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ECONOMIC AND LEGAL STATUS OF FOREIGN INVESTMENTS
IN SELECTED COUNTRIES OF LATIN AMERICA

(Prepared by the Secretariat)

FOREIGN INVESTMENTS IN COSTA RICA

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I. THE NATURE OF FOREIGN INVESTMENTS IN COSTA RICA

Costa Rica extensively borrowed in London and New York between about 1870 and 1930. Direct investments, largely by United States enterprises, began about 1900 and assisted Costa Rica in developing agricultural production, railroads and other public utilities.

Aside from an external obligation assumed on the dissolution of the Central American Federation in 1827, Costa Rica did not incur any foreign debt until 1871 when a 6 per cent loan of £1 million was raised in London. A seven per cent loan of £2.4 million was raised in 1872 in connexion with the construction of the Costa Rica Railway. Both loans went into default in 1874. A settlement with the bondholders made in 1885 was effective for ten years. A new settlement was made in 1897 but four years later a new default occurred. In 1911, final settlement was made by the issuance of 5 per cent refunding bonds in the amount of £2 million.^{1/}

In addition to the sterling loan issued in connexion with the refunding of previous bonds, Costa Rica in 1911 raised a loan of 35 million French francs at 5 per cent. The proceeds were used for the redemption of bonds through which had been financed the construction of the Pacific Railway (see below) and of the internal debt. Another 6 per cent loan of £188,720 was obtained in 1912 in London for public construction projects. Full service on the two sterling and the French franc issues was maintained from 1911 to 1931.

Costa Rica entered the New York bond market in 1926 when it obtained a 7 per cent loan for \$8 million for redemption of internal debt and for construction of public works. A 7 1/2 per cent loan of \$1,800,000 was raised in 1927 to pay for electrification of the Pacific Railway. These two loans were also fully serviced until 1931.

The world economic depression brought about an acute shortage of foreign exchange in Costa Rica and the Government discontinued servicing its foreign debt. From 1931 to 1941 several attempts were made to arrive at a satisfactory arrangement with the British and United States bondholders. At first 5 per cent funding bonds were issued in lieu of interest for all bonds; however, in 1937

^{1/} For further details with respect to this early period of Costa Rica's foreign indebtedness see the annual reports of the Council of the Corporation of Foreign Bondholders, London.

payment of interest and amortization on these funding bonds also was defaulted. From 1939 to November 1941, a dollar debt adjustment plan was in effect; since 1941, default has been complete.^{1/}

Table 1 summarizes the external bonded debt of Costa Rica at the end of 1949.

Table 1. Outstanding External Bonded Debt of Costa Rica - 31 December 1949

In millions of currencies indicated	
<u>Dollar bonds:</u>	<u>U.S. Dollars</u>
7% dated 1926	5.4
5% dated 1932 (funding)	1.1
7 1/2% dated 1927	1.2
5% dated 1933 (funding)	0.4
Total.....	<u>8.1 a/</u>
 <u>Sterling bonds:</u>	 <u>£ Sterling</u>
5% dated 1911	1.4
6% dated 1912	0.0
5% dated 1933 (funding)	0.2
Total.....	<u>1.6</u>
 <u>French franc bonds:</u>	 <u>French francs</u>
5% dated 1911	5.5

Source: Foreign Bondholders Protective Council, Report 1946 through 1949, pp. 158-159.

a/ According to the United States Treasury's "Census of American-Owned Assets in Foreign Countries" (1943), residents of the United States reported ownership of \$2.3 million of such bonds.

1/ For details of the 1939 Dollar Debt Adjustment Plan, see Foreign Bondholders Protective Council, New York, Annual Report, 1938, p. 335.

The United States Foreign Bondholders Protective Council was reported early in 1951 to be negotiating a new agreement with the Costa Rican Government.

In 1928, the Mortgage Bank of Costa Rica obtained dollar funds in Spain through the sale of \$4 million of 7 per cent bonds. A moratorium was declared in 1933, and in 1936 under a new agreement with the bondholders the interest rate was reduced to 3 1/2 per cent and a new amortization schedule established.^{1/} No later information is available with respect to these bonds.

In addition to the external bonded loans, the Costa Rican Government has obtained two credits from the Export-Import Bank in Washington, one of \$5 million in 1940 and one of \$2 million in 1942. Both credits were granted in connexion with the construction of the Inter-American Highway. The original amortization schedule was modified in February 1946 in order to reduce Costa Rica's annual payments to a level consistent with its exchange income. According to the new agreement total annual payments of \$350,000 were to be made until the end of 1950. In February 1951, a new service plan was established. On 30 June 1950, \$6.5 million was outstanding under these two credits.^{2/}

In 1948, Costa Rica also borrowed \$1.25 million from the International Monetary Fund; this sum was repaid in full in 1949.^{3/}

Finally, the United Fruit Company granted the Government a \$1 million credit in 1938. In the concession contract of 31 December 1949, the Company agreed to a moratorium without interest on the balance still outstanding.^{4/}

Foreign business investments in Costa Rica amount to approximately \$92 million. No complete record of such investments exists, but available information suggests that foreign business investments by nationality of ownership were approximately as follows:^{5/}

1/ Moody's Governments, 1950, p. 1759.

2/ Export-Import Bank, Tenth Semi-Annual Report to Congress for the period January to June 1950, pp. 30-31.

3/ International Monetary Fund, International Financial Statistics, December 1950, p. X.

4/ La Gaceta, No. 295, 31 December 1950.

5/ United States Treasury Department, Census of American-Owned Assets in Foreign Countries, 1947; United States Department of Commerce, Survey of Current Business, November 1949, pp. 22-23 and January 1951, p. 23; Cleona Lewis, Debtor and Creditor Countries: 1938-1944, 1945, p. 81.

	<u>Year</u>	<u>Amount</u> in millions of U.S. dollars
United States	1949	68
United Kingdom	1938	17
Other countries	1938	7

Of the total United States investments of \$68 million, approximately \$54 million was reported as invested in agriculture; \$9 million in public utilities. The large investment in agriculture is of relatively recent origin, as is shown in Table 2:

Table 2. United States Investments in Agricultural Enterprises
Million of U.S. dollars

1897	3.5
1908	12.2
1914	16.4
1919	13.0
1924	13.0
1929	12.5
1935	5.4
1943	21.7
1949	54.0

Sources: Cleona Lewis, America's Stake in International Investments, 1938, p. 590;
United States Treasury, op. cit., p. 70;
United States Department of Commerce, op. cit., Nov. 1949, pp. 22-23, and January 1951, p. 23.

The increase in the 1940's is due largely to the change in location of the banana plantations necessitated by the ravages of plant diseases, and to the installation of spraying equipment in order to protect the new plantations.

United States investments in public utilities in Costa Rica have expanded little during the last two decades.

Little information is available with respect to British direct investments in Costa Rica. It is believed that the ownership of the Northern Railway represents a large portion of these investments. At the end of 1943, British investments in Costa Rica which are listed on the London Stock Exchange were valued at \$18 million.^{1/} This figure does not comprise all British business investments but includes holdings of Costa Rican Government bonds.

^{1/} South American Journal, London, 22 January 1944, p. 37.

II. ECONOMIC SIGNIFICANCE OF FOREIGN INVESTMENTS

Costa Rica is primarily an agricultural country and relies for foreign exchange principally on coffee and bananas, which normally constitute more than 80 per cent of Costa Rican exports. Other exports are cacao, as well as sugar, tobacco and rice, which latter commodities, however, are produced chiefly for domestic consumption. It has been estimated that more than one-half of the total agricultural production of the country is exported.

Of the two principal agricultural commodities grown largely for export, only bananas are produced by foreign-owned plantations. The United Fruit Company, operating through the Compania Bananera de Costa Rica and the Chiriqui Land Company, is the main producer and exporter of bananas. Banana cultivation by United States interests started at the end of the 19th Century. At that time the plantations were mainly located along the Caribbean coast of Costa Rica. The building of the Northern Railway by British companies was closely linked with the production of bananas. When the diseases wiped out many of the banana plantations along the Caribbean coast, the United Fruit Company started to develop extensive plantations on the Pacific Coast side of the country. Most of Costa Rica's banana exports now come from plantations in that new location.

Practically no foreign capital is invested in other agricultural enterprises. Coffee and other foodstuffs are produced primarily by Costa Rican interests.

Most of the important public utility enterprises in Costa Rica were developed with the aid of foreign capital. One of the three major railway systems, the Pacific Railway, is government-owned but was built largely with the aid of funds borrowed abroad; its electrification was also financed with foreign capital. This line runs from the capital San Jose to Puntarenas on the Pacific Coast. The railroad running from San Jose to the city of Limon, the site of the original United Fruit plantations, is owned and operated by the Northern Railway Company, a British concern. The third railway system serves the Pacific coast of Costa Rica; it belongs to the United Fruit Company but is used also as a common carrier. In 1938, when the Costa Rican Congress approved a new contract with United Fruit Company, that company agreed to build two new railway lines within eight years, both of them in the Pacific coast area, connecting the

/newly-built

newly-built ports at Quepos and Golfito with other centres in the country and with railway lines in Panama. By the end of 1949, the United Fruit Company had practically completed extension of its line to the Panamanian border and connecting it with its lines in Panama.

Compania Nacional de Fuerza y Luz, which is almost fully owned by the American and Foreign Power Company, a United States concern, accounts for a large portion of the electric energy generated in Costa Rica. This company serves primarily the central area of Costa Rica. Since the rates that may be charged for electric current are fixed by law and have not been changed for years, and since no foreign exchange has been allocated recently for the transfer of the company's earnings, the company has been very reluctant to finance any further expansion. A contributing factor may have been the risk of nationalization which was being contemplated by the government previously in power.^{1/} This company also operates the telephone service and the electric street car service in the capital. The British-owned Northern Railway Company owns and operates the telephone service in the city of Limon. The United Fruit Company operates a telephone system of its own.

So far, no foreign capital has engaged in the development of mineral deposits. In 1949, a United States oil company had entered into a contract for exploration and drilling, but opposition to the terms of the contract was raised in the Constituent Assembly and the company suspended its activities.^{2/} No further attempt has been made to develop potential petroleum resources.

A branch of a British bank operates in Costa Rica. However, after 1948, when the five domestically owned commercial banks in Costa Rica were nationalized, it could not accept deposits in Costa Rica; only the nationalized banks, therefore, may now offer complete banking facilities.

^{1/} United States Department of Commerce, International Reference Service, op. cit., p. 3.

^{2/} Ibid., p. 2.

Figures for Costa Rica's balance of international payments in 1948 are shown below:

Table 3. Costa Rica: Balance of Payments in 1948

Inward (+) or outward (-) payments in millions of U.S. dollars.

Merchandise exports	+	50.9
imports	-	42.3
Miscellaneous services and donations	+	0.6
Investment yield	-	10.7
Total above items	-	1.5
Known capital transactions	-	2.4
Balance due to errors and omissions	-	3.9

Source: International Monetary Fund, Balance of Payments Yearbook, Vol. 1948, p. 127.

In 1948, the export of bananas amounted to approximately \$27.7 million or over half of all exports.^{1/} However, only a portion of the foreign exchange proceeds from banana exports becomes available to finance general imports since under the existing concession contract the United Fruit Company may retain abroad dollar exchange to cover its profits, depreciation allowances and funds needed for certain imports (see section III below). In 1948 the banana company turned over approximately \$8 million of dollar exchange to the Central Bank; more foreign exchange was obtained from this source than from the export of any other single commodity; the proceeds from coffee exports were slightly lower. Since coffee prices have risen sharply since 1949, whereas banana prices have remained fairly stable, it may be assumed that the exchange proceeds from coffee exports, which are largely in Costa Rican hands, now exceed the exchange turned in by the banana company.

Although the United Fruit Company's operations in Costa Rica are generally profitable, annual earnings have fluctuated considerably. According to the International Monetary Fund, the investment yield, representing largely income of that company, amounted to \$1.3 million in 1946, \$3.9 million in 1947 and \$10.3 million in 1948.^{2/}

^{1/} According to Costa Rica's trade returns, banana exports amounted to \$8.0 million in 1948; this figure, however, represents only the foreign exchange turned over by the United Fruit Company to the Costa Rica Central Bank. In the statement on the balance of payments, \$19.7 million has been added in order to arrive at the full value of the banana exports. See International Monetary Fund, op. cit., p. 128.

^{2/} International Monetary Fund, op. cit., p. 127.

III. GOVERNMENT POLICY AND FOREIGN INVESTMENTS

According to the Exchange Control Law of 1 April 1950, foreign capital being registered with the Central Bank and entering the country at the "official" buying rate of exchange (for years 5.60 colones per United States dollar) enjoys the advantage of the official selling rate plus 10 per cent surcharge (together 6.24 colones) for remittance of interest, dividends and amortization. The "free" rates of exchange, applying to other (not registered) capital transactions, involve a lower exchange value of the domestic currency (buying rate in February 1951 fluctuating around 8 colones; selling rate, including surcharge, around 8.57 colones per dollar).

The Central Bank can refuse to register new foreign capital if it deems the investment contrary to the national interest or inconsistent with the aims of the country's economic policy. If registration is approved, the foreign exchange must be sold in the official market, and the investor subsequently may obtain exchange in the official market for interest, dividend and amortization remittances. Remittances of interest and dividends may not exceed 10 per cent per annum of the registered value of the investment; capital withdrawals have to be approved at each occasion by the Central Bank.

Foreigners enjoy almost complete equality with citizens of Costa Rica in doing business in the country. According to Article 12 of the Constitution, foreigners "may acquire, possess and transfer real property, navigate the rivers and coasts, and engage in commerce and industry in accordance with regulations determined by law and by international treaties."^{1/} However, according to the Law for the Nationalization of Commerce of 28 December 1943 new commercial enterprises cannot be established by citizens of countries with which Costa Rica has not concluded a treaty of amity and commerce.

No governmental authorization is required for the organization and operation of business. Every enterprise must employ not less than 90 per cent Costa Rican workers and employees who must receive at least 85 per cent of the total annual wage and salary payments.^{2/} However, the Government has the power to reduce these proportions to 80 and 75 per cent respectively. Managers and directors are not included in the limitations if there are not more than two such

^{1/} Inter-American Development Commission, A Statement of the Laws of Costa Rica, 1948, p. 12.

^{2/} Ibid., p. 26.

persons in the company.

Coal and petroleum deposits are the property of the State and a concession must be obtained from the Government to exploit such deposits.^{1/} As was mentioned above (page 7) a contract for oil development made in 1949 with the United States company was suspended due to opposition by the Constituent Assembly.

Extensive privileges may be granted to new industries which are deemed of benefit in the national economy. Such privileges may include tax exemption, reduction or elimination of import duties on machinery and imported raw materials, customs protection and a guarantee that no competing industry will receive similar advantages during a certain period of time.^{2/} It is also possible for new or existing enterprises to obtain special concession contracts from the Government, subject to approval by the Legislature. Public lands may be rented to Costa Ricans and foreigners provided 75 per cent of the land is used for the cultivation of major export products such as coffee, bananas, cacao.

Article 29 of the Constitution guarantees that property is "inviolable". Property cannot be expropriated except in the public interest and unless prior reimbursement has been made. During recent years the most important case of such action was the nationalization of the four major commercial banks, all of them owned by Costa Ricans. The share-holders were reimbursed with Costa Rican government bonds.

Foreign exchange regulations have been in effect since September 1931 and have been subject to numerous revisions since that time. In general, the exchange regulations have been complicated, at times combining quantitative import licensing with multiple currency practices. Exports require licence, which is readily granted provided the exchange is sold according to the rules established by the Exchange Control Board. Exceptions to this rule are provided in a number of contracts made with foreign investors; thus, the United Fruit Company is required to sell only that portion of foreign exchange which remains after deducting from the export proceeds the requirements for profits, depreciation and certain imports.

1/ Ibid., p. 60.

2/ United States Department of Commerce, op. cit., p. 7.

Since 1 April 1950, when the new Exchange Control Law became effective, imports are no longer subject to licensing but to a system of multiple exchange rates. The rate most favourable to importers is the Official rate with a surcharge of 10 per cent applied in the case of "preferential" goods. The basic rate applicable to other goods is the free rate - which in February 1951 attributed an exchange value to the colón that was 29 per cent lower than the official rate - with a surcharge computed at 10, 55, 75 and 100 per cent respectively of the official rate for the four categories into which such goods have been divided on the basis of "essentiality". The United Fruit Company is allowed to retain out of the proceeds of its exports the foreign exchange it requires for the import of goods belonging to the "preferential" and the "first" categories; it has, however, to pay the same exchange surcharges as other importers.

Costa Rican taxes do not discriminate between nationals of Costa Rica and foreigners, except that a tax of 1/2 per cent per annum is levied on profits earned by branches or agencies of any foreign company established in Costa Rica.^{1/} It is the policy of the Costa Rican Government to encourage the establishment of new enterprises by affording tax advantages.

In 1948 when the provisional Government announced that it was contemplating the establishment of several government-owned enterprises, a decree was issued requiring the payment of a 10 per cent tax levy on all private capital holdings of 50,000 colones (about \$9,000) and over. This levy, which was non-recurrent, was to be paid in ten annual instalments and was intended to provide funds to finance a programme of public works, including the improvement of the government-owned railway.

The concession granted in September 1930 to the United Fruit Company guaranteed the company against any increase in existing taxes and against the imposition of new taxes. The company agreed to pay the banana export tax of 2 cents per bunch. The company was also exempt from all import duties. In the amendment of 31 December 1949 to this concession, however, the original tax provisions were drastically modified.^{2/} Effective 1 January 1950 the United

^{1/} Inter-American Development Commission, *op. cit.*, p. 31.

^{2/} La Gaceta, Diario Oficial, San Jose, 31 December 1949.

Fruit Company agreed to pay:

- (a) A tax of 15 per cent on the net profits on all activities in Costa Rica, as provided by the income tax legislation enacted in 1949. (The calculation of net profits as submitted to the income tax authorities in the United States will be acceptable to the Costa Rican Government.)
- (b) The 10 per cent levy enacted in 1948 on capital not invested in the banana and abaca industries.
- (c) The property tax enacted in 1946.
- (d) The consular tax applicable to imports enacted in 1930, except on imports for the abaca industry.
- (e) The export tax on cacao enacted in 1948.
- (f) The charity tax enacted in 1932.

The Costa Rican Government, on the other hand, agreed not to raise any of these taxes or to levy new taxes.

The amended contract of 1949 also provides for the surrender of foreign exchange and for the right of expropriation (see above). The Costa Rican Government specifically agreed to pay just compensation in United States money prior to expropriation in case such action would be necessary for public service establishments of recognized necessity.

The Government does not compete with private business except in three fields where monopolies have been created, namely the production of distilled alcohol and liquors, the manufacture and importation of salt, and insurance underwriting. Governmental match and gasoline monopolies existed till the middle thirties; at that time, they were turned over to private interests.^{1/}

The Costa Rican tariff is primarily of a revenue character. However, in recent decades tariff protection has been established for certain industries. Numerous newly established domestic and foreign concerns have been granted freedom of duty on machinery and raw materials.

^{1/} United States Tariff Commission, Economic Controls and Commercial Policy in Costa Rica, Washington, 1945, p. 14.