

BRENTHURST DISCUSSION PAPER

**INVESTMENT PROMOTION
IN CHILE AND COSTA RICA**

Lyal White



STRENGTHENING AFRICA'S ECONOMIC PERFORMANCE



Strengthening Africa's Economic Performance

www.thebrenthurstfoundation.org

BRENTHURST DISCUSSION PAPER 6/2009

About the author

Dr Lyal White is a research associate of the
Institute for Global Dialogue (IGD).

Published in August 2009 by:
The Brenthurst Foundation
E Oppenheimer & Son (Pty) Ltd
PO Box 61631
Johannesburg 2000
South Africa
Tel. +27-(0)11 274-2096
Fax. +27-(0)11 274-2097
www.thebrenthurstfoundation.org

All rights reserved. The material in this publication may not be reproduced,
stored, or transmitted without the prior permission of the publisher.
Short extracts may be quoted, provided the source is fully acknowledged.

ISBN: 978-0-9814226-6-4

Designed and produced by Acumen Publishing Solutions, Johannesburg
Printed by Lawprint, Johannesburg

INVESTMENT PROMOTION IN CHILE AND COSTA RICA

Lyal White

CHILE AND Costa Rica have two of the most successful investment promotion models in Latin America. In per capita terms, and as a percentage of gross domestic product (GDP), these countries have the highest levels of foreign direct investment (FDI) in the region.¹ In 2007 Chile attracted over \$14 billion of FDI.² In the same year, FDI stock in the country reached 65 per cent of GDP, or about \$110 billion. Meanwhile, in Costa Rica FDI flows reached nearly \$2 billion in 2007, with a stock of 33 per cent of GDP, which has seen a rapid increase in recent years and is now well above the developing world average of around 25 per cent.³

It is not only the growth of FDI in these two countries that is impressive, but also the diversity of investment inflows and the dynamic strategies that have been implemented to attract sustainable investment and reinvestment in both traditional and non-traditional sectors. This type of investment in Chile and Costa Rica has enabled sustainable export-led growth and diversification, as well as job creation and the highest level of skills development in Latin America.

While their results might be similarly impressive, their models or methods of investment promotion or, more broadly, investment attraction are different. Both countries have aspired to establishing highly competitive investment environments, and maintaining the highest international standards in their operating environments. But the Chilean approach is steeped in its orthodox reform process dating back to the first structural reforms undertaken in the early 1970s, where investment has been lured through targeted legislation and policies, and supported by, at times, a wide range of government-driven organisations. Costa Rica's model, meanwhile, has also encouraged investment through targeted legislation and incentives in specific sectors. But, more specifically, its investment promotion model is shaped around and driven by a privately run agency that has become synonymous with investment growth and sectoral diversification in that country. A range of 'softer' resources – in particular the role of personal efforts and promotion – have complemented investment policies and legislation throughout.

Both models are success stories in their own right, and offer instructive lessons for countries in Africa looking to achieve similar results of foreign investment growth or create similar institutions geared toward investment promotion. Understanding effective

investment promotion strategies is important, as this is an endogenous factor that governments can control and manage, especially where FDI has been recognised as a key ingredient of sustainable economic growth and development.

Table 1: FDI flows and stock, 2002–07 (\$ million)

	FDI flows		FDI stock		FDI as % of GDP
	2002	2004	2007	2007	2007
Chile	2,550	7,603	14,500	109,000	65%
Costa Rica	658	618	1,900	9,400	33%
Latin America & the Caribbean	50,492	67,526	126,000	960,000	34%

Sources: UNCTAD, *World Investment Report 2008*, Geneva, 2008; World Bank data (www.worldbank.org)

THE CHILEAN INVESTMENT PROMOTION MODEL

Chile does not have one outright investment promotion agency with the sole responsibility of promoting and attracting investment. Instead, there are a number of investment and development organisations, each of which has, as one of their many functions, an investment dimension. These organisations have collaborated to varying degrees over the years in specific areas of investment promotion and sector development.

Chile therefore does not appear to have one particular or clearly apparent investment promotion model in the way that Costa Rica or perhaps other key investment locations further abroad, like Ireland and Singapore, have. The Chilean approach is entrenched in the policy framework of the country, and was initiated and driven (almost exclusively) by government or public entities.

Today the two most prominent organisations involved in investment promotion in Chile are the Foreign Investment Committee and the *Corporacion de Fomento de la Produccion* (CORFO). While the Foreign Investment Committee focuses on attracting FDI to traditional sectors like mining, using policy and legislation instruments, and providing the necessary information around these laws and regulations to investors, CORFO concentrates its efforts on particular regional projects and investment initiatives geared toward development. CORFO is also more concerned with attracting investment to non-traditional sectors, and is involved in a range of strategies and initiatives to develop these new growth areas in Chile through foreign investment. These two organisations function independently of each other, but complement each other's activities most effectively in the Chilean investment environment.

The Foreign Investment Committee was established in 1974 when the first structural reforms were initiated in Chile. This was shortly after the coup d'état led by General Augusto Pinochet that brought about dramatic political and economic change. FDI was recognised as key to economic growth and development. The Foreign Investment

Committee was thus at the centre of the structural changes that were implemented and the institutions that were designed to improve Chile's competitive advantage in attracting investment and, importantly, to help the country develop a healthy reciprocal relationship with investors. It also played an important role in improving the country's investment image, which had been tainted by the crippling nationalisation drive of former President Salvador Allende.

While the broad-based investment strategy involved a complex integration of policy and legislative guarantees implemented in a holistic fashion, there were two principal legislative measures or instruments on which this was based, and which were – and remain – the cornerstones of the Foreign Investment Committee. These are the Chapter XIX debt-to-equity swaps, and, most notably, the Decree Law 600 (DL-600).

The Chapter XIX debt conversion programme, which was implemented in 1985 following the crisis in 1981–82, was part of the second phase of reforms in Chile and is said to have complemented the DL-600, which was implemented in 1974. While the Chapter XIX programme was successful – it was responsible for up to 46 per cent of FDI flows between 1985 and 1990⁴ – the DL-600 favoured mining investments in particular due to the long-term nature and complexity of mining projects. These projects traditionally required the necessary guarantees and a fixed tax regime most closely associated with the DL-600 more than immediate and impressive incentive packages. The DL-600 essentially helped to convince multinational companies (and mining companies in particular) to invest in the long-term prosperity of Chile.⁵

The DL-600 is the centrepiece of investment policy and related legislation in Chile. It was implemented in 1974, but real results only became apparent toward the end of the 1970s. It was designed to address the concerns of foreign investors, and was very effective at doing this.

The Central Bank of Chile summarises the basic principles of DL-600 as follows:⁶

- Free market access granted to foreign investors, subject to prevailing legal provisions. The choice of activities and subsequent development are open and flexible, left to the judgement and discretion of the investor who has control and management over the project.
- Non-discrimination between domestic and foreign investors. The Statute is based on objective norms, with Chilean legislation, regulation and procedures equally applicable to all investment.
- The rules and contractual framework, with investor rights and obligations, are fixed and available in advance. They are impersonal and automatic and are thus not determined by a rigorous negotiation process, but rather rely on a standardised, non-bureaucratic procedure.

Most importantly, the rules and regulations of the DL-600 are constitutional, and involve a binding contract between the state and the investor that can only be altered or nullified with the consent of both parties.

The DL-600 focuses more on consistency and investment security than favourable

incentives. One example is the income tax rate associated with the statute. Currently at 42 per cent (following an amendment from 49,5 per cent in 1992), it does not appear to be impressively low when compared to other tax rates around the region and in other mining locations around the world. But investors engaged in long-term mining projects seek guarantees and security more than anything else. It is for this reason that the Chilean investment ratio (particularly in FDI and mining operations) far outstrips competing nations in the region like Peru and Argentina, which may have offered impressive incentive packages at some point, but, for the most part, could not ensure political and economic stability or guarantee policy continuity.

It is precisely this aspect of FDI promotion, i.e. authorising and providing facilitative information, and refraining from actively promoting particular sectors – especially non-traditional sectors – or targeting specific firms, that is the responsibility of the Foreign Investment Committee.

CORFO, on the other hand, has pursued a nuanced approach to investment promotion (by Chilean standards) by exploring new areas of potential investment and developing a regional approach to investment that carries with it a strong developmental component, and targets various non-traditional sectors.

CORFO was created in 1939 as an 'autonomous public development agency'. It has long prided itself on its highly professional and competent technocratic practices that have operated in close accordance with Chile's market-oriented principles.⁷ CORFO has therefore emerged as a strong institutional support for the rigorous structural reform process that took place from the early 1970s.

CORFO's economic development priority led it to identify particular products and requirements in each region. Given the country's obvious economic limitations, geography and market size have always been important considerations in Chile. This is a truly distinguishing feature relevant to investment promotion. Regional products, like metals in the north, fruit and wines in the central areas, and salmon further south, were some of the products identified or specially targeted in an effort to attract foreign investment in these industries and other derivative industries around them.

Besides this, investment promotion in Chile since the early 1990s has been geared to the export potential of some of these products and the country's trade strategy, or, more specifically, the trade agreements it has signed. Products and entire industries focused on exporting to particular trading partners have been developed using FDI. Investment and investment promotion are therefore important components of Chile's export-led growth and development. It is for this reason that CORFO has started identifying new and non-traditional sectors that will deliver alternative areas of potential growth and labour absorption on different skills levels.

The rationale behind CORFO's investment promotion strategy is to use knowledge and transnational strategic networks to develop more effective investment promotion policies in non-traditional sectors. CORFO has undertaken a conscious drive to learn from others outside of Chile who have greater insight into these sectors or their international business trends, and to match them with Chile's business environment. In this way, CORFO is able

to learn from this international strategic network and the first tier of investors entering a particular sector in Chile, and thus constantly seeks to improve its investment promotion model for a larger pool of investors and, most importantly, to encourage reinvestment.

This approach has two key ingredients. The first, as noted above, is a coherent international strategic network, with which CORFO collaborates closely. This network includes an array of partners, from certain strategic investors and think-tanks to academic institutions and other investment promotion agencies – in this case the Industrial Development Authority in Ireland, the Economic Development Board in Singapore, and the *Coalición Costarricense de Iniciativas para el Desarrollo* (CINDE) in Costa Rica (for a discussion of the latter, see below).

The second is a competent and independent technocratic class which manages and drives the process. The roots of this lie in Chile's political–economic landscape. Through an established democratic system, and a strong sense of political and party stability, Chile has been able to replace the patrimonialism that has characterised so many of the public institutions like CORFO in Latin America with an efficient and effective technocracy. Such an institutional reform is far better suited to the open and free market principles of investment and trade promotion in Chile.⁸

THE COSTA RICAN INVESTMENT PROMOTION AGENCY

While Chile's reform process informed Costa Rica's structural adjustments in the 1980s and 1990s, investment promotion was one area where it deviated from the Chilean pattern. Costa Rica established an investment promotion agency (IPA) more similar to those found in Ireland and Singapore than the likes of CORFO or the Foreign Investment Committee in Chile.

CINDE, the Costa Rican IPA, is a private, apolitical, non-profit organisation established in 1982. From this so-called 'non-political and non-sectoral interest position', CINDE is able to fulfil its principal role of catalyst and facilitator of investment in Costa Rica. It does this through a healthy interaction between the private and public sector – which it brings together in the realm of investment policy and decision-making – and by creating strategic alliances between local and foreign companies.⁹

CINDE's mission, as is the case with investment in Chile, is to utilise foreign investment to drive economic growth and development in Costa Rica. It provides the necessary information, and identifies important market opportunities and particular areas requiring an injection of FDI in an effort to maximise the returns for the investor, the local operator, and overall development in the sector or country in general.

CINDE is a typical privately run and privately driven IPA. Its promotional efforts target very specific sectors that have been identified as important nodes for sustainable growth and development in the country, in order to ensure that Costa Rica is competitive vis-à-vis rival locations in the region and globally. CINDE's strategy also targets specific large multinational corporations that act as magnets for additional investment, and often form the foundation for the building and development of entire industries. Intel is one example of

this, around which a microchip and even small information technology industry could be built in Costa Rica for export to the global market.

Four sectors have been identified to help focus CINDE's expertise in developing a competitive investment environment, and attracting FDI compatible with the future economic prospects of the country: medical devices, electronics, services, and special projects. 'Special projects' is an amorphous category that includes a range of unrelated sectors, like tourism and textiles, which are regarded as established or even traditional sectors in Costa Rica and therefore do not need specific investment promotion expertise, as they are already recognised by foreign investors and thus have an established investment strategy and portfolio.

Each sector has a qualified team of promotion executives and researchers. Detailed studies of the sector are conducted, which analyse particular market segments and tendencies, and identify subsectors of interest, while providing relevant information for potential investors and local partner organisations. A detailed list of all the stakeholders and investors is also generated in such studies.

CINDE provides a comprehensive service and guidance to investors by providing insight into general business practice and culture in Costa Rica. It also facilitates meetings, and business trips with customised itineraries. In the medium to long term, CINDE provides on-the-ground support before, during, and after operations are established in the country, and offers additional assistance in the years that follow. Besides this, CINDE has offices and support facilities in New York, in close proximity to its primary source of foreign investment on the east coast of the United States. This office provides specific services to investors in the United States, and actively looks for potential investors or partners across the country.

This combination of strong service orientation, research, and insight and a facilitative role between the private and public sector (relevant to policy lobbying and strategic investments) comprises the key attributes of CINDE's success. The organisation's results tend to support the notion that independent agencies (i.e. independent from government), or even privately driven organisations, that maintain close co-operation with government are more effective investment promoters, especially for smaller, emerging countries like Costa Rica.

KEY RESULTS AND ATTRIBUTES RELEVANT TO INVESTMENT PROMOTION AND POLICY IN AFRICA

Both Chile and Costa Rica show that a **stable political democracy** is an important prerequisite for FDI. This supports a number of studies on this issue, all of which show a strong correlation between democratic transparency and investment. Politics does matter, and this kind of political environment is a crucial foundation on which an enabling environment for investment can be built – one that is competitive, predictable, and easily understood by foreign and local investors alike.

Policy also matters. Chile and Costa Rica used – and continue to use – policy measures to entice foreign investors and encourage reinvestment.¹⁰ Policy and legislation in Chile and Costa Rica created the enabling environment and provided the necessary guarantees for

POLITICAL ECONOMY CRITERIA FOR INVESTMENT IN CHILE AND COSTA RICA

A stable and vibrant democracy is the most important factor attracting investment in emerging developing countries like Chile and Costa Rica. Both countries have attributed their growth in investment to political democracy and its associated institutions. But Chile in particular has demonstrated the importance of democracy in the political economy of investment.

Despite well-established policies and market-oriented reforms – and even political stability under Pinochet's government – substantial FDI only started flooding into the country post-1989 following its democratic transition. Over 90 per cent of FDI in Chile between 1974 and 2006 flowed in after 1990. Foreign investors perceived democratic transition as a real indication of political stability and predictable policy continuity. Costa Rica, meanwhile, is hailed as the longest-established stable democracy in Latin America.

The ability to provide robust guarantees both politically and in the policy domain has made Chile and Costa Rica an investment destination of choice (especially for FDI), and certainly makes for easy investment promotion. Relative political and economic risks are low in both countries as a result of coherent policies and reliable institutions, and this, in turn, lowers the associated cost of investment.

Other relevant factors prevalent in both Chile and Costa Rica include:

- a skilled, educated and highly versatile workforce;
- a high standard of living and human development compared to neighbouring countries in Latin America;
- a relatively safe operating environment, with levels of corruption well below the regional average;
- an array of trade and investment agreements that have increased the market size and pool of opportunities for investors;
- equal treatment of both foreign and local investors;
- export-oriented, cheap and efficient infrastructure; and,
- a range of incentive packages geared to target investment in selected industries.

These factors and investment dynamics or criteria that contribute towards holistic investment strategy may have taken years to establish, but still require ongoing attention and improvement. Image-building is important, and helps to ensure that both Chile and Costa Rica retain an impression of highly competitive and integrated investment locations ahead of other countries vying for a similar position in the region and elsewhere.

foreign investors wary of the risks associated with long-term investment. Most importantly, domestic and external policies (around trade and investment) were not only coherent, but also comprised a collective and holistic export-led and investment-oriented growth strategy. Contradictions in policy formulation – especially around trade, investment, and industrial policy – were avoided, which is a relatively straightforward, though important, lesson for many African countries, where severe disassociation between the policy framework and the rhetoric still persists.

Functional institutions are a vital component of the enabling environment. These support policy and provide a tangible entity for the private sector to not only understand policy and legislation, but also engage with policy-makers, and lobby where necessary. These institutions act as an important conduit for public–private exchanges, which serve to improve investment policies and the investment or operating environment in general.

These institutions and the investment promotion agencies that emanate from them – along with targeted policies – are endogenous variables that government can manage and control to influence investment flows. Such general criteria or perhaps even fundamentals of investment, which are evident in Chile, Costa Rica, and other investment-friendly locations, are central to investment attraction and promotion, and therefore important preconditions for the political economy of investment in Africa.

But apart from these general issues, both Chile and Costa Rica offer a few very specific lessons around investment promotion that are instructive for small to medium-sized economies in Africa.

Firstly, evidence from previous investment promotion experiences across the globe suggests that **privately run and privately driven investment promotion agencies** work better than large public institutions. This is especially the case with CINDE in Costa Rica, which maintains a healthy relationship with private investors, various government institutions, and policy-makers. It also helps to facilitate a healthy exchange of information and dialogue between government and the private sector. Such a relationship between the public and private sectors still eludes most African countries, and this has been detrimental to investment promotion up to now.

While the case of Chile does tend to contradict this assumption, there has, more recently, been some criticism around the lack of private sector involvement in Chile's investment promotion strategy. Some investors have commented on a lack of dynamism and slow response time from CORFO and the Foreign Investment Committee, which have recently had to cope with this next, somewhat challenging, phase of investment promotion outside of traditional sectors.

This reveals the second important lesson for investment promotion, especially where the IPA is not privately run: the need for a **highly competent, well-remunerated and effective technocratic class**. Chile certainly had this in both CORFO and the Foreign Investment Committee throughout the 1980s and 1990s, and early in the new millennium. These technocrats added a dynamic element to investment promotion, and instilled a great deal of confidence in public sector-led investment initiatives. This highly skilled class of individuals seemed able to straddle the divide between the private sector and local politics,

thus engaging with both and delivering on basic investment requirements while contributing towards certain development priorities.

Most importantly, CORFO in particular managed to shed the patrimonial characteristics that tend to taint so many similar public institutions, which ultimately render them useless in their functional role as investment promoters or development agencies when they fall victim to political infighting and party politics. In the case of CORFO, an effective technocracy replaced the destructive patrimonial elements of the organisation, creating a sense of functional independence despite its government affiliation. This is particularly instructive for small African countries, where public institutions, which often start off as effective agents of development and promotion, become hostage to the political system and its players.

Thirdly, Costa Rica and later Chile identified the need to **target specific sectors through specialised expertise and international strategic networks**. These were, in most cases, non-traditional sectors that offered new areas of growth, and were thus essential for broader-based socioeconomic development and future prospects of a more integrated economy. Expertise stretched from research to specialised services, and even to collaborative efforts in the United States and other locations where there are large numbers of potential investors.

Costa Rica took this approach a step further by targeting particular multinational corporations, which could, in turn, be used to attract additional investors in the same or similar sectors and thus create a competitive cluster geared for the global export market. This is clearly a more focused investment strategy that African countries could look to replicate in an effort to create a competitive investment environment and industry in a specialised sector.

Fourthly, while Chile and Costa Rica both promote new investment opportunities, they have not lost sight of existing investment projects, and constantly **seek reinvestment from existing investors**. While this may not necessarily be in the same sector or industry, both countries encourage foreign investors to invest in the country *per se* and its future prospects, more so than short-term or even 'once-off' incentive packages. Reinvestments are an important determinant of confidence in a country, and thus encourage new investors to follow suit. They are thus the best provider of tangible evidence of investor confidence in a country.

Finally, while Chile and Costa Rica may have pursued slightly different models of investment promotion, both have recognised the importance of **long-term image-building in the investment domain**. Foreign investment has become increasingly mobile, making competitive investment criteria that much more important. In the world of investment, perception is often reality. This can most often be determined and manipulated by IPAs and governments themselves. Through effective IPAs and policies that contain robust guarantees, governments can shape and direct the investment decisions of foreign investors – just as Chile and Costa Rica have succeeded in doing.

This approach to investment promotion and investment rationale in general should be adopted by more African governments. These governments and their agencies need to take

ownership of their investment environments, and thus identify the necessary promotional efforts required for their own national interests and growth prospects.

ENDNOTES

- 1 Chile has a population of about 16,5 million people, and an annual GDP of \$164 billion; Costa Rica has a small population of just 4,4 million people, and an annual GDP of nearly \$27 billion.
 - 2 A surge from about \$8 billion the previous year on the back of the commodity boom and favourable copper prices which led the massive state-owned copper company, CODELCO, to unbundle some of its assets.
 - 3 See UN Conference on Trade and Development (UNCTAD), *World Investment Report 2006*, Geneva, 2006; UNCTAD, *World Investment Report 2008*, Geneva, 2008.
 - 4 The DL-600 was responsible for the other 54 per cent of FDI during that time.
 - 5 See J Kline, *Foreign Investment Strategies in Restructuring Economies: Learning from Corporate Experiences in Chile*, Westport: Quorum Books, 992.
 - 6 See Banco Central de Chile, *Foreign Investment in Chile: Some Special Features, Decree Law No 600*, Santiago: Banco Central de Chile, 1984.
 - 7 This information about CORFO is based on interviews conducted at CORFO in Santiago, Chile, in May 2008, and on R Nelson, 'Transnational strategic networks and policymaking in Chile: CORFO's High Technology Investment Promotion Program', *Journal for Latin American Politics and Society*, 49:2, 2007.
 - 8 These are the central tenets of Nelson's thesis.
 - 9 This information is based on interviews conducted at CINDE in December 2007 and on various guideline documents dealing with investment and investment promotion in Costa Rica. See www.cinde.org
 - 10 To be sure, these two countries have not relied solely on industrial policy incentives geared toward selecting 'champions'. As suggested earlier, a range of other criteria have contributed equally toward investment promotion in certain sectors.
-

