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MSMES IN COSTA RICA: CHRONICLE OF THEIR POOR INTEGRATION IN TIMES OF ACCELERATED INTERNATIONAL INTEGRATION

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Abstract

This paper focuses on MSMEs and public policies aimed at fostering their development in the Costa Rican economy. I use an alternative approach to classify economic activity that allows us to more accurately determine inequalities between traditional long-established activities in the economy and newly emerging activities characterized by their great dynamism. Results provide evidence of the evolution of a development style that magnifies the presence of different types of economies that have their own dynamics and marked inequalities among them, putting traditional activities, less skilled workers and MSMEs at a disadvantage. These sectors have to perform in an environment of accelerated international integration. Public policies have been implemented but have been insufficient to distribute the benefits generated by the momentum provided to the “new economy”.

— Key Words: SMEs, new economy, old economy, labor market, economic growth, inequality, productivity, openness to trade, public policies.
JEL Classification: O25.

Introduction

This paper focuses on MSMEs and public policies aimed at fostering their development and integrating them into the Costa Rican economy in the last two decades. It analyzes MSME participation in the consolidation of a heterogeneous production structure where dynamic and highly productive sectors coexist with other straggling sectors that have generated significant labor market gaps. The integration of smaller enterprises into the dynamics of the export sector is addressed in detail.

The above is particularly important because in the last twenty years, trade policy in Costa Rica has focused mainly on international integration and not on fostering the development of traditional economic sectors such as industry and agriculture, promoting a “new economy” and neglecting activities associated to an “old economy” (Estado de la Nación Program 2009, 2010,

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and 2011). The outcomes of the development style that has prevailed in the last decade are in line with outcomes in Latin America and have been thoroughly analyzed by several authors (Machinea 2004; CEPAL 2004; Sunkel and Infante 2009; Guillen sf; Porcil 2010; CEPAL 2011a). These authors pick up the concern over the impact of growing structural duality¹ in an economy on growth and equity, postulating and corroborating the existence of two distinctly different productivity profiles. On one hand, a sector that has been gaining strength since the eighties, capable of adjusting to change, recipient of public/private incentives and tied to international dynamics, and on the other, a sector that did not participate in the transformation process, weakened in terms of public policy and linkages to dynamic sectors. At the same time, the heterogeneity of the economic structure translates into a dual labor market. “There is a small sector of workers made up by those who work in more modern sectors with high productivity and income levels; and another large sector comprised of those who work in medium and low productivity sectors with low income levels” (CEPAL 2011b).

In addition to public policy reorientation, institutionality has been accompanied by problems in making adjustments in the institutions created to address challenges. According to Machinea (2004) “this situation reflects that the development process is more complex than they thought back in the early nineties and institutional capacity has not been capable of responding to present challenges” (page 33). Through parallel yet still scarcely integrated efforts, it has been possible to create a service and promotion platform for micro, small and medium-sized enterprises (MSMEs). However, the impact of these policies has been low, partly due to functionality issues in the design and execution of support programs and to lack of information required for an adequate characterization of the operation of smaller enterprises. This situation evidences the need to align and integrate the efforts of policies aimed at developing productive sectors with the rest of the public policies (social, fiscal, monetary, trade, financial), known as advocating for policies aimed at achieving “productive convergence”.²

Because of these policies and of the evolution of economic activity, there are great differences in labor productivity in Costa Rica, both between and within³ sectors, and they have increased in recent years. For the analysis, I use a new alternative approach to classify economic activity. This approach allows me to differentiate between traditional long-established economic activities and newly emerged activities characterized by their great dynamism. Using this approach, I observe that on one hand, a “new economy” with links to the export sector, attractive to direct foreign investment (DFI) and an important public policy issue, has emerged. On the other, a weakened “old economy” that is mostly oriented towards the internal market, exports traditional products and has been abandoned by public policies, has survived. In parallel, there

¹ Latin American development theory introduced the term structural duality in the analysis of underdevelopment to refer to the coexistence of a modern sector and a stragglng sector in productive systems on the outskirts, which translates into an heterogeneous social structure (Guillen, R.sf). Other authors that collaborate with ECLAC later replaced this term with structural heterogeneity, which better reflects the different types of production that have accompanied developing countries throughout their history.

² Understood as “a set of actions usually included in industrial policy but also macroeconomic, financial, trade, education, science, technology and regulatory policies as well as those that advocate for the creation of incentives that influence investment dynamics and markets in the short and long term” (CEPAL 2011a).

³ Situation known as heterogeneity of the production structure.(Porcile, in CEPAL 2011a).

is a third sector comprised of support service activities that serves both the old and the new economy, is affected by their development and works as a “hinge” between both economies (Estado de la Nación Program 2009).

These different types of economies employ workers with different characteristics; for some, these differences prove to be an advantage in terms of job opportunities but at the same time, for less skilled workers they are barriers to employment and access to instruments that enable them to improve their work skills. The “new economy” offers better salaries and employs skilled labor; on the contrary, the “old economy” employs less-skilled labor, worker salaries are lower and it has a large informal component.

MSMEs have integrated into this dynamics in different ways. On one side, traditional low-skilled activities have greater capacity to absorb labor, usually unskilled workers in smaller businesses, and tend to concentrate mostly in the “old economy”, which, in addition, has a large rural component. On the contrary, the “new economy”, characterized by its large urban component, provides better opportunities for larger businesses (small and medium-sized).

MSMEs have become an extremely important issue in public policy, not just in Costa Rica but also in countries in the Latin American region. There is a clear consensus about the relevance of these actors in economic and social dynamics as well as regarding the fact that opportunities provided by this development style are not generating the proper mechanisms to achieve integration beneficial to these businesses.

To achieve my goal of analyzing MSME integration into productive dynamics in the country and their links to sectors that have benefited from free trade, this paper is structured in four sections in addition to the introduction. Section 1 presents information sources. Section 2 analyzes the configuration and consolidation of a production and employment structure with marked inequalities that afflict the “old economy”. Section 3 describes the analysis of the disadvantageous integration of MSMEs into a dual economy and into a dynamic export sector. This section also addresses the issue of weak institutional support to MSMEs. Finally, Section 4 presents the conclusion and the recommendations.

1. Sources of Information and Methodological Notes

To tackle the first item (MSME integration into a dual economy), I begin by analyzing the evolution of the Costa Rican economy by type of economy, as defined in the 15th Estado de la Nación Report (2009). Economy types are identified using an alternative approach to group productive activities using the Uniform International Industrial Classification, third revision (UIIC3). Groups are formed according to activity; traditional economic activities (old economy), activities that have become the driving force behind growth and are the most dynamic (new economy) and service-related activities (support services). These three large categories comprise 10 subgroups (Table 1).

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Table 1
Reclassification of the Sectors of the Costa Rican Economy

Type of Economy	Economic Sector	Acronym	Examples
Old Economy	Agriculture, internal market	EAMI	Rice, beans, potatoes.
	Traditional agricultural exports	EAT	Coffee, bananas, sugar cane, and cattle.
	Traditional industry	IT	Milling products, food processing, construction, woodwork or carpentry, sewing, and other.
New Economy	Non-traditional agricultural exports	EANT	Foliage, fruit, sea products.
	Free zone industry	IZF	Electronics, medical components, metallurgy machinery, and other.
	New services	NS	Call centers, entrepreneurial, tourist, financial, and insurance services.
Support services	Trade	COM	Private businesses.
	Public sector	GOB	Central Government, autonomous institutions.
	Other services: specialized	OSE	Legal, private medical, engineering, and architectural services.
	Other services: non-specialized	OSNE	Domestic services, laundromats, rentals.

Source: Estado de la Nación Program 2009, using Meneses 2011 data.

The analysis uses household survey data. The suggested classification takes into account 99% of the workers registered in the household surveys (Table 2). The analysis of the evolution of the different types of economy is based on EHPM 2001-2009 data. National Household Survey 2010 data (INEC 2010) is used specifically to follow MSMEs.

It is important to keep in mind that even though the “new economy” includes activities related to the international market such as the exportation of goods and services (free zones, tourism, financial sector, entrepreneurial services), it also includes activities that have gained momentum in recent years such as those related to marketing, advertising and information technology, among other. For the “free zone” group not every activity performed is included, only newly emerged activities that carry a lot of weight in export dynamism. See Meneses 2009 and 2011 for more detailed information on the classification methodology used.

Table 2
Distribution of the Employed Population^{1/} by Type of Economy

Economic Sector	1991		2001		2009	
	Employed	Participation	Employed	Participation	Employed	Participation
Old Economy	422.491	42,5	446.886	29,0	456.583	23,5
Agriculture, internal market	250.531	25,2	135.695	8,8	118.537	6,1
Traditional agricultural exports	2.954	0,3	76.714	5,0	69.162	3,6
Traditional industry	169.006	17,0	234.477	15,2	268.884	13,9
New Economy	121.914	12,3	303.439	19,7	393.364	20,3
Non-traditional agricultural exports	0	0,0	34.051	2,2	50.957	2,6
Free zone industry	78.594	7,9	92.570	6,0	73.465	3,8
New services	43.320	4,4	176.818	11,5	268.942	13,9
Support services	450.765	45,3	791.350	51,3	1.090.211	56,2
Traditional services: trade	156.132	15,7	241.573	15,7	312.349	16,1
Traditional services: government	114.083	11,5	182.426	11,8	284.156	14,6
Traditional services: other services	180.550	18,1	367.351	23,8	493.706	25,4
Total	995.170	100,0	1.541.675	100,0	1.940.158	100,0
Total EHPM Register	1.006.646		1.552.924		1.955.507	

Note: 1/ CIU2 was used for 1991 groups. CIU3 was used for 2001-2009 groups.

Source: Self-elaborated using National Institute of Statistics and Census data (INEC, several years).

I tackle the second item (MSME integration into export dynamics) using findings identified in the Estado de la Nación Program over several years, outcomes of a panel analysis of export statistics by company size and outcomes of a survey of 200 exporting companies conducted in 2011. This allowed me to find certain differences between the characteristics of companies that are still exporting and the characteristics of companies that have stopped exporting but are still active in the market.

Finally, for the third item (evolution of policies aimed at fostering the development of MSMEs) I use Estado de la Nación Program reports and policy and program evaluations.

In this paper, employment is used as an indicator for classification purposes because it allows me to compare different sources of information, though I admit there are more integral criteria to classify company size (sales and assets). Micro enterprises have less than nine employees, small enterprises have between 10 and 29 and medium-sized enterprises between 30 and 100. Classification ranges differ significantly from those used in other countries. For example, in Costa Rica, medium-sized enterprises have between 30 and 100 employees, a range that applies to small companies using European Community parameters, and would classify as either small or medium-sized enterprises according to classification parameters used in Latin America. Furthermore, in Latin America, the ceiling for medium-sized enterprises is 249.

2. Evolution of the Costa Rican Economy: A Production and Employment Structure with Marked Inequalities

The Costa Rican economy, characterized by its small size and its active implementation of policies aimed at international integration, has been successful in terms of attracting foreign direct investment (FDI), opening markets and product diversification. This evolution has had an impact on the country's production structure, particularly in the export sector. In addition, it has created more profound differences in worker profiles. This indicates the presence of a sizeable informal sector and a dual structure in the labor market, with repercussions on distribution and productivity.

The outcomes of the development style that has prevailed in the last two decades are in line with those in Latin America and have been thoroughly analyzed by several authors (Machinea 2004; CEPAL 2004; Sunkel and Infante 2009; Guillen sf; Porcil 2010; Infante 2011). They all pick up the concern about the impact on growth and equity of deepening structural duality⁴ in an economy with two markedly different productive sector profiles. One that is fully evolved and capable of adjusting to change, that is the recipient of public/private incentives and is linked to international dynamics, and another that that did not participate in the transformation process and is weakened in terms of public policy and links to dynamic sectors. This heterogeneity of the economic structure (CEPAL 2009) has an uneven impact on the labor market, with a small sector of highly productive, better qualified and better remunerated workers employed in more modern activities and another

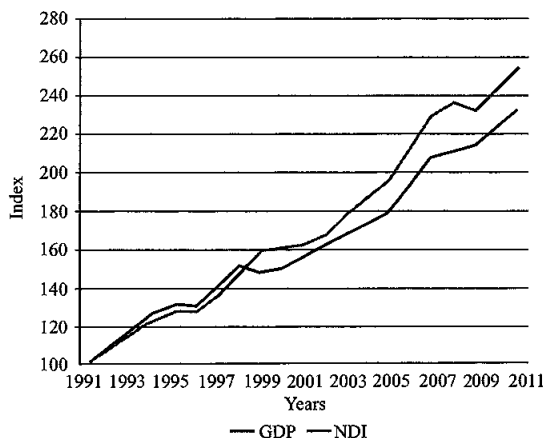
⁴ Latin American development theory introduced the term structural duality in the analysis of underdevelopment to refer to the coexistence of a modern sector and a straggling sector in productive systems on the outskirts, which translates into a heterogeneous social structure (Guillen, R. sf). Other authors that collaborate with ECLAC later replaced this term with structural heterogeneity, which better reflects the different types of production that have accompanied developing countries throughout their history.

quite numerous sector made up by unskilled low-income workers employed in low productivity sectors.

Despite significant advances in terms of international integration and the subsequent creation of a new and dynamic economy, the country has encountered significant difficulties to address inequality and productive linkage issues. In terms of inequality, the country has moved from a situation that brought it closer to industrialized countries to one more similar to the situation in Latin American countries (Estado de la Nación Program 2011). Internally, income gaps show a growing tendency within a range of 17 to 19 times the difference between income for the highest decile and income for the lowest decile.

With regard to linkages and FDI in the local economy, the gap between GDP and national disposable income (NDI) persists and is mostly explained by external payments (Figure 1). This situation reflects that IND generated in the country by the production process is lower than the value of production. In real as well as in per capita terms, growth rates are extremely low. In addition, certain elements make it difficult to link local economies in less developed areas with FDI dynamics (Martínez and Hernández 2011). This is mainly due to unskilled labor force and low-quality infrastructure.

Figure 1
GDP and NDI Index (1991=100)



Source: Self-elaborated using Central Bank of Costa Rica (BCCR) data.

In addition to productive displacement, the dynamics of the growth model followed has no fiscal ties because of tax exemptions granted to promote free zones. In terms of sustainable human development, even though Costa Rica is in the group of countries with a high human development index (HDI), if we take into account purchasing power parity, per capita tax is lower than in this group of countries⁵ (1,529 dollars in Costa Rica; 2,310 dollars is the average for the group, 2007). In other words, the country would need to improve tax collection by at least 4 percentage points of

⁵ Estonia, Poland, Hungary, Chile, Croatia, Lithuania, Latvia, Uruguay, Bulgaria, Rumania, Malaysia, Serbia, Belarus, Brazil, Bosnia and Herzegovina, Colombia, Peru, Turkey, Kazakhstan and Lebanon.

GDP if it wants to equalize its level with countries with a similar GDP per capita and by 7 percentage points if it wants to move closer to the group of countries with high HDI. This situation is not the result of low tax payments by individuals but of dynamic sectors not paying taxes because they have received tax-exempt status. The current structure of the fiscal system considerably reduces the scope of tax policies on productive (infrastructure, innovation) and social development (education, health, housing).

From a retrospective long-term point of view, changes in the production structure show that the primary sector, which used to represent around 40% of GDP in the fifties, represented less than 20% in the nineties and has represented less than 10% in the last ten years. This decrease in participation moved mostly towards the tertiary sector. Meanwhile, the structure of the export sector has seen new sectors emerge. For example, a new agricultural sector (non-traditional agricultural exports), a dynamic industrial sector of foreign capital export companies operating under the free zone regime and a new sector of service exports such as call centers, entrepreneurial services, software and tourism (Estado de la Nación Program 2009). In general, in addition to increasing market participation, these new services have become leaders in terms of growth and productivity levels. For example, the growth rate of entrepreneurial services is four times higher than GDP growth and five times higher than agricultural growth, and average labor productivity is higher than the national average. The performance of the financial sector is similar, growth rates are twice as high and productivity is almost three times the national average. Despite their successful performance, work opportunities are scarce. The first three sectors in the list in Table 3 employ 15% of the employed population.

On the contrary, traditional sectors such as agriculture, industry (including construction) and trade show significant lags in terms of growth rates and in terms of productivity levels. These sectors are vulnerable to economic behavior, both to the expansion and the contraction phase of the economy. This is due to high informality levels, which tend to accentuate economic differences because they restrict participation in more profitable activities and condemn businesses to operate in low productivity sectors.

Table 3
Average GDP Growth and Number of Products per Worker, by Line of Business
(Average 2000-2011)

Sector	Growth	Products per worker
Other services provided to companies	11,8	1,6
Transportation, warehousing and communications	9,3	2,7
Financial and insurance companies	7,7	2,6
Construction	6,2	0,9
Electricity and water	3,9	1,8
Trade	2,8	0,7
Industry	2,7	2,0
Agriculture	2,5	0,7
GDP	4,1	1,0

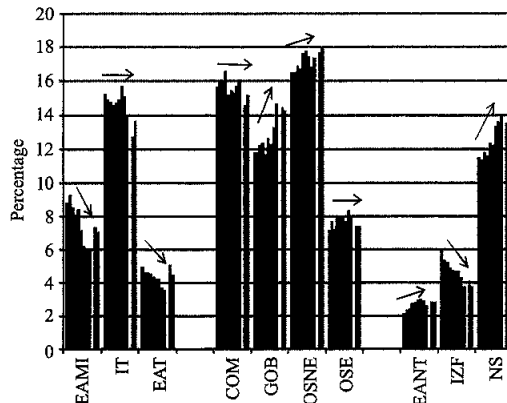
Source: Self-elaborated using BCCR data.

In Costa Rica, one third of the employed population works in the informal sector.⁶ The sectors with the highest informality rates are construction and trade. In addition, workers in these activities have low education and income levels. On average, those who work in these activities have 8 years of schooling, four years less than formal workers do, and almost half earn less than the legal minimum wage. This creates a vicious circle arising from poor education, low productivity, low income and more poverty (Meneses 2010). However, these sectors are a major source of job creation. Forty six percent of the employed population works in agriculture, trade and construction.

An analysis by type of economy allows me to determine inequalities in the productive and employment structure of the country. The profile of the employed population shows marked differences between workers in more dynamic sectors and workers in traditional sectors.

Over the last decade, employment generated by productive sectors linked to the “old economy” has decreased; they went from generating 29% of employment in 2001 to generating 24% in 2009. Meanwhile, representative sectors of the “new economy” were not particularly dynamic in terms of job creation; over the same period, they employed around 20% of the employed population. In this group, the only sector that was relevant as an employer and expanded between 2001 and 2009 was new services, explained by the position of entrepreneurial services in the market. The weight of non-traditional agricultural exports and free zones is marginal (approximately 8% of the employed population) and the importance of the latter has decreased (Estado de la Nación Program 2009). On the contrary, employing most of the employed population, “support services” is the sector that has more actively contributed to generating employment; it went from generating 51% of employment to 56% between 2001 and 2009. In this sector (made up of the public sector, trade and specialized and non-specialized services) the government largely explains active hiring activity (Figure 2).

Figure 2
Percentage of the Employed Population, by Sector^{1/} and Year (2001-2009^{2/})



Notes: 1/ Agriculture, internal market (EAMI), Traditional agricultural exports (EAT), Traditional Industry (IT), Non-traditional agricultural exports (EANT), Free zone industry (IZF), New services (NS), Trade (COM), Public sector (GOB), Other specialized services (OSE) and other non-specialized services (OSNE). 2/ Bars correspond to each year.

Source: Estado de la Nación Program 2009, updated using Meneses 2011 and INEC 2009 methodology.

⁶ “Informal economy” is a series of non-agricultural productive activities whose distinctive feature is the small endowment of capital (human and physical) with which they are performed.

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According to this classification, the structure of the employed population confirms the persistence of a production structure with marked differences that have an impact on distribution and productivity. This is explained by education and worker skills gaps. There is a “new economy” that employs workers with higher education and skill levels. Furthermore, it has received direct public policy incentives to help certain sectors such as the financial sector, tourism and entrepreneurial services, recover. On the other side, the “old economy” and “support services” have workers with lower educational levels owing mainly to the presence of sectors such as construction, trade and non-specialized services. For example, those employed in the “new economy” have an average of 9 years of schooling, almost 2.5 years higher than the average of workers in the “old economy”.

In addition to differences in education levels, there are significant competency gaps, increasing the possibility of workers opting for quality better remunerated jobs. Those employed in the “old economy” represent the group of workers with the lowest percentage of people who have a good command of English, have access to computers and use the Internet (Table 4).

The above-mentioned differences are reflected in income inequalities. The income of those who work in the “new economy” is 1.4 times higher than the income of those who work in the “old

Table 4
Selected Characteristics of the Employed, by Type of Economy (2010)
(percentage)

	Incomplete secondary education or less	Good command of English	Access to computers	Access to the Internet
Old Economy	85,7	4,2	29,6	14,1
Traditional industry	74,6	5,8	40,2	21,2
Traditional agricultural exports	89,4	2,7	18,6	5,7
Agriculture, internal market	90,0	2,5	19,2	7,6
New economy	63,2	17,4	51,5	31,8
New services	57,9	22,2	56,7	36,2
Free zones	48,2	11,8	55,0	29,8
Non-traditional agricultural exports	83,4	2,6	21,7	7,0
Support services	7,8	12,8	56,2	33,8
Government	24,7	20,6	73,3	48,7
Other specialized services	28,0	20,3	70,2	49,5
Trade	60,2	9,3	51,7	28,5
Other non-specialized services	74,8	6,3	40,2	22,7
All workers	59,8	11,6	48,5	28,8

Source: Estado de la Nación Program 2011.

economy” and 1.1 times higher than the income of those who work in “support services”. These differences have grown wider in the last decade. This pattern, in turn, is reflected in the distribution of workers by income quintile; for example, the number of people in the low-income quintile who work in the “old economy” is twice the number of people who work in the “new economy”. In the former, this group represented 24.1% of the employed population while in the latter, it represented 10.6% (data for 2009). These ratios are reversed in the last quintile (higher income), with 10.8 and 25%, respectively (Estado de la Nación Program 2010).

There is evidence that the evolution of economic activity in the country in the last twenty years has created structural heterogeneity and originated a dual labor market with significant differences in the characteristics and skills of workers in each type of economy. For some, these differences prove to be an advantage in terms of job opportunities but at the same time, for less skilled workers they are barriers to employment and to access to instruments that allow them to improve their work skills. As a result, this type of labor shows little mobility and tends to be less versatile and more vulnerable.

Two conclusions are evident from this analysis. First, a “new economy” has emerged, a dynamic economy linked to the export sector, attractive to foreign direct investment (FDI), a public policy priority, offering higher salaries and hiring highly skilled labor but only capable of hiring around 20% of the employed population. Second, an “old economy” and “support services” still survive, weakened and operating primarily in the internal market, exporting traditional products and abandoned by public policies, hiring unskilled labor, offering lower salaries, with a large informal component, but still the main source of employment; 80% of the employed population works in this economy. In the whole process of evolution described above, complete integration of MSMEs has not been achieved, as we will see below.

3. Disadvantageous Integration of MSMEs into the Dual Economy and the Dynamic Export Sector

Over the last twenty years, especially in the last decade, MSME participation in the national economy has become the primary focus of research and public policies, particularly owing to their contribution to generating employment and to the difficulties they have encountered to position themselves in dynamic sectors. . .

The relevance of this sector in the productive and employment structure justifies this attention. Businesses in this sector represent 98% of the total number of companies (81% are microenterprises and 16.7% are small and medium-sized enterprises), employ 78% of the employed population and 49% of the formal workers in the country. This situation is not too distant from the situation in Latin America although in terms of employment, their average is higher than the average in the region. In the Latin American region, MSMEs represent more than 90% of the total number of companies. Meanwhile, their contribution to employment represents around 64% of the economically active population in the region (Saavedra and Hernández 2008) (Mexico, 50%,⁷ Uruguay, 47%, Argentina and Brazil, close to 43%, and Central America, 42%, to mention some examples based on Ferraro and Stumpo 2010).

⁷ Saavedra and Hernández 2008.

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Empirical evidence regarding their contribution to production is neither sufficient nor conclusive. Most studies focus on the manufacturing sector (due to available statistical records), where participation in labor intensive activities is higher, economies of scale are lower and businesses are generally oriented towards the internal market (Ferraro and Stumpo 2010). In addition, the technological content and value added in goods produced by MSMEs is not a widespread process in the region. In some countries, these businesses produce goods with higher technological content than larger companies do while in others the opposite is true.

3.1 Inequality deepens: MSMEs are mostly in the “old economy”

The following analysis excludes public sector and domestic service workers to be able to determine the contribution of the business sector more accurately. Having clarified this, MSMEs concentrate mostly in “support services” and in the “old economy”, employ 75% of the workers engaged in activities such as construction, trade, traditional industry and agriculture and non-specialized services. On the contrary, in the “new economy” the number of workers employed by MSMEs is lower despite that fact that it includes sectors that have been strategically promoted such as free zones, tourism and entrepreneurial services (Table 5).

Table 5
Workers in MSMEs^{1/} by Type of Economy

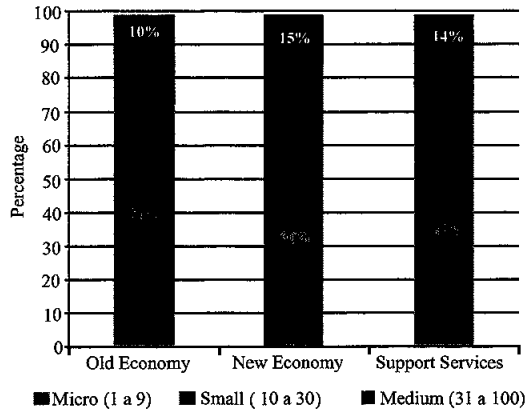
Type of Economy	Total	Percentage
Old Economy	374.435	32,2
Agriculture, internal market	132.062	11,3
Traditional agricultural exports	55.711	4,8
Traditional industry	186.662	16,0
New Economy	286.198	24,6
Non-traditional agricultural exports	32.935	2,8
Free zone industry	41.240	3,5
New services	212.023	18,2
Support Services	503.447	43,3
Traditional services: trade	240.110	20,6
Traditional services: other non-specialized services	172.868	14,9
Traditional services: other specialized services	90.469	7,8
Total MSMEs classified	1.164.080	100,0
Other^{2/}	167.584	
Total MSMEs	1.331.664	
Total Workers ^{3/}	1.902.000	

Note: 1/ Excludes the public sector and “private homes with domestic workers”. 2/ Public sector-related workers. 3/ Total number of workers in the country in 2010.

Source: Self-elaborated using INEC 2010 data.

Distribution according to company size in each type of economy shows that the number of workers in small and medium-sized enterprises is larger in more dynamic activities than in traditional activities operating in the internal market. In the “old economy”, the percentage of workers employed by microenterprises is 74%, compared to 60% in the “new economy” (Figure 3).

Figure 3
Worker Distribution by Company Size and Type of Economy



Source: Self-elaborated using INEC 2010 data.

Finally, territorial distribution also makes a difference. “Support services” and the “new economy” are mostly urban MSME activities (37% and 70%, respectively), while the “old economy” is mostly a rural economy (57%). This outcome is largely explained by a significant agricultural component in the “old economy”.

3.2 Gaps between workers in MSMEs, by type of economy

In Costa Rica, inequalities in the country have become a recurring concern. Even though identifying the determinants is complex, it is possible to find certain factors that indicate differences in the profiles of workers employed in each type of economy and have an impact on income.

The gaps between the different types of economy are present in every area analyzed for workers in MSMEs. In terms of skill levels and instruments to help them improve their skills, in the “new economy” and in “support services” workers have an average of 9 years of schooling, compared to 7 years of schooling for those who work in the “old economy”. In addition, skill levels⁸ in the first two sectors are 68% and 76%, respectively, and in the latter, 66%. Workers in MSMEs in the “new economy” and in “support services” have similar advantages in terms of access to computers, the Internet and good command of a language other than Spanish (most of them refer to English).

⁸ People with secondary education or more.

Job quality in MSMEs differs in each type of economy and the “old economy” is at a disadvantage. It has the highest percentage of uninsured workers and time-related underemployment (Table 6). In addition to reducing their possibilities of integrating into another type of economy, these differences make workers in the “old economy” more vulnerable, as evidenced during the last crisis. Workers in dynamic sectors and in service sectors showed more signs of recovery than those employed in the “old economy” (Estado de la Nación Program 2010).

Table 6
Skills and Job Quality Indicators for Workers in MSMEs, by Type of Economy (2010)

Indicator	Old Economy	New Economy	Support Services
Average education (years)	6,8	9,3	9,4
Skills (percentage of skilled workers)	66,0	67,5	76,2
Good command of other languages (percentage)	5,1	15,6	11,8
Access to computers	29,2	49,5	53,0
Access to the Internet	13,3	29,2	32,4
Time-related underemployment (percentage)	12,6	10,9	10,1
Insurance (percentage of uninsured)	24,4	16,4	14,1

Source: Self-elaborated based on INEC 2010 data.

In terms of income, the “new economy” offers better salaries. As discussed in the first section, the average income of workers in the “old economy” was more than 30 per cent lower than the income of workers in the “new economy”, a difference that has been widening over the last decade. During this period (2001-2009), the main income source of workers in non-traditional activities grew at an average annual rate of 1.9%, almost twice the rate observed in traditional activities (1.0%). This pattern is magnified when we analyze MSME performance. The average income of workers in MSMEs in the “new economy” is 34% higher than the income of workers in the “old economy”. In addition, it has less internal disparities. The income of workers in the last quintile is twice the income of workers in the first quintile; in the “old economy” the figure is 5.3 and in “support services”, 4.3.

Because of these gaps, poor workers concentrate in the “old economy”, 43% compared to 35% in “support services” and 22% in the “new economy”. Distribution by business size shows a similar pattern. Of the total number of people working in microenterprises, 45% are in the “old economy” and 39% of the workers in small and medium-sized enterprises are in the “old economy”.

Thus, differences in terms of qualification and access to instruments that allow them to improve their skills and the quality of their job are reflected in income levels, which are higher for workers in the “new economy”. These gaps are responsible for growing inequality in the country. This situation indicates the need to actively promote policies aimed at productive development, not only by fostering the development of dynamic sectors but also by reconsidering the need to cast our eyes toward straggling economic sectors. These sectors employ a significant percentage of the employed population, less skilled workers that have no options to improve their quality of

life, reducing the possibilities of correcting the negative impact this has on productivity and equity in the country. All the above without neglecting the support provided to sectors that contribute to the economic growth of the country.

3.3 Difficult for MSMEs to remain in the export sector

Although MSMEs generate most of the employment in the country, their modest integration into economic growth is evident not only in their links to traditional vulnerable and not very dynamic sectors. It is also evident in the reduced number of opportunities that they have to enjoy the benefits generated by the process of international integration despite the fact that public institutions in the country dedicated to promoting openness have grown.⁹ Even though public policies have had a positive impact on openness and diversification, they have not facilitated access to ensure continuous MSME participation and reduce differences in profile between exporting companies and companies that operate only in the internal market.

With respect to public policies, only incomplete integration of macroeconomic policies has been achieved. Even though through lower tariffs, free trade agreements and FDI, trade policies have been combined with monetary policies, establishing a system of mini devaluations, and with fiscal policies, granting incentives and tax exemptions, adequate alignment with policies on productive development, technology and education has not been achieved. Results have been positive in terms of openness and diversification (the first round 96% in the last decade and to date, more than 4,200 products are exported to 141 countries) but weak in terms of creating the necessary conditions for MSMEs to incorporate into this dynamics either by exporting directly or through linkages to export companies. Even though over 80% of the export companies are MSMEs, their contribution to sales ranges between 11 and 15% (Procomer 2011).

With regard to becoming regular exporters, MSME participation is vulnerable and depends on policies implemented. Conditions have been different and so have results. The probability of a small enterprise surviving in the international market is 20%, while for large companies probabilities exceed 80% (Umaña 2011). In addition, 75% of the companies that enter and exit each year have less than 30 employees and only 30% of the export companies established in 1998 have survived (Rivera 2010). Innovation efforts, the effectiveness of policies aimed at promoting exports and technology transfers increase the probabilities of a MSME becoming an exporter. It has been estimated that innovation processes increase MSME probabilities of becoming exporters by 50%. Similarly, firms that launch technology transfer initiatives are three times more likely to become exporters (Benavides and Sánchez 2010).

In addition, a number of external factors affect the process of becoming a regular exporter, such as business environment, economic capacity to cover the costs, the formalization process and meeting international requirements. Public policy plays a fundamental role in this process.

⁹ A new institutionalality on foreign trade was established by creating the Ministry of Foreign Trade, the Foreign Trade Corporation (Procomer) and the Costa Rican Coalition for Development Initiatives (CINDE). Procomer is a public non-governmental agency whose mission is to promote exports and CINDE is a private entity, declared to be in the public interest whose task is to attract FDI (Estado de la Nación Program 2009).

Another clear example is quality standards. As regards certification, companies have identified the following as the main obstacles: lack of resources and financing alternatives, little information regarding formalities and advantages, lack of information on support programs and constraints imposed by their organizational structure (FUNDES 2010). In Costa Rica, these restrictions translate into a high percentage of companies (over 90%) that are not certified (self-estimated using UNIMER 2011 data).

This behavioral pattern is similar to patterns observed in other Latin American countries. In almost every country in the region, MSMEs account for more than half of export companies, but their contribution to total external sales is around 11% and has been relatively stable over time (Milesi 2009). The percentage of companies capable of going into the export business is low (between 5% and 10% according to Heieck, S. et al 2009) and those who do must face unstable dynamics with high birth and mortality rates.

A number of studies have shown that company size is a determinant of permanence in the export market. For example, Milesi (2008) concludes that in Argentina, Chile and Colombia the percentage of regular exporters, those that have been exporting uninterruptedly since their first export, exceeds 84% for large companies and decreases to 70% for medium-sized companies. For small enterprises, the highest figure is 52% (in Argentina) and for microenterprises, it is less than 40%. Similarly, size also affects the geographical scope of exports. The scope of large companies is larger than the scope of medium-sized enterprises and the scope of the latter is larger than the scope of small enterprises (Milesi 2009).

In terms of linkages, results have been modest. Even though it is true that certain small enterprises have been able to create links with large multinationals, most of them had already met production and worker qualification standards. However, a large group of enterprises has not been able to participate in this process because to be able to participate in linkage programs they need to build internal capacity and to create this capacity, public policies that go beyond the scope of trade policies must be promoted. Attempts to achieve visible results in productive linkages boosted by FDI are in the same situation, particularly in areas with low socioeconomic development. To make these areas attractive, it is necessary to improve local capacities in terms of worker skills and quality of infrastructure (Martínez J. and Hernández R. 2011).

Along with their vulnerable incorporation into the export business, differences have emerged between exporting MSMEs and MSMEs linked only to the local market. It has been shown that there is a gap between productivity levels in exporting and non-exporting MSMEs (Mayer and Ottaviano 2008). The 17th State of the Nation Report found significant differences in worker characteristics and skills and in management models between exporting MSMEs and MSMEs that used to be in the export business but ended up producing exclusively for the local market. For example, in the former, 79% of the workers have a university degree (65% in the latter) and the number of employees that have good command of English and use specialized software is twice as high. Similarly, exporting MSMEs have a higher percentage of workers specializing in market analysis, international marketing and IT and technology and they have better command of accounting, administration, the Internet and other means to facilitate management (Table 7).

Table 7
Differences between Exporting and Non-Exporting Companies, by Area

Area	Type of Company (percentage)		Difference (times)
	Exporting	Stopped exporting	
Areas with specialized personnel			
International Marketing	47,5	20,8	2,3
International Market Analysis	43,4	22,8	1,9
IT/Technology	69,7	55,4	1,3
Areas the company has good command of			
Business Administration	80,8	55,4	1,5
Accounting	78,8	56	1,4
Computerized accounting records	83,8	70,3	1,2
E-mail	85,9	73,3	1,2
Internet	80,8	68,3	1,2

Source: Self-elaborated using field work data.

In summary, evidence points at a situation where MSMEs have very little opportunities to enjoy the benefits generated by the process of international integration. Size related differences are evident not only in the integration of most enterprises into traditional and vulnerable less dynamic sectors but also in their poor and irregular integration into dynamic sectors linked with international trade. The obstacles that MSMEs have to overcome to become regular exporters and create links with the “new economy” are largely explained by skill shortages, which make access to dynamic sectors difficult for most of the population, condemning them to work in low productivity activities and accentuate existing inequalities. In addition, there are marked differences in entrepreneurial management between enterprises capable of exporting regularly and enterprises that do so intermittently. In addition, linkages between this sector and large enterprises are weak.

In view of this scenario, the role of public policies has become a critical tool. However, they have not responded as required; on the contrary, the institutionality that has been established has significant weaknesses in terms of design and articulation, not only among policies on productive development but also between these policies and the rest of the policies. In addition, the qualitative leap to improve conditions and provide MSMEs improved access depends on the ability of policies aimed at promoting exports and attracting investment to stimulate the “old economy” and a part of “support services” to close existing gaps. The following section describes this situation focusing on the analysis of MSME support policies, the outcomes of which have not been as successful as required.

3.4 MSME development policies: center of attention but weak institutional

Even though economic dynamics sets the tone for MSME integration into the economy, public policies have actively participated in this process. Thus, MSMEs have become matters of vital importance in public policies in the country as well as in the Latin American region. Countries have recognized the importance of these actors in economic and social dynamics and have accepted that the opportunities provided by this development style are not generating the proper mechanisms to achieve beneficial MSME integration.

As described in the above sections, the integration of these enterprises has not been the best integration possible. On one hand, most of them have integrated into traditional economic sectors and into certain lower productivity sectors, accentuating the existing disadvantages in terms of schooling, skills and income of workers employed in these sectors. On the other hand, MSMEs that are able to integrate into the dynamic economic sector encounter serious difficulties to stay in the export business. Although we have to recognize that the design of these policies has been improved and innovated, in terms of MSME integration into the economy, results have been poor and structural gaps in the productive tissue have not been reduced, hindering the consolidation of an inclusive development style. Over the last 20 years, “public policies and institutional strengthening in the country have been oriented toward dynamic sectors such as non-traditional exports, tourism and the financial sector, while sectoral policies targeting traditional productive sectors are weak or have been completely abandoned, and those aimed at promoting small and medium-sized enterprises have failed to become a new industrial policy. Thus, the country has a fragmented economy: a significant number of sectors are dynamic and technologically advanced; others are weak and have considerable disadvantages; furthermore, they concentrate most of the population” (Estado de la Nación Program 2009).

In addition to the implementation of policies on international integration, the creation of an institutional platform responsible for guiding the integration process of MSMEs into economic dynamics was fostered. Because of these efforts, the Small and Medium Enterprise Development Act No. 8262 and the System of Development Banks Act No. 8634 were passed and more recently, policies to foster the development of MSMEs and entrepreneurship were implemented. In addition, there is a wide range of institutions that have programs and implement measures to foster the development of the sector. In both policy areas (trade and fostering MSME development) accomplishments have been insufficient to unfold the benefits of economic dynamism in MSMEs.

In terms of MSME support policies, despite recognizing achievements in terms of turning the problems encountered by this sector into a topic of national interest, having an increasing supply of support programs and promoting services in remote areas in the country, the platform used to foster MSME development has not achieved the expected results. Design and functionality issues as well as problems in the execution of support programs have become evident. This is largely explained by the institutional complexity that has arisen, resulting in the lack of articulation of multiple support programs and in the absence of adequate inter-institutional linkage and coordination mechanisms (Estado de la Nación Program 2009).

For example, significant flaws in the support platform deployed to service the sector, as provided by Strengthening Act No. 8634, were identified in the 14th State of the Nation Report. This gave rise to activities and programs characterized by lack of coordination, not enough clarity regarding their orientation, duplication of efforts, program fragmentation, nonexistent impact evaluations, lack of intervention protocols or methodologies and slow response capabilities. Similarly, evaluations in the field of financial support indicate that results have not been satisfactory and that there have been no significant improvements over time in terms of perception and identifying obstacles. According to Chaves and Meneses (2008), although more financing alternatives are available in the country, they show significant weaknesses. For example, businessmen have very little information regarding their offer, low-specialization levels in financial entities to meet the demands of a sector of markedly different characteristics, low guarantee issuance levels and lack of integration between financial and non-financial services. One year later, a report on the oversight of Banco Popular, the institution responsible for offering financing alternatives to vulnerable sectors, concluded that in addition to significant weaknesses in management, accountability and follow-up of strategic lines of action, the institution had not been able to fulfill its mandate. It had failed even though specialized programs to meet the needs of vulnerable sectors and actors (CGR 2012) were available. Nevertheless, for MSMEs, financial procedures and regulations remain a key obstacle to access to credit. Finally, two years later, an evaluation of the System of Development Banks showed disappointing results. The report indicates lack of design functionality and identifies the following weaknesses: i) lack of definition and articulation among actors, resources, roles and new pieces added to the System; ii) heterogeneous target populations and inadequate follow-up of each population; iii) attracting committed public resources; iv) lack of strategic planning; v) poor coordination among the different parts of the System and an administrative structure that is weak in terms of presenting proposals and becoming specialized, translating into a complex institutionality of the organs that make up the System of Development Banks; and vi) lack of complementarity among actors (Gutiérrez-Saxe et al 2011).

The above-mentioned difficulties regarding public policies targeting MSMEs are combined with large information gaps that make proper characterization impossible, thus reducing policy impact. It is difficult to define MSMEs because this sector includes a large heterogeneous group of enterprises and demands additional efforts to design and implement policies capable of visualizing an integral action framework and taking dedicated action to address the multiple needs identified. As the Estado de la Nación Program (2009) rightly indicates, “The lack of a complete characterization of the sector has brought about regulations that delimit the target population of public policies, for whom the reality of the situation of the sector has been too much and has hindered their capacity to act”.

This reference reflects that public policies have been present aiming to provide support to the sector of small-sized enterprises. This has resulted in the creation of a large number of institutions, expanding the jurisdiction of some, and in a considerable increase in resources allocated to support programs, but this has been accompanied by problems in making the adjustments required to integrate efforts, achieve accountability and produce results for the population. The development process has been quite complex in terms of public policy convergence to ramp up straggling economic sectors and ensure productive and socially satisfactory worker integration (CEPAL 2011a and Machinea J. 2004).

4. Final Considerations

The main findings of this paper highlight certain elements that should be considered in the design and implementation of public policies. The main conclusion is that the evolution of the economy has contributed to the creation of a labor market with significant qualification and skills gaps among workers and productive sectors. Inequalities in the different types of economy, which for some prove to be an advantage in terms of job opportunities, also represent barriers to employment for less qualified workers. As a result, this type of labor shows low worker mobility and tends to be less versatile and more vulnerable.

Traditional activities that require workers with low specialization levels have the highest capacity to absorb the labor force of smaller enterprises and tend to concentrate mostly in the “old economy”, which, furthermore, has a high informal rural component. On the contrary, the “new economy” provides more opportunities for larger enterprises (small and medium-sized) and is characterized by its high urban component.

In addition, the achievements of sectors with links to open trade, (Nota: oración incompleta) even though it provides product diversification and market expansion opportunities for large enterprises, it complicates sustained MSMS integration. MSMEs need to improve their performance and business environment to be able to meet the demands of free trade.

Most of the improvements required to advance MSME integration depend on institutional support. Nevertheless, the institutions that have been created to provide support to productive sectors, particularly to MSMEs, have not been able to help them achieve successful integration. These poor results are largely explained by functionality issues in the design and execution of support programs, lack of information and lack of articulation with the rest of the public policies.

Productive development efforts remain insufficient to improve MSME performance and address the challenge this represents for public policies. This sector is having difficulties to successfully integrate into the dynamic economy. The solution should involve an integral proposal to strengthen efforts to achieve productive development with equity facilitating, on one hand, the integration of actors and sectors into the dynamics of growth and on the other, orienting economic dynamics towards reducing existing gaps in terms of productive heterogeneity and their impact on the population.

The consolidation of these two types of economy (“new economy” and “old economy”) in the production structure of the country accentuates structural heterogeneity and inequality issues. On one side, we have a dynamic economy that has enjoyed significant incentives created by public policies. As a result, it offers the best jobs, job and professional training opportunities but has little capacity to integrate smaller enterprises and absorb workers. In addition, even though exporting MSME participation in this economy is growing, these enterprises are immersed in volatile and vulnerable dynamics. On the other side, we have an economy that employs 80% of the employed population, incorporates most microenterprises, many of them in industry and traditional agriculture, trade and construction. Less skilled informal sector workers who earn lower salaries make up most of the population employed in microenterprises. Furthermore, they had to go through a relocation process and experienced the weakening of support programs and policies.

The evidence described throughout this paper underlines the importance of consolidating a development style with public policies aimed at promoting linkages. Similarly, it agrees with the recommendations made by ECLAC. In recent years, ECLAC has revisited the issue of the dual structure of the productive apparatus, indicating the need to promote policies on productive convergence. Productive convergence should be understood as “a set of actions usually included in industrial policies, but also macroeconomic, financial, trade, education, science, technology and regulatory policies as well as those that advocate for the creation of incentives that influence investment and market dynamics in the short and long term (CEPAL 2011a).

In addition, sector heterogeneity, not only in the country but also among different Latin American countries, is a major challenge for policy design because international experience has to be cleverly transformed to include a component of the reality of the local situation.

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