RESEARCH REPORT

JANUARY 2003

# Successful Integration into the Global Economy: Costa Rica and Mauritius

NATHAN
ASSOCIATES INC.
www.nathaninc.com

**SUBMITTED TO**
USAID/Washington

**SUBMITTED BY**
Nathan Associates Inc.
TCB Project

**UNDER CONTRACT NO.**
PCE-I-00-98-00016-00, Task Order 13

RESEARCH REPORT

JANUARY 31, 2003

# Successful Integration into the Global Economy: Costa Rica and Mauritius

SUBMITTED TO
USAID/Washington

SUBMITTED BY
Nathan Associates Inc.
Support for Trade
Capacity-Building Activities
Arlington, Virginia

PREPARED BY
James W. Fox

UNDER CONTRACT NO.
PCE-I-00-98-00016-00, Task Order 13

Sponsored by USAID's Bureau of Economic Growth, Agriculture and Trade (EGAT) and implemented by Nathan Associates Inc., the Trade Capacity Building (TCB) Project, 2001–2004, helps developing countries assess their trade constraints and prioritize their trade-related technical assistance needs. The project provides trade experts for short-term technical assistance in developing countries and assists USAID Missions in designing, implementing, monitoring, and evaluating technical assistance that will stimulate economic growth and reduce poverty. Electronic copies of reports and materials related to trade needs assessments, resource guides, and trade training workshops are available at www.tcb-project.com. USAID Missions and Bureaus may seek assistance and funding for activities under this project by contacting John Ellis, USAID/EGAT, TCB Project Task Manager at jellis@usaid.gov.

For further information or for hardcopies of publications, please contact

Erin Endean
Nathan Associates Inc.
Chief of Party, TCB Project
eendean@nathaninc.com

This report was made possible through support provided by the United States Agency for International Development under the terms of Contract No. PCE-I-00-98-00016-00. The opinions expressed herein are those of the authors and do not necessarily reflect the views of the United States Agency for International Development.

# Contents



## ILLUSTRATIONS

### Figures



### Tables

# 1. Introduction

Costa Rica and Mauritius have experienced dramatic growth in exports over the past three decades. They have done this mainly by finding new export products to supplement their traditional agricultural exports—coffee and bananas for Costa Rica and sugar for Mauritius—and shifting from export of agricultural products to export of manufactures and services. From 1970 to 2000, exports from Mauritius grew from $98 million to $2.8 billion, and exports from Costa Rica grew from $281 million to $7.45 billion. Over the period, this represents a nearly 26-fold increase in exports, about a 6-fold increase in constant dollar terms. In both countries, major improvements in indicators of well-being—GDP per capita, life expectancy, and poverty rates—accompanied the boom.

Most developing countries have sought to achieve such growth, though most made only modest progress over the same period. Each country is unique, and what worked for Costa Rica and Mauritius two decades ago may not work for a country seeking rapid growth today. Nevertheless, some characteristics of both countries contributed to their success and appear to be broadly applicable. Both Cost Rica and Mauritius

- Had democratic institutions that were seen as fair and representative and provided broad-based education and health services to the population;
- Maintained sound macroeconomic policies, including an appropriate exchange rate;
- Attracted foreign investment into exports by offering a favorable environment; and
- Continually worked to increase their ability to compete in world markets by steadily reducing administrative obstacles to imports and exports, striving for efficient and competitively priced infrastructure, promoting specialized support services for exporters, and providing exporters with access to inputs at world prices.

In this report we explore why Costa Rica and Mauritius succeeded when others did not and what lessons can be drawn from that success. Section 2 provides development overviews of the two countries. Section 3 describes the growth and transformation of exports in each country. Section 4 describes the policy and institutional characteristics that contributed to the success. Section 5 examines reasons for the success, and provides policy recommendations for other small developing countries.

# 2. Development Overview

## Costa Rica

During colonial times, Costa Rica was the poorest of the five Central American provinces, lacking both significant mineral wealth and a large indigenous population to work the land for Spanish overlords. The small indigenous population had been killed, assimilated, or driven into remote corners of the province. The population thus consisted of a relatively homogeneous collection of small farmers and merchants of Spanish origin until Jamaican workers immigrated to Costa Rica during construction of the country's first railway in the 1880s. Descendents of the Jamaican workers remain concentrated along the Atlantic coast. With land for all in the early days, the society was egalitarian, described by one observer as an "equal distribution of poverty" (Gonzalez-Vega and Cespedes 1993, 387). Most of the population was illiterate at Independence, but education was widely supported and primary education was made compulsory in the 1870s.

The introduction of coffee around 1830 created the first opportunity for prosperity, and the building of the railroad led to banana cultivation and a second export crop. Still, by the end of World War II the country remained poor and relatively isolated. No all-weather road connected the country's central valley, where most people lived, with neighboring countries or the Atlantic coast.

The country's long democratic tradition was interrupted in the 1940s by a questionable election, leading to the 1948 revolution that set the broad parameters for the next half century: a welfare state, with government support for education and health, government ownership of banks, electricity distribution, and telecommunications, and the abolition of the national army. The creation of an independent electoral commission laid the basis for scrupulously fair elections—usually leading to alternation of executive power between the two leading parties—for the rest of the century.

The completion of the Pan-American Highway in the 1950s provided the backbone of a national roads system, and the rapid expansion of government-provided electricity, telephone, and water services changed the face of the country. Export prices were favorable during the first two decades of the post-World War II period, and local manufacturing grew rapidly during the 1960s after Costa Rica joined its four neighbors to establish the Central American Common Market (CACM). Because Costa Rica had the best educated labor force in the region, it attracted substantial foreign investment aimed at the CACM market.

## Mauritius

With an area of about 720 square miles, Mauritius was an uninhabited island in the Indian Ocean until the 16th century, when the Dutch temporarily, and later the French permanently, established settlements there. By 2000, it had a population of 1.1 million. Its most notable natural feature was the dodo bird, which was driven to extinction in the 18th century by settlers. The French established sugar plantations and imported Africans to work the land. In 1810, the British conquered the island, but chose to leave the status quo untouched. French planters and shopkeepers continued their economic dominance. English became the official language of government, but French remained the language of business. Today, most educated Mauritians are bilingual, speaking English and French. They also speak Kreol, a French dialect.

After the abolition of slavery in 1835, the resistance of former slaves caused labor shortages that led to the importation of indentured servants from India. By the late 1850s, Mauritius was the largest source of sugar for the British market, accounting for 7.4 percent of world sugar production. The Indian population grew rapidly, with a net inflow of nearly 300,000 people between 1835 and 1900. People of Indian descent now constitute more than 60 percent of the population.

The country had substantial self-government as a British colony after 1948, and gained full independence in 1968. Some, especially Franco-Mauritians, feared that independence would bring political domination by Indians and nationalization of the sugar plantations, but neither happened. Except for a short period after 1982, no single political party has ever been able to gain control of the parliament, so political control has depended on negotiating among ever-shifting coalitions of religious, ethnic, and economic groups. Literacy was almost universal in the country well before independence.

In 1961, Nobel economist James Meade forecast a Malthusian nightmare for Mauritius (including a population of 3 million in 2000) unless the country developed labor-intensive manufactures for export markets. Meade's advice was ignored at first, though a ministry for emigration was established to promote departures from the island. To create jobs, legislation in 1962 encouraged import-substituting industries by offering them protection from imports. A few thousand jobs resulted, but the small size of the domestic market prevented this approach from becoming a sustainable process. By 1970, with a national unemployment rate approaching 20 percent, Mauritian leaders were willing to give export-oriented manufacturing a second look.

Overall, Mauritius is a smorgasbord of conflicting ethnicities, interests, religions, and languages. The Indian majority is three-quarters Hindu and one-quarter Muslim. The substantial population of African descent is mostly Catholic and Francophone. The small group of Franco-Mauritians has much wealth derived from their traditional ownership of sugar plantations and subsequent diversification. Chinese make up only 3 percent of the population, but are very important in the Export Processing Zone (EPZ) and as owners of small shops and restaurants.

# 3. Trends in Exports, 1970–2001

## Costa Rica

Costa Rica's export base has widened gradually. Coffee and bananas were long the staple exports, but beef and sugar exports grew rapidly from a zero base in the 1960s, the latter after gaining preferential access to the U.S. market when the large Cuban quota was reallocated. Costa Rica also joined the CACM in 1961, which led to a two-decade boom in exports of manufactured goods to other Central American countries.

While the CACM was the most successful regional integration scheme among developing countries during the 1960s, it failed to nurture "infant" industries that became competitive on world markets. In her analysis of countries or regions with high external tariffs, Anne Krueger (1991) explains this failure by emphasizing two factors: the greater profitability of production for the domestic market over exporting, and the inability of firms to export if they lack access to raw materials of price and quality comparable to that available on world markets. Keesing and Singer (1990) emphasize the perspective of the entrepreneur, arguing that businessmen producing behind high tariffs learn three lessons that make them unfit to compete in world markets: that quality doesn't matter, that meeting delivery schedules is unimportant, and that packaging and product presentation are of little consequence. In short, firms in the CACM never shifted from production for the internal market to exporting because they were spoiled as infants, and therefore unable to grow into self-reliant adults.

Figure 1 and Table 1 provide an overview of Costa Rican exports from 1970 to 2000.[1] In 1970, the four traditional primary products of coffee, bananas, sugar, and beef accounted for 61 percent of all goods and services exports. The CACM accounted for another 17 percent, almost entirely manufactured goods. Because that export market has traditionally been

[1] Costa Rican trade statistics differ from usual compilations by including services and estimates of EPZ exports. The latter were included in official export statistics only after 1991. Including the gross value of such products, with their large import content, inflates export numbers, but this inflation is often a matter of degree rather than kind in comparison with other exports. Import content of CACM exports is estimated to have been as high as 50 percent, and that of banana exports 35 percent.

protected from world prices and competition, exports to it are artificially high and treated as a separate category. These two categories continued to grow somewhat during the 1970s, but stagnated in real terms between 1980 and 2000.

**Figure 1**

*Costa Rican Exports, 1970–2000*

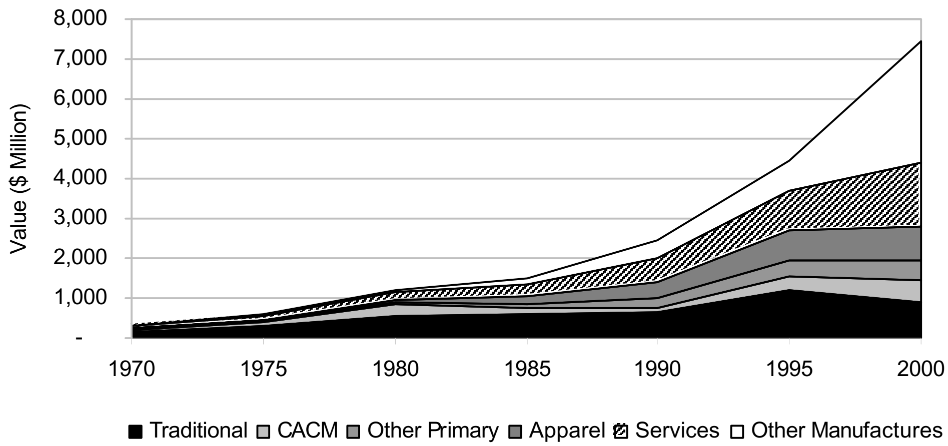


**Table 1**

*Costa Rican Exports, 1970–2000, by Major Product Category*

| Product Category | 1970 | 1975 | 1980 | 1985 | 1990 | 1995 | 2000 | |
|---|---|---|---|---|---|---|---|---|
| VALUE ($ MILLION) | | | | | | | | Growth Rate 1975-2000 (%) |
| Traditional | 168 | 316 | 567 | 591 | 634 | 1,187 | 878 | 4 |
| Other primary | 13 | 30 | 82 | 120 | 250 | 427 | 527 | 12 |
| Apparel | 3 | 11 | 40 | 217 | 380 | 757 | 827 | 19 |
| Other manufactures | 1 | 30 | 46 | 155 | 449 | 755 | 3,061 | 20 |
| CACM | 46 | 107 | 270 | 143 | 135 | 350 | 558 | 7 |
| Services | 50 | 112 | 194 | 275 | 609 | 969 | 1,600 | 11 |
| Total, goods | 231 | 493 | 1,006 | 1,226 | 1,848 | 3,476 | 5,850 | 10 |
| Total, goods and services | 281 | 605 | 1,200 | 1,501 | 2,457 | 4,445 | 7,450 | 11 |
| SHARE (%) | | | | | | | | Share Change 1970-2000 (%) |
| Traditional | 60 | 52 | 47 | 39 | 26 | 27 | 12 | -48 |
| Other primary | 5 | 5 | 7 | 8 | 10 | 10 | 7 | 2 |
| Apparel | 1 | 2 | 3 | 14 | 15 | 17 | 11 | 10 |
| Other manufactures | 0 | 5 | 4 | 10 | 18 | 17 | 41 | 41 |
| CACM | 16 | 18 | 23 | 10 | 5 | 8 | 7 | -9 |
| Services | 18 | 19 | 16 | 18 | 25 | 22 | 21 | 3 |

*Source: Central Bank of Cost Rica, IMF, and World Bank.*

*Note: Before 1992, Costa Rican export statistics excluded EPZ exports. The official data have been adjusted to include them in earlier years. Traditional exports include coffee, bananas, sugar, and beef.*

Following several years of stagnation after 1980, exports of other products and services began to rise rapidly. Apparel exports from newly created EPZs grew 30 percent per year. Tourist visits to Costa Rica began to rise rapidly after the country was marketed as an environment-friendly destination. And a variety of other products—cut flowers, ornamental plants, melons—began to emerge as rapidly growing export products. Various services, including computer programming and cosmetic surgery, also became sources of export earnings. By 1995, the variety of Costa Rican exports outside of Central America (mostly to the United States) was dramatically larger than it had been in 1983.

Costa Rican exports of apparel began to stagnate by 1995 as new foreign investors in the sector shifted to Costa Rica's Central American neighbors. This repeated a pattern that started with coffee exports in 1830, when Costa Rican export niches were imitated by its neighbors, who had lower wage rates. Between 1995 and 2000, Central American exports of apparel rose by $2 billion. While apparel firms established in Costa Rica did not flee the higher wages paid to Costa Rican workers, all incremental investment in the sector did flow to the lower-wage countries.

While apparel exports stagnated, other manufactures provided growth and variety. The country's EPZs were manufacturing other products, and exports of non-traditional agricultural products continued to grow rapidly. Beginning in 1998, the largest new export industry was computer chips fabricated by Intel. These exports reached $1 billion in 2000, dwarfing all other products in gross export value.

The impact of the Intel plant is evident in the rapid growth of non-apparel manufactures, but it was not an isolated case (see Figure 1). Some other manufacturing sectors as well as services also grew rapidly. By 2000, the traditional standbys of coffee, bananas, sugar, and beef had shrunk to only 12 percent of export earnings, down from 61 percent in 1970. And none too soon, for world coffee prices collapsed shortly afterward. By 2002, world coffee prices were less than half of their 2000 level, with no prospect of an early recovery. But Costa Rica, with its diverse economy, was little affected. Three decades earlier, such a price collapse would have been catastrophic.

## Mauritius

In the 19th century, the prosperity of Mauritius ebbed and flowed with the price of sugar in the protected markets of developed countries to which Mauritius had preferential access. This pattern was complicated by periodic tropical storms that would destroy some or much of the crop. In 1950, sugar represented 96 percent of exports; by 1970 total merchandise exports were $69 million, of which 92 percent, or $63 million, was sugar. Export diversification was occurring, but very slowly. The volume of sugar exports was stable because all arable land had been planted in sugar for decades.

Over the next three decades, the volume of sugar exports stagnated, but the country developed important new sources of comparative advantage. Figure 2 and Table 2 show the commodity composition of Mauritian exports from 1970 to 2000 in four categories: sugar, the EPZ, other goods, and services. As indicated in Table 2, total exports of goods and services grew dramatically, rising from $89 million in 1970 to $2.8 billion by 2000.[2]

**Figure 2**

*Mauritius Exports, 1970–2001*

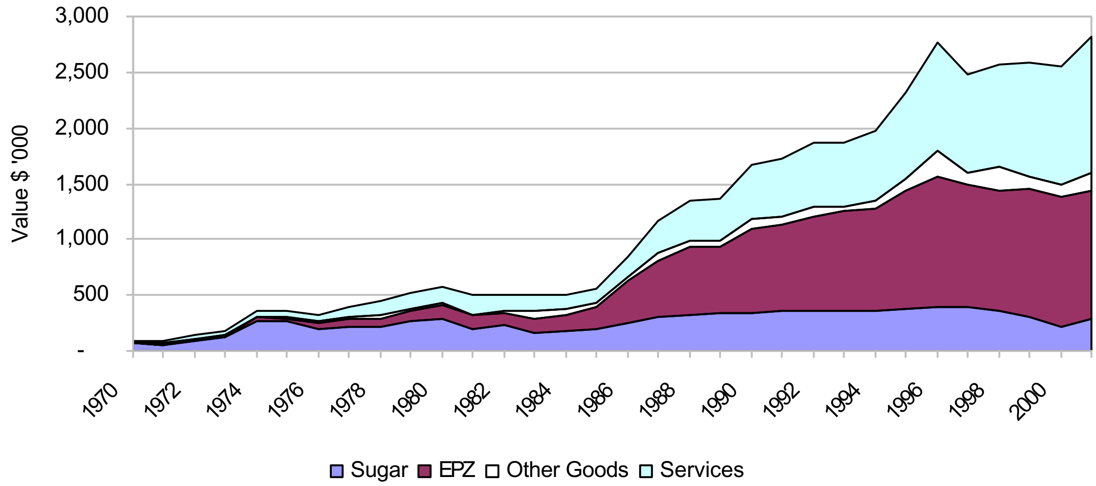


**Table 2**

*Mauritius Exports, 1970–2000, by Major Product Category*

| Product Category | 1970 | 1975 | 1980 | 1985 | 1990 | 1995 | 2000 | |
|---|---|---|---|---|---|---|---|---|
| VALUE ($ MILLION) | | | | | | | | Growth Rate 1975-2000 (%) |
| Sugar | 63 | 261 | 296 | 192 | 337 | 384 | 211 | -1 |
| EPZ | – | 33 | 116 | 212 | 768 | 1,050 | 1,179 | 15 |
| Other goods | 6 | 12 | 19 | 32 | 71 | 104 | 97 | 9 |
| Services | 29 | 80 | 145 | 148 | 484 | 778 | 1,071 | 11 |
| Total exports | 98 | 386 | 576 | 584 | 1,660 | 2,316 | 2,558 | 8 |
| SHARE (%) | | | | | | | | |
| Sugar | 64 | 68 | 51 | 33 | 20 | 17 | 8 | |
| EPZ | 0 | 9 | 20 | 36 | 46 | 45 | 46 | |
| Other goods | 6 | 3 | 3 | 5 | 4 | 4 | 4 | |
| Services | 30 | 21 | 25 | 25 | 29 | 34 | 42 | |
| Total exports | 100 | 100 | 100 | 100 | 100 | 100 | 100 | |

[2] For both countries, we focus on exports of goods and services. The latter, often ignored in export statistics, are becoming an increasingly important part of world trade. For both Mauritius and Costa Rica, tourism is the most important service export, but computer-related services and financial and medical services also offer earnings, albeit smaller. Unfortunately, statistics on service exports are sparse.

After 1975, the value of sugar exports stagnated, and its share of the total fell from 72 percent to 10 percent. The two export categories responsible for the dramatic change in the country's export capabilities were the EPZ and services. As Table 2 shows, Mauritius experienced two distinct stages of expansion. During the early years, the EPZ was the fastest growing segment, rising from zero in 1970 to 42 percent by 1990 (and 42 percent in 2000). After 1985, services were the fast-growth sector, rising from 21 percent to 38 percent of total exports between 1985 and the millennium.

Export diversification began in 1971 with the establishment of the Mauritius EPZ. Export growth from the zone was spectacular, growing from $1 million in 1971, to $116 million in 1980, to $721 million by 1990, and to $1 billion by 1995. Thereafter, EPZ exports leveled off, growing only slightly to $1.1 billion by 2001.

Initially, EPZ exports were almost entirely apparel. Apparel as a share of the total has since fallen slowly, to 96 percent in 1986 and to 82 percent in 2000–2001. The import content of EPZ exports has also fallen steadily, from perhaps 80 percent in the early years to just below 50 percent by 2001. For apparel, Mauritius has changed from a recipient of foreign investment (mostly from Hong Kong) to an investor in apparel production in other countries, notably Madagascar and Mozambique.

The EPZ provided a means for solving Mauritius's serious unemployment problem without generating political conflict. Its strong labor unions and strong labor legislation, which mandated high minimum wages, limits on worker layoffs, and high fringe benefits, posed an obstacle to foreign investment in export-oriented production. Exempting women workers in the EPZ from most of the labor legislation helped EPZs bring women into the country's labor market. The later expansion of the EPZ solved, at least temporarily, Mauritius's unemployment problem. Unemployment fell from 20 percent in 1970 to less than 3 percent in 1991. Unemployment rose in the 1990s, but not because of lack of job creation. Immigrants continued to flow into the country from abroad to work in low skill jobs.

After 1990, services replaced the EPZ as the dynamic sector. Tourism was the largest earner of foreign exchange, with Mauritius successfully marketing itself as an upscale destination. Offshore banking also became an important sector. With good financial regulation and the large ethnic Indian population, the country provided a platform for investment in India and for offshore investment by Indian nationals. Information technology also began to be a significant sector, again with a connection to India, and an information technology-based industrial park is scheduled to open in 2003.

As with Costa Rica, the traditional export sector shrank dramatically between 1970 and 2000, from 71 percent of exports to 10 percent. Export diversification reduced the country's vulnerability to the vagaries of industrial countries' sugar policy. And the country's reputation as a sophisticated center for investment and offshore operations offered possibilities for continued movement into higher value activities.

# 4. Policies and Institutions of Export Empowerment

Costa Rica and Mauritius clearly achieved what most LDCs want—a dramatic change from production of one or a few primary products to competitive production of manufactures and services in world markets. What policies and institutions contributed to this achievement? Costa Rica and Mauritius followed broadly similar policies during the period under study. Both sharply devalued their currency around 1982 to improve competitiveness in exports and to align local labor costs with worker productivity. After 1982, both followed broadly conservative fiscal and monetary policy, offering the business community a stable economic environment. Both countries took steps to reduce bureaucratic red tape and encourage foreign investment. In both countries, an import-substitution manufacturing sector protected from world prices co-existed with another manufacturing sector that depended entirely on its capacity to export to world markets at world prices.

## Costa Rica

Before 1970, Costa Rica had had long experience with new export development. In 1970, policymakers concluded that the country's performance was satisfactory on the basis of a decade of high commodity prices, development of the new export products of sugar, beef, and manufactures to the CACM, and the prospect of becoming a major exporter of bauxite.[3] At that time the government created an export promotion office to develop more export products and two government-owned EPZs.

With the export problem apparently solved, successive Costa Rican governments spent the next decade on internal problems—extending the welfare state, creating a new government institution to invest in and promote industry, and ensuring that the benefits of the rapid economic growth were widely distributed, under the leadership of a beneficent government.

---

[3] Despite investment of substantial government resources this possibility never was realized.

Rapid economic growth, however, did not occur. International commercial banks were happy to lend to Costa Rica to bridge the growing gap between its exports and imports, particularly after banks became recyclers of OPEC "petrodollars." One by one, export prospects began to wilt, slowly, then quickly. Meanwhile, external debt grew. The full crisis began in 1979 when the United States decided to stop inflation using tight monetary policy. Commodity prices fell and interest rates rose from 6 percent to 16 percent almost overnight; Costa Rica borrowed at variable rates based on the London InterBank Offered Rate (LIBOR). Costa Rica found itself bankrupt. For several years thereafter, the government in power failed to face the crisis. Unwillingness to devalue the currency in the face of high and rising inflation led to controls on imports, shortages, and capital flight by those fortunate enough to obtain dollars. The depth of the crisis and the evident failure of the government to address it produced a broad consensus that different policies were needed.

In 1982, a "leftist" government supplanted its conservative predecessor in Costa Rica. It sharply devalued the currency, agreed with the IMF on a stabilization program, and began to seek ways to pull the country out of its crisis. The consensus was that the state-led and CACM-oriented policies of the past had failed, that prospects for traditional exports were poor, and that new export products were needed.

Because foreign investment was needed to bring world-market technology to the country, Costa Rica revised its legislation to increase incentives for foreign investment and for export production. The law allowing for EPZs was liberalized, and other provisions to encourage foreign investment and exports were legislated.

In 1984, a private-sector led investment and export promotion institution—the Coalition to Promote National Development and Exports (CINDE)—was established after discussion among Costa Rican businessmen, politicians of both major parties, and USAID. Largely funded by USAID, CINDE promoted foreign investment, encouraged domestic Costa Rican firms to export, and provided training to businesses interested in exporting. The high quality of CINDE's leadership and staff, its independence from government rules for paying and retaining staff, and its goal-oriented monitoring of performance, made it extremely effective in promoting foreign investment.

Initially, about 90 percent of the firms attracted to Costa Rica were apparel firms interested in using Costa Rica as a platform to avoid quotas on exports to the U.S. market. The conventional wisdom is that firms in the apparel trade from EPZs will relocate quickly if wages or other costs begin to rise. But the industry did not leave Costa Rica despite a rapid increase in wages and enormous growth in apparel exports by Costa Rica's neighbors from 1982 to 1992. Instead, production reached a plateau in the early 1990s and stagnated. It is likely that the benefits of an established location and a trained labor and supervisory force outweighed the benefits of shifting production to lower-wage countries. But higher wages appear to have discouraged new entrants.

Even as foreign investor interest in apparel flagged, the country began to be able to attract investors in other manufacturing sectors. Apparel exporters had overcome many of the problems facing exporters from Costa Rica in general. For example, between 1982 and 1990

- The number of cargo flights to the United States increased from 9 to 28 per week;
- Changes in government procedures eased exporters' paperwork processing burden;
- Many firms supporting exporters with specialized documentation and packing services were established;
- Contractual arrangements providing clear rules for liability for spoilage en route between producers and shippers were developed; and
- Producers established industry associations in a number of sectors, increasing information flow and making possible cooperative approaches to marketing.

By 1990, these changes reduced the risk and the cost of exporting, making it much easier for a new firm to begin to export. In economists' terms, the initial growth in exports provided "external economies" to later exporters. From the perspective of the country, the essential feature was increasing returns to scale of export. Each time that exports increased, further increases became easier, and more possibilities for future exports opened up.

So far, the culminating proof of these increasing returns to scale was the locating of an Intel chip fabrication plant in Costa Rica in 1995. This $300 million plant employs 3,500 Costa Ricans and is by far the country's largest exporter. In attracting Intel, Costa Rica competed against Mexico, Brazil, Chile, Indonesia, and Thailand. The Costa Rican fabrication plant is Intel's first in Latin America.

A decade earlier locating a plant in Costa Rica would have been inconceivable. Why was Intel attracted to Costa Rica? In the previous decade, Cost Rica had greatly improved its capacity to produce for world markets, promote investment, and satisfy foreign investors, especially with additional infrastructure. For example, Intel wanted its high-value chips routed to their destinations as their manufacture was completed, requiring 12 flights daily to the United States. Without the growth in air traffic over the previous decade arising from increased shipments of cut flowers, apparel, and other new exports, and from the increased tourist flow to Costa Rica, Intel would not have considered locating its plant there.

## Mauritius

By the end of the 1960s, it was clear that import substitution would not revive Mauritius's stagnant export base or generate employment. Yet the proposal put forth by Meade and orthodox economists—eliminating import tariffs to make Mauritius a free-trade based economy—was even less feasible than in 1962. The import substitution firms created since 1962 had several thousand workers. The political power of the labor unions representing these workers and of the owners of the companies was too strong to make any general trade liberalization feasible.

In 1969, the country sent a study team to Hong Kong, Taiwan, Singapore, Jamaica, and Puerto Rico to study export-oriented production. The team's report led the government in 1970 to propose a Mauritian EPZ. The legislation passed that year provided the usual exemption from taxes for EPZ firms and exempted them from national minimum wage laws and from labor unions. Firms in Hong Kong producing apparel were attracted by the prospect of a stable offshore platform for exporting to Europe.

The EPZ grew rapidly, with employment rising to 22,000 by 1980. During the 1970s, one-third of all net employment creation was in the EPZ. During this period, sugar prices rose spectacularly, quadrupling export earnings from sugar between 1970 and 1975. As in Costa Rica, politicians took rapidly growing export earnings and general prosperity to mean that government spending should increase and that wage increases should be imposed on employers.

The world recession of the late 1970s hit Mauritius hard. Employment stagnated in the EPZ and declined in the rest of the economy. The country implemented IMF and World Bank structural adjustment programs, returning to growth by 1983. The programs included the usual fiscal and monetary reforms. The World Bank also sought a reform of trade policy, but only modest progress was made in that area. The Mauritius Export Development and Investment Authority (MEDIA) was established in 1984 (the same year as CINDE) and this organization became an efficient tool for attracting foreign investment and improving the domestic conditions faced by new investors. Improvements in procedures for foreign investors and exporters and infrastructure upgrading appear to have steadily reduced the costs of exporting.

With these policy and institutional improvements, employment in the EPZ exploded during the next few years, rising from 23,000 in 1982 to 91,000 by 1990. Large numbers of new workers, mainly women, entered the labor force. Employment rose by 41 percent, or 80,000 workers, over this period, with the EPZ accounting for 84 percent of additional jobs. Reforms in labor legislation made employment of men in the EPZ economically possible, so the share of EPZ jobs held by men rose from about 10 percent during the 1970s to 35 percent by 1990.

As in Costa Rica, the increased volume of trade led to more frequent shipping, infrastructure improvements, establishment of service providers in the export and import trade, better financial services, and a wide range of expertise in trade-related matters. Mauritius also embarked on a campaign to make the country a preferred tourist destination, marketing itself as a high-end and exotic destination. To support this approach, charter flights of tourists were not permitted.

The evidence that Mauritius could compete in world markets, together with the considerable wealth accumulated by successful exporters, led more Mauritian entrepreneurs away from import substitution and to exporting. Over time, the share of EPZ firms owned by Mauritians gradually rose, reaching about 40 percent by 2000. The close link between exports and economic growth in the country has also caused government to continually seek ways to support the industry by improving infrastructure and procedures. As in Costa Rica, this appears to have created a virtuous circle. Increases in exports have led to improvements in the environment for exporting, making further increases in exports easier.

The process of identifying future directions for growth has been experimental. For example, some Mauritian apparel exporters found compelling the theoretical argument that firms should "move up the value chain" by developing their own brand. These firms expected higher margins from this move into marketing. According to Gibbon (2000), this approach worked better in theory than in practice, for it led firms away from their basic competence. Rather than move up the value chain, Mauritian firms found it more profitable to move horizontally to larger production by setting up additional factories in other countries.[4]

---

[4] Madagascar and Mozambique are the most favored locations for new offshore production.

# 5. Lessons from Export Success

It is easy to identify the characteristics of successful countries and then conclude that other countries can attain similar success by copying these characteristics. Each country, however, is unique in a variety of ways, and identifying particular qualities that produce success or failure is fraught with risk, even for the most sensitive observer. The risks are even greater for economists who restrict comparisons to quantifiable indicators. Moreover, the world is not a laboratory wherein the results of an "experiment" conducted in 1983 can be replicated in 2003. In 1983, for example, EPZs had a promising future because few countries were taking advantage of the Multi-Fibre Agreement (MFA). In 2003, with the MFA set to expire and many more countries seeking to become export platforms, EPZs are no longer a certain path to prosperity. Consequently, recommendations must be offered with caveats and implemented with caution. It may be useful, therefore, to identify a few similarities and differences between Costa Rica and Mauritius before proceeding to recommendations.

## Comparison of Costa Rica and Mauritius

### SIMILARITIES

- ***Macroeconomic Stabilization***. Both countries began to move toward rapid, sustained export and economic growth in 1982–1983, with orthodox stabilization programs supported by the IMF. In the two decades since, both countries have maintained stable real exchange rates, controlled government spending, and provided more scope for the private sector.
- ***Export Processing Zones.*** EPZs were important to Costa Rica and Mauritius, especially the structure of rules that led to their success. EPZs were first established in both countries about 1970. In Mauritius, firms operating anywhere on the island could qualify for the EPZ and a variety of legal requirements (most notably labor legislation) were suspended for the EPZ. In contrast, Costa Rica's first two EPZs were government-owned, located away from the country's industrial and population center, and decidedly not responsive to the needs of potential investors. This effort was a failure. Only in the early 1980s, when new legislation

allowed private EPZs and permitted individual factories to become EPZs under more liberal rules (as in Mauritius), did the EPZs begin to be effective.

- ***Foreign Investment Promotion***. Both countries used foreign investment heavily, but sensibly. Environmental concerns were taken into account in promoting tourism in both countries, and the environment was used as a tourist attraction in Costa Rica.
- ***Democracy.*** From 1970 to 2000, Costa Rica and Mauritius (except for a period in Mauritius in the early 1970s) were intensely democratic and respectful of political opposition, the rights of free speech and press, and, in general, the rule of law.
- ***Small Size.*** Costa Rica's population is 4 million and Mauritius has slightly more than 1 million. Such small states may be more flexible than larger ones, given that regional differences will tend less to cloud understanding of the country's national interest. At the same time—as both countries demonstrated in the 1970s—small countries cannot afford bad government. Weak policies quickly give rise to national crises.
- ***"Welfare State"-ism.*** The political culture of both countries emphasized the government as distributor of benefits to the electorate. This strengthened support for government, but also led to expansive government programs during prosperity, leaving the country less prepared to face downturns in external markets.
- ***Pragmatism***. In both countries, real progress occurred in 1982, when the government was more socialist than its predecessor. Because they were unable to export enough to pay for imports, both countries were facing serious national crises and rising external debt. Leaders in both countries adopted market-oriented policies as the only way out of crisis.[5]
- ***Large Foreign Aid Flows.*** Both countries have received significant amounts of foreign aid, each using its democratic tradition and other tools to encourage donor largesse. Costa Rica received massive assistance from the United States during the 1980s. Mauritius had more diverse sources. The county marketed itself for both aid and market access as a former colony of France as well as England, and as an African and Indian Ocean country. It is the largest recipient of foreign aid from India.
- ***Pushing the Limits***. Both countries suffered near-catastrophe when government spending in support of the welfare state expanded rapidly during boom periods. Adjustments for the inevitable downturns were difficult. Both countries were able to adjust because of the strength of their political institutions.
- ***Muddling Through***. While both countries have successfully addressed crises, they have never developed comprehensive and consistent policies. Rather, the political compromises required to achieve consensus seem always to leave reform incomplete (and unsatisfying to external donors promoting reforms).

---

[5] In Mauritius, the prime minister was described as socialist with Thatcherite policies. See Wellisz and Saw, 1993.

- ***Cultural Outlook.*** In neither country did an indigenous population influence the national culture. The dominance of European cultural values may have increased receptivity to experimentation and to integration into the world economy. In the 1960s, both countries experienced some of the sharpest declines in fertility in the developing world. The fertility rate (i.e., the average number of children per woman during her life) fell from 6 to 3 in Mauritius and from 7 to 4 in Costa Rica between the late 1950s and the early 1970s. This dramatic change suggests that the populations of both countries underwent a rapid shift in cultural values.
- ***No Army.*** Costa Rica abolished its army after the revolution of 1948. Mauritius never had one following Independence. This may have removed one source of political instability.
- ***But Progress Has Been No Panacea.*** The obvious success of the two countries compared to their neighbors over the last several decades has not brought popular contentment with progress. In both countries, dissatisfaction with wage levels (though wages are far higher than two decades ago), with the quality of government services, with the rate of growth of the economy, and with the honesty of politicians and businessmen is widespread.

### DIFFERENCES

- ***Political Systems.*** Costa Rica and Mauritius are both democratic, but their political systems are sharply different. In Costa Rica's presidential and two-party system, the president usually represents a majority of the voting electorate, but may serve for only one four-year term. In most cases, parties alternate in power. In Mauritius, the multiparty parliamentary system prevents any single party from gaining control except for brief periods. Shifting coalitions, however, have led to great stability in prime ministers. Only three people have held the office of prime minister since Independence. In each case, they kept power by gaining the support of a shifting coalition of parties.
- ***Cultural Diversity.*** Most Costa Ricans are united by a common language, religion, and cultural heritage. Mauritius has an extremely broad mix of cultures, religions, and languages.

## Conclusions

This review suggests five factors as key to the export success of Costa Rica and Mauritius:

- ***Good Governance***. Both countries have had democratic political systems that provided reasonable expectations that stability would be maintained and that the populations would view elections as fair.
- ***Economic Policy***. The quality of a country's economic policies—at the macroeconomic and sectoral level—is important. For export growth, the maintenance of a stable and realistic exchange rate is particularly important.

- ***Export Processing Zones.*** EPZs play a key role in preparing a developing country to participate in world markets. In Mauritius, EPZs also provided a means for solving an unemployment problem without attacking the status quo. Each country's openness to foreign investment for export was a critical ingredient of the EPZ's success. Nevertheless, it must be remembered that the success of the EPZs owed much to the system of quotas for apparel. With the end of such quotas due in 2005, the scope for use of EPZs as the leading edge in an export drive may be less.
- ***Long-term Vision***. The capacity of the political system to focus on long-term issues means that short-term politics do not undercut progress. Administrations were able to make commitments that were honored by subsequent administrations.
- ***Pragmatism and Willingness to Experiment***. The willingness of elites in the private sector and in government to experiment and to adapt to external conditions helps sustain success. The pragmatism of the private sector and of government in Costa Rica and Mauritius allowed both countries to move beyond initial export success from EPZs to new opportunities in other areas. Some were successful, and some were not. The role of investment and export promotion institutions appears to have been very important in spurring improvements in the countries' economies, and in marketing the countries to foreign investors.

More broadly, nothing succeeds like success. The results of new approaches sparked the interest and involvement of more entrepreneurs and encouraged government to nurture the export sector by seeking further ways to support it. The EPZs in Costa Rica and Mauritius may have been most important in making people see possibilities. The realization that small countries could produce something other than agricultural products that are competitive in world markets built the confidence necessary to experiment.

## Implications for Other Countries

What aspects of the experience of these two countries are relevant to other countries? We can draw three lessons:

### 1. ATTRACT EXPORT-ORIENTED FOREIGN INVESTMENT

Foreign investment was critical to the export drive of both Costa Rica and Mauritius, serving as the training vehicle for nationals to learn how to interact with the world economy. Export orientation is critical, for this is the skill most needed. For example, even though Costa Rica attracted much foreign investment in the 1960s, firms produced almost entirely for the domestic market and had little incentive to use efficient technology or to attend to costs, a focus critical in competitive world markets. Both countries had excellent institutions, staffed by professionals, to market the country, with close and effective links to policymakers.

## 2. MAINTAIN GOOD MACROECONOMIC POLICIES

A favorable exchange rate is the most critical variable for exporters, but sound macroeconomic policies in general are necessary for a predictable business environment. Trade liberalization is less critical, at least in the early years, as long as exporters have access to inputs at world prices.

## 3. SEIZE THE DAY

Costa Rica and Mauritius took advantage of preferential access to OECD markets, something available to nearly all other developing countries. Most failed to use the opportunity. In an important sense, export success seems to require making exporting important and doing what is needed to make exports grow. Initial success not only builds momentum but also serves as a basis for the learning and institutional changes that make further increases in exports possible.

# Bibliography


Alter, Rolfe. 1990. Export Processing Zones for Growth and Development: The Mauritian Example. Working Paper No. 90/122. Washington, DC: International Monetary Fund.

Bank of Mauritius. Various Years. *Annual Report*. Port Louis.

Bowman, Larry W. 1991. *Mauritius: Democracy and Development in the Indian Ocean.* Boulder, Colorado: Westview Press.

Dabee, Rajen and David Greenaway (eds.). 2001. *The Mauritian Economy: A Reader*. Houndmills, UK: Palgrave.

De Ferranti, David, Guillermo Perry, Daniel Lederman, and Willam F. Maloney. 2002. *From Natural Resources to the Knowledge Economy: Trade and Job Quality.* Washington, DC: World Bank.

Eriksen, Thomas Hylland. 1998. *Common Denominators: Ethnicity, Nation-Building and Compromise in Mauritius.* New York: Berg.

Fox, James W. 1990. Feedback Loops and Economies of Scale: Export-Led Growth in the Caribbean Basin. Staff Working Paper No. 2. Washington DC: USAID/LAC.

Fox, James W. 1998. Real Progress: Fifty Years of USAID in Costa Rica. Program and Operations Assessment Report No. 23. Washington, DC:USAID.

Dommen, Edward and Bridget. 1999. *Mauritius: An Island of Success.* James Currey: Oxford.

Gibbon, Peter, 2000. "Back to the Basics" through Delocalization: The Mauritian Garment Industry at the End of the Twentieth Century. Working Paper No. 7. Copenhagen: Centre for Development Research.

Gonzalez-Vega, Claudio and Victor Hugo Céspedes. 1993. Costa Rica in *Costa Rica and Uruguay: The Political Economy of Poverty, Equity and Growth.* Edited by Simon Rottenberg. Oxford Press for the World Bank.

Gulhati, Ravi and Raj Nallari. 1990. Successful Stabilization and Recovery in Mauritius. EDI Development Policy Analytical Case Study No. 5. Washington, DC: World Bank.

Keesing, Donald, and Andrew Singer. 1990. Development Assistance Gone Wrong: Why Support Services Have Failed to Expand Exports. Staff Working Paper No. 543. Washington, DC: World Bank.

Krueger, Anne, 1990. Asian Trade and Growth Lessons. *American Economic Review* 80:2, pp. 108-112.

Monge, Alexander. 2001. Exports and Foreign Investment in Costa Rica and El Salvador during the 1990s. Processed, Northwestern University.

Monge, Ricardo. 1998. Costa Rica's Experience in the Area of Export Promotion. *Integration and Trade*, 2:4-5, pp. 147-77.

Spar, Debora. Attracting High Technology Investment: Intel's Costa Rica Plant, FIAS Occasional Paper 11. Washington, DC: World Bank.

Subramanian, Arvind and Devesh Roy. 2001. Who Can Explain the Mauritian Miracle: Meade, Romer, Sachs, or Rodrik? Working Paper No. 01/116. Washington, DC: International Monetary Fund.

Teal, Francis. 1999. Why can Mauritius export manufactures and Ghana not? *The World Economy*, 22:7, pp. 981-93.

Wellisz, Stanislaw and Philippe Lam Shin Saw. 1993. Mauritius. In *The Political Economy of Poverty, Equity and Growth: Five Small Open Economies.* Edited by Ronald Findlay and Stanislaw Wellisz. New York: Oxford Press for the World Bank.

World Bank. 1995. *Mauritius Country Economic Memorandum: Sharpening the Competitive Edge.* Report No. 13215-MAS. Washington, DC: World Bank.