

## Research Articles

# Foreign Direct Investment in Costa Rica

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This paper examines the factors that drive foreign direct investment in Costa Rica and evaluates its broader macro and micro level impacts, specifically on infrastructure development and knowledge spillovers. Drawing from data between the years of 1995 and 2012, the study employs a statistical analysis to investigate how institutional quality and investment into infrastructure influence the attractiveness of Costa Rica and the inflows of foreign direct investment, along with whether FDI contributes to domestic productivity through the transfer of knowledge. Results show that there is a strong correlation between infrastructure development and increased FDI, even without consistent high-quality institutions. While foreign direct investment is positively correlated with government investment into education and research and development, its effect on productivity has less measurable outcomes. This suggests that FDI encourages investments into greater capacity for knowledge but does not automatically transfer into productivity gains. The study contributes to a deeper understanding of how an emerging market like Costa Rica can optimize the benefits of foreign direct investment.

### Introduction

Costa Rica, a country located in South America whose name means the “rich coast,” is a democratic country that gained its independence from Spain in 1821. Costa Rica is unique in that it abolished their military in 1949, so it relies on good allyships with neighboring countries for protection. In the last few decades, Costa Rica has flourished as a country, establishing itself as a leading destination for foreign direct investment in South America.

The country attracts investment from multinational corporations in major industries such as advanced manufacturing, medical devices, and technology. This attraction in Costa Rica is based on their unique institutional conditions that make the country successful for foreign direct investment. Costa Rica offers a stable political environment with minor corruption, as it is one of the longest-running democracies in South America. With a well-educated population, there is high human capital and a significant demand for skilled workers, especially in the technology sector. They have an extensive network of free trade agreements along with a government agency, called PRO-COMER, that promotes foreign investment. This type of investment is crucial for the country’s economic diversification and overall economic growth.

Costa Rica has had a long history of depending on just a few traditional exports for growth, such as natural resources and commodities. Relying on natural resources keeps an economy stagnant and forces a country to depend on something affected by uncontrollable factors like weather and natural disasters. Foreign direct investment has helped the country diversify its economy, no longer re-

lying on only a few exports for economic growth. In the past few decades, Costa Rica has created and maintained a favorable business environment for multinational corporations to invest in, having positive spillovers on both the home and host country.

The institutions within Costa Rica play a fundamental role in supporting economic development. Strong institutions can be characterized by transparency, fair legal systems, and efficient regulatory policies, those of which create a stable environment for economic stability. As Costa Rica is one of the longest-standing democracies in Central America, it has low levels of corruption and supports organizations that promote foreign investment. FDI interacts positively with strong institutions as businesses have more certainty in their investments and the benefits they receive. On the other hand, Costa Rica’s extremely bureaucratic environment can create weak institutions as laws are more inconsistent, and there are several hurdles to jump through. This can hinder how foreign direct investment views the environment within Costa Rica. The influx of FDI in Costa Rica encourages them to focus on the strength and sustainability of their institutions.

Businesses that invest their resources in other countries have a range of criteria that must be met to predict their success correctly. Costa Rica is a popular country for investment because of its political stability, number of incentives, commitment to sustainability, and a strong workforce. They also have several partnerships with other countries, making them more attractive to investors. For example, under the CHIPS and Science Act passed by the U.S., Costa Rica was designated as a key ally of the United States. This makes them more attractive to multinational corporations seeking

to manufacture microchips and medical devices (BBC, 2025).

Although Costa Rica has developed a favorable business environment for FDI, there are also a multitude of challenges that companies will face when investing. A large amount of competition comes from their surrounding neighbors, like Mexico, who also provide a reasonable environment for foreign direct investment. Costa Rica is a bureaucratic country, meaning that there are a lot of regulatory hurdles and red tape that companies must face. This paper will address questions such as what are the key factors that drive FDI growth in Costa Rica? What risks or barriers do these foreign investors face? How does their competitive landscape affect foreign businesses? We aim to understand the overall implications that foreign direct investment has on Costa Rica.

## Literature Review

Foreign direct investment in Costa Rica has been on the rise since the 1990's, when they were struck with a period of import substitution industrialization and the lost decade. Since then, they have focused on reforms that seek market-friendly policies. They have transitioned into a leading destination for multinational corporations, especially in high-tech and service industries. Extensive research has been conducted to help explain why Costa Rica is a favorable environment for foreign direct investment. Researchers have investigated the key factors that produce growth in FDI, barriers and risks to FDI, and the competitive landscape that can positively and negatively affect foreign businesses. This section of the paper aims to analyze literature related to foreign direct investment in Costa Rica.

Costa Rica's FDI has grown so significantly that in the 1970's, they saw FDI inflows of around 44 million annually, and by the late 1990s, this figure rose to 416 million annually. Just two years ago, in 2023, Costa Rica hit a milestone with FDI inflows totaling around 3.9 billion dollars. Researchers have investigated this significant growth, explaining how Costa Rica has become so attractive for FDI (Cordero & Paus, 2008, p. 6).

One of the leading factors pushing FDI in Costa Rica is political and institutional stability, a crucial factor in multinational corporations' decision-making. According to researchers Shuler and Brown (1999), what makes FDI so unique is that "it crosses the borders- and thus the institutions- of sovereign nations," meaning that institutions are one of the most important factors when deciding to invest (Schuler & Brown, 1999, p. 452). Since 1948, Costa Rica's constitution has "established a strong democratic state with relatively transparent institutions, competitive elections, and a solid social welfare," those which provide the legitimacy and stability that the Costa Rica government needs to gain FDI attractiveness (Schuler & Brown, 1999, p. 451). These researchers from Rice University believe that institutional structures for commerce could potentially constitute a location-specific advantage, "this location-specific institutional advantage represents an advanced factor for national competitiveness" (Schuler & Brown, 1999, p. 452).

Another key factor that researchers found to drive foreign direct investment in Costa Rica is incentives such as tax exemptions. In 1996, Costa Rica competed with several other countries for Intel Corporation to establish a semiconductor plant in their country. The Costa Rican government "offered asset and export tax exemptions, full exemption from taxes on profits for the first eight years, and infrastructure improvements," which allowed them to ultimately win over their competitors (Bailey & Warby, 2019, p. 67).

However, these researchers found that this competitive landscape "does not always favor the foreign investor" (Bailey & Warby, 2019, p. 67). When a Canadian mining company sought to develop a site in the early 2000s, the Costa Rican government offered no concessions and created significant roadblocks for the company. These researchers identified a possible barrier or risk to FDI in Costa Rica: bureaucratic measures that may create uncertainty because they aren't applied the same across the board.

Preferential trade agreements are another key factor that promotes FDI and creates a competitive landscape for foreign companies doing business in Costa Rica. Researchers at the WTO found that in the 1980s, Costa Rica's "attempt to reduce the anti-export bias and facilitate the increase and diversification of exports" was their first significant push towards trade liberalization (Monge-Ariño, 2011, p. 3). The government also issued laws on export processing zones and tourism, which propelled the attraction of FDI. As a result of this trade liberalization, "the average import tariff went from 46.3% in 1982 to 16.8% in 1989," allowing more foreign companies to invest in Costa Rica without high levels of taxes (Monge-Ariño, 2011, p. 4).

Despite the multitude of incentives for investing in Costa Rica, MNEs must consider a number of barriers and risks to foreign direct investment. Several laws foster investment and provide strong safeguards, but actions such as uncompensated expropriation sometimes occur. According to Ferrate, "expropriated property may be neither prompt nor fair and disputes over the expropriation of real property are infrequently resolved," because litigation is often an extremely slow process in Costa Rica (Ferrate, 1996, p. 129). To further confirm this barrier, researchers at Harvard Business School found that "Given FDI's high sunk costs, it is especially vulnerable to uncertainty stemming from bureaucratic inefficiency and policy reversals," conditions that are sometimes found in Costa Rica (Alfaro, 2014, p. 21).

Despite the research surrounding foreign direct investment, questions are still missing that have yet to be answered. For instance, there have been many studies that explore why foreign investment is attracted to Costa Rica. Not as commonly found in these studies is how FDI benefits domestic businesses beyond just job creation. We plan on investigating this question, hypothesizing that FDI in Costa Rica has also led to significant knowledge spillover effects, ultimately increasing the productivity and competitiveness of local businesses.

While most literature focuses on how stable institutions promote FDI, there is less research on how infrastructure

**Table 1. The Effects of Infrastructure Development through Institutional Quality on FDI**

| Year | FDI Inflows (USD) | Total Infrastructure Investment | Economic Freedom/ Institutional Quality |
|------|-------------------|---------------------------------|-----------------------------------------|
| 1995 | 336,900,000       | 0.20%                           | 68.0                                    |
| 1997 | 409,440,000       | 1.20%                           | 65.6                                    |
| 1999 | 619,469,212       | 1.00%                           | 67.4                                    |
| 2001 | 621,846,413       | 0.80%                           | 67.6                                    |
| 2003 | 774,386,240       | 2.00%                           | 67.0                                    |
| 2005 | 1,530,000,000     | 3.50%                           | 66.1                                    |
| 2007 | 1,800,000,000     | 4.00%                           | 64.0                                    |
| 2010 | 1,910,000,000     | 4.50%                           | 65.9                                    |
| 2012 | 2,700,000,000     | 5.00%                           | 68.0                                    |

**Sources:**

World Bank Open Data. (2025). <https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?end=2000&locations=CR&start=1990&view=chart>.

Oviedo, A., Sanchez, S., Lindert, K., & Lopez, J. (2015). *Costa Rica's Development: From Good to Better*. The World Bank Group. <https://openknowledge.worldbank.org/server/api/core/bitstreams/c25b83ae-351d-50b7-961e-88f1a34807a6/content>.

The Heritage Foundation. (2025). *Index of Economic Freedom: Costa Rica*.

development is affected by those institutions and the direct impact it has on FDI. We hypothesize that institutional frameworks focused on infrastructure development are a key factor in the attraction and inflow of foreign direct investment in Costa Rica. Throughout this paper, we aim to identify these missing links and answer the questions that have not been researched as extensively.

### Data Collection

To investigate these hypotheses surrounding foreign direct investment in Costa Rica, this data collection employs a statistical analysis designed to capture key trends and patterns. In exploring how institutional frameworks focused on infrastructure development affect FDI, the analysis will use variables such as FDI, infrastructure investment, and institutional quality based on economic freedom to reveal how these factors are linked. In terms of the effects of FDI on knowledge spillover effects, this statistical analysis will use variables like FDI inflows, education investment, productivity per worker, and total factor productivity to identify its linkages. The data will determine how foreign direct investment may impact these unanswered questions.

**Table 1** focuses on every other year from 1995 to 2012, with the data points of FDI inflows, total infrastructure development, and economic freedom, otherwise known as institutional quality. Through this model, we can identify the level of institutional quality and infrastructure investment in the same year, determining if higher institutional quality leads to more investment in infrastructure. We correlate this with the level of FDI inflows and whether positive inflows match with higher levels of infrastructure investment and institutional quality.

The data shows us that while FDI inflows have increased yearly since 1995, investment in infrastructure and institutional quality levels varies with both growth and loss. In 1995, the level of institutional quality was 68 out of 100, which means more economic freedom, accounting for the rule of law, regulatory efficiency, open markets, and more. At the same time, infrastructure investment was only 0.20

percent of GDP, so there wasn't much focus on developing infrastructure to attract foreign investors. In 1995, FDI inflows were almost 340 million. In 2001, institutional quality was about the same at 67, but infrastructure investment rose to 0.80 percent, and FDI increased to 620 million. If you jump to 2005, institutional quality dropped to 66, infrastructure investment rose to 3.5 percent of GDP, and FDI inflows increased to 1.53 billion dollars.

To research the second hypothesis, how FDI leads to knowledge spillovers, we used variables such as FDI inflows, research and development expenditures, education expenditures, labor productivity growth per worker, and the total factor productivity. These variables will explain to us how these factors interact with one another. If FDI inflows, investment in R&D and education, and productivity move together at high or low levels, we know whether or not FDI creates knowledge spillover effects. We can identify the positive or negative correlations by identifying the patterns within these variables.

In **Table 2**, we can see that in 1999, FDI was 620 million, R&D expenditure was 0.37 percent, education was 5.40 percent, labor productivity per worker was 0.90 percent, and total factor productivity was 0.674. This was a jump from 1995 when FDI was 336 million, education was at 3.4 percent, productivity per worker was only 0.47 percent, and total factor productivity was a bit higher at 0.757. In 2012, FDI was at its highest level of 2.7 billion, and education and R&D investments were 6.6 and 0.8 percent. However, total productivity and productivity per person have seen higher levels in previous years, such as in 1995 or 2007.

### Empirical Analysis

The data collected above helps us identify the missing gaps we exposed in the literature review. After initial research into foreign direct investment in Costa Rica, we were left with unanswered questions from a lack of research into certain topics. Based on what we already discovered, we hypothesized how FDI interacts with knowledge spillover effects and infrastructure development. We can conclude that

**Table 2. The Effects of FDI on Knowledge Spillover Effects**

| Year | FDI Inflows (USD) | R&D Expenditure | Education Expenditure | Trend Labor Productivity Growth | Total Factor Productivity |
|------|-------------------|-----------------|-----------------------|---------------------------------|---------------------------|
| 1995 | 336,900,000       | N/A             | 3.4%                  | 0.47%                           | 0.757                     |
| 1997 | 409,440,000       | 0.30%           | N/A                   | 0.37%                           | 0.698                     |
| 1999 | 619,469,212       | 0.37%           | 5.4%                  | 0.90%                           | 0.674                     |
| 2001 | 621,846,413       | N/A             | 4.8%                  | 0.46%                           | 0.675                     |
| 2003 | 774,386,240       | 0.36%           | 5.1%                  | 0.43%                           | 0.634                     |
| 2005 | 1,530,000,000     | N/A             | N/A                   | 0.32%                           | 0.629                     |
| 2007 | 1,800,000,000     | 0.36%           | 4.6%                  | 0.94%                           | 0.626                     |
| 2010 | 1,910,000,000     | 0.48%           | 6.6%                  | 0.92%                           | 0.647                     |
| 2012 | 2,700,000,000     | 0.55%           | 6.6%                  | 0.80%                           | 0.672                     |

**Sources:**

World Bank Open Data. (2024). <https://data.worldbank.org/indicator/GB.XPD.RSDV.GD.ZS?end=2012&locations=CR&start=1996>.

Compareyourcountry.org. (2019). <https://www.compareyourcountry.org/productivity-indicators/en/0/477/default/all/CRI>.

Federal Reserve Bank of St. Louis. (2019). Total Factor Productivity Level at Current Purchasing Power Parities for Costa Rica. <https://fred.stlouisfed.org/series/CTFPPPCRA669NRUG>.

World Bank Open Data. (2024). <https://data.worldbank.org/indicator/SE.XPD.TOTL.GD.ZS?end=2012&locations=CR&start=1995>.

our hypotheses about Costa Rica are only partially correct based on the further data and measurements we collected.

The data in [Table 1](#) points out that investment in infrastructure is a key factor in growing foreign direct investment. As government investment in infrastructure grew throughout the years, so did the inflow of foreign direct investment. The most recent year in our data, 2012, had the highest infrastructure investment that Costa Rica had ever seen, in correlation with the highest foreign direct investment inflows. This proves that governments prioritizing infrastructure attract more FDI because firms are looking for countries with structures and facilities that can support their goals.

However, there is less correlation between institutional quality affecting infrastructure development and FDI inflows. In years when institutional quality dropped, infrastructure investment and FDI inflows were still on the rise. This means that institutions don't always need to be at their best for development to occur. Infrastructure growth can happen despite a drop in institutional quality. This statistical model proves our hypothesis about infrastructure development attracting more foreign investors, but does not show as much of a correlation between institutional quality affecting that investment.

These correlations were discovered with the help of AI, which used the data to run a test on the Pearson correlation coefficients (OpenAI, 2025, ChatGPT, "take this data and measure the correlation"). This statistical measure quantifies the strength of a relationship between two variables. The correlation coefficient between FDI and infrastructure investment is 0.97, -0.20 for FDI and institutional quality, and -0.38 for infrastructure development and institutional quality. This suggests a strong positive correlation between FDI and investment in infrastructure, showing how it plays a crucial role in attracting FDI. However, the correlation between infrastructure development and institutional quality proved weakly correlated. This reveals that the infrastructure development necessary for attracting FDI can happen without strong institutions.

In terms of knowledge spillover effects, this data proves that FDI does, in fact, create some knowledge transfer. The data in [Table 2](#) shows us that there is a high correlation between FDI inflows and the level of investment that the government partakes in for education and research and development. During times when education and R&D expenditure was high, FDI inflows were also at high levels. As FDI grew throughout Costa Rica, so did the government's investment in their citizens. This indicates that FDI positively affects knowledge as the government uses the money earned to invest in education and research.

Our hypothesis also predicted that FDI ultimately leads to higher productivity levels due to these knowledge spillover effects. However, based on our data, we found less of a correlation between FDI inflows and the actual productivity of domestic workers. There are many years when productivity, investment, and FDI are all at high levels, but there are also years when productivity is low while FDI and investment are still high. In times when FDI was positively affecting investment into education and R&D, productivity levels didn't see that same type of positivity. This proves our hypothesis is semi-correct; FDI creates knowledge spillover effects in terms of greater investment but it doesn't always guarantee higher productivity.

These correlations were also discovered with the help of AI, who used the data to run another test on the Pearson correlation coefficients (OpenAI, 2025, ChatGPT, "take this data and measure the correlation"). The correlation coefficient between FDI and expenditure on R&D is 0.83, 0.59 for FDI and expenditure on education, 0.37 for FDI and labor productivity growth, and 0.11 for FDI and total productivity growth. The strong correlation between FDI and the expenditures on R&D and education implies that foreign direct investment might contribute to "greater knowledge production capacity." However, the weaker links between FDI and productivity suggest that measurable spillover gains in productivity may be limited.

The insights we gained from our data collection help us further understand the impacts of foreign direct investment

on Latin American countries like Costa Rica. It shows us that there are both positive and negative effects from foreign investment being brought into a country, such as positive spillovers into citizen's education but no impact on productivity growth. The data also allows us to understand how Costa Rica's decisions affect whether their country is attractive to foreign firms. Infrastructure development is a key factor in a country's attractiveness, but quality institutions are not always required for it to be conducive to growth. These conclusions and insights further our understanding of FDI in Costa Rica.

### Conclusion

The impact of foreign direct investment in Costa Rica is a topic that has long been studied and debated by researchers. Costa Rica has become a significantly attractive environment for foreign investors, driven by factors such as their political stability, good institutions, free trade agreements, and more. This paper reveals both the positive and negative impacts that foreign direct investment has on the economic stability and growth of Costa Rica. We used statistical analysis and data trends to investigate why Costa Rica is attractive to foreign investors and how those investments affect the overall economy.

We explored how FDI creates knowledge spillover effects, revealing that FDI encourages further investment into research and education, but is less conducive to growing the workers' productivity. Foreign investment can lead to broader benefits beyond just job creation; investment into education and research development allows for innovation, which leads to overall economic growth. Although

our data discovered that knowledge spillover effects exist, the lack of translation into productivity levels means additional efforts, such as workforce training, are required for more growth.

We also discovered how infrastructural quality is crucial for attracting foreign investment but isn't necessarily dependent on maintaining strong institutions. Current literature reveals that foreign investors are attracted to economies with strong physical and financial structures. However, we found that investment in physical, technological, and economic infrastructure can happen even with fluctuations in the quality of the government and its institutions. The data shows that if policies set by the Costa Rican government support infrastructure development, their environment will grow in attractiveness to foreign investors.

In conclusion, Costa Rica has proven successful in creating an attractive environment conducive to foreign direct investment. They have worked hard to develop political stability, strong safeguards, incentives, and effective trade agreements. However, the gaps in this research prove more must be done. With further investment into education, research, and training, Costa Rica can benefit from and create more knowledge spillover effects. Furthermore, strengthening their institutions and investing in infrastructure will help them maintain attractiveness. Further research into foreign direct investment in Costa Rica will help the government create better policies to continue growing their foreign direct investment.

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