TAKING STOCK OF COSTA RICA'S JOURNEY TO STRENGTHEN CORPORATE GOVERNANCE OF ITS STATE-OWNED ENTERPRISES

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BETTER POLICIES FOR BETTER LIVES

Key topics

1) Why the OECD gives priority to strengthening the governance and performance of state-owned enterprises
2) Why it is important for Costa Rica
3) The journey Costa Rica has begun and the road (and challenges) ahead

Why the OECD focuses on SOEs

Why is there a need for the OECD's Guidelines on Corporate Governance of SOEs?

- In some OECD countries, and most emerging economies, the state is the largest single enterprise owner. Privatisation is often not an option.
- Too often SOEs display major governance failures in the form of unclear objectives, excessive politicisation, weak accountability, as well as outright corruption.
- Governance failures can deter investment and raise red flags regarding the costs and risks associated with doing business, especially if weak rule of law.
- Corporate inefficiencies have major fiscal, macroeconomic and structural impacts. SOEs prevalent in key sectors with important impact on competitiveness and impact on day-to-day lives of citizens (public service).

The *SOE Guidelines* embody a shared vision

- **The general public is the ultimate owner of SOEs.** The *SOE Guidelines* are based on, and complementary to, the *G20/OECD Principles of Corporate Governance*, which apply to stock exchange-listed companies. The idea is that SOEs should be as accountable to the general public as listed enterprises and the general public should be considered as their shareholder.

- **Concrete recommendations.** On how to manage ownership responsibilities, thus helping to make SOEs more competitive, efficient and transparent. Good practices on the legal and regulatory framework for SOEs, the professionalisation of the state ownership function and the corporate governance arrangements of SOEs.

- **Setting a high level of aspiration.** The *SOE Guidelines* establish a high bar for good practices. They are designed to serve as a lodestar for reform – not establish minimum standards. Not many countries have fully implemented the *SOE Guidelines*, but ongoing SOE reform is almost always consistent with their standards.

Directrices de la OCDE sobre el Gobierno Corporativo de las Empresas Públicas

1. Razones que justifican la propiedad pública
2. El papel del Estado como propietario
3. Las empresas públicas en el mercado
4. Tratamiento equitativo de los accionistas y otros inversores
5. Relaciones con los actores interesados y responsabilidad empresarial
6. Publicidad y transparencia
7. Responsabilidades de los consejos de administración de empresas públicas

The main priorities of the SOE Guidelines

- **A rules-based environment**. SOEs should be subject to the same rules and regulations as other enterprises. They should compete on a level playing field with private enterprises and not distort competition.
- **Reinforcing the ownership function.** The state administration should exercise SOE ownership on a whole-of-government basis. The state ownership function should be separate from the regulatory function to avoid conflicts of interest.
- **Equitable treatment of shareholders**. The state should not have any undue advantages over other investors in SOEs.
- **Transparency and disclosure.** SOEs' objectives and performance should be disclosed and reviewed.
- **Stakeholder relationship.** SOEs and their owners should treat employees, creditors and affected communities fairly and equitably.
- **Boards of directors**. The boards are the highest decision-making bodies within the SOEs. They should exercise their powers free of political interference.

The OECD “model” for SOE ownership and corporate governance

- The ownership of SOEs should be separated from regulation
- Each ownership decision should be taken at the appropriate level

Why is SOE Governance Reform important for Costa Rica

Costa Rica's SOEs play a key role in the economy and services to citizens:

- The OECD's corporate governance accession review focused on enterprises involved in economic activities, meaning that they charge for their services.
- These SOEs' impact on the daily lives of Costa Rican citizens is huge: 13 SOEs and 18 subsidiaries, including ICE for electricity and telecoms; RECOPE for petroleum, INCOFER for railroads, AyA for water, Correos for mail services, INCOP and JAPDEVA for ports, INS for insurance, Banco Nacional and Banco de Costa Rica for financial services; and even liquor (FANAL) and television (SINART).
- Good governance can contribute to greater efficiency and a level playing field for competition, which can translate into lower prices for citizens.
- Clear objectives for their public services can also improve citizens' access and improve the reliability and quality of those services.
- They are also a significant source of jobs and employment for 2% of the Costa Rican workforce.
- However, when the OECD began its review process, we discovered many weaknesses.

What were the OECD's initial findings with respect to Costa Rican SOEs?

- Costa Rica suffered from a decentralized approach to ownership and oversight of its SOEs, split between the Presidency, the Ministry of Planning and Development, Ministry of Finance, the Comptroller General, and sectoral supervisors and regulators. The government lacked a capacity to clearly track and incentivize the performance of its SOEs from a whole of government perspective.
- No formal structures for board appointments existed, and politicians or people with political backgrounds were often appointed to SOE boards.
- Scandals involving SOEs exposed weaknesses in the effectiveness of boards to oversee company strategy, management, and their responsibilities for internal controls and compliance.
- Because SOEs were not following International Financial Reporting Standards, it was difficult to assess the true state of their financial condition and performance on an internationally comparable basis. Non-financial reporting and disclosure was also weak.
- Differential treatment between state-owned banks and privates sector banks have contributed to a non-level playing field which has undermined competitive pressures for efficient performance in the banking sector.

How did Costa Rica respond?

- Following initial recommendations from the OECD Working Party, the Costa Rican government moved quickly to establish a specialized advisory unit for SOEs within the Presidency.
- The unit has subsequently provided support to the Presidency to issue a series of policies, decrees and guidance including:
  - An ownership policy (Protocol of Understanding on the Relations between the state and the Enterprises under its Property);
  - Three annual aggregate reports on SOEs with comparative information on financial and non-financial performance;
  - An SOE board member nominations policy establishing transparent criteria on qualifications for appointments;
  - A web site to manage board member nominations and an applicant pool;
  - Decrees on the roles and responsibilities of SOE boards and establishing board performance evaluations;
  - A training programme for SOE board members in collaboration with the Costa Rica Institute of Corporate Governance.
- In addition, laws were enacted to:
  - remove the Minister of Energy and Environment from the board of the state-owned petroleum refinery company RECOPE; and
  - to establish a deposit insurance programme covering both state-owned and private sector banks to contribute to a more level playing field in the banking sector.
  - Reform the public procurement system to strengthen competition for contracts involving SOEs.

What priorities did OECD recommend in 2020 for further reforms for Costa Rican SOEs?

- Fully implementing International Financial Reporting Standards (IFRS).
- Developing and implementing a system for establishing and monitoring the achievement of financial and non-financial performance objectives.
- Developing a consistently applied policy regarding information confidentiality.
- Taking action to remove the Minister of Agriculture from the board overseeing the state-owned liquor company, FANAL.
- Pursuing public procurement reforms to monitor and limit the use of exceptions for direct public procurement between public entities including SOEs.
- Making further progress on implementing initiatives to strengthen SOE boards.
- Reviewing SOE board remuneration and developing recommendations to support competitive remuneration and incentives for good board performance.

What are additional longer-term desirable reforms?

- Corporatising and other streamlining of SOE legal and corporate forms.
- Considering further legal reforms to strengthen boards, including staggering of board appointments and separating the role of the Chair and CEO.
- Continuing to work towards a more level playing field between SOEs in competition with the private sector.
- Defining, reporting and assessing the costs of public service objectives for each SOE.

Key issues for the new government

- OECD is currently undertaking a review of Costa Rica's post-accession progress
- Its updated recommendations will be addressed to both the current and incoming government
- Key next steps:
  - appointing a new crop of qualified SOE board members
  - Establishing clear and transparent ownership objectives for SOEs

For further details on the OECD's findings:

http://www.oecd.org/corporate/corporate-governance-in-costa-rica-b313ec37-en.htm

Or in Spanish:
http://www.oecd.org/corporate/gobierno-corporativo-en-costa-rica-74f5db04-es.htm

Thank you!