic quality that can be developed and strengthened over time through various experiences and practices. Costa Rica has been considered a success story in terms of development, it has shown a steady economic growth over the past 30 years as a result from an outward-oriented strategy, based on the openness to FDI and trade liberalization. The country faces fiscal and social challenges that have been intensified by the COVID-19 pandemic, but it was attenuated by a strong economic performance in 2021 and 2022. This paper confirms that foreign affiliates especially play an important role supporting the country's economic resilience. The country's central location between North and South America, with ports on the Pacific and Atlantic coasts, provides logistical benefits to interested foreign investors.

In Costa Rica's case, particularly for CINDE during the COVID-19 pandemic it was key to ensure business continuity. Making sure companies that were looking into starting operations in the country or expanding their business that were already established could continue operating made a difference. The pandemic brought new challenges but also new opportunities. Reaching record numbers in investment projects and job creation was a positive signal

that efforts made even before COVID-19 arrived at were successful and that the goals that were previously set could be surpassed.

There are new challenges to be faced in the following years; losing more than 70% of CINDE's funding presents unprecedented challenges, but hopefully, the experience and knowledge that have been gained can help overcome them and continue reaching new goals: attracting more investments and creating more jobs in strategic sectors for Costa Rica. Further research on the resilience of other economies during crisis periods, such as the COVID-19 pandemic, can contribute to an understanding of resilience in the context of FDI.

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