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**THE IMPACT OF FOREIGN DIRECT INVESTMENT
ON PATTERNS OF SPECIALISATION IN THE CARIBBEAN**



ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN
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Table of contents

1.	Introduction	1
2.	FDI and trade inter-relationship: Some theoretical issues.....	2
3.	Trends in foreign direct investment inflows.....	3
	3.1 Breakdown of foreign direct investment inflows by sector	7
4.	Factors influencing foreign direct investment into the Caribbean	13
	4.1 National FDI policy framework	13
	4.2 Strategies of transnational corporations in the Caribbean.....	15
5.	The impact of FDI on patterns of specialisation in the Caribbean	17
	5.1 FDI and structural change: The evolution of specialisation patterns	18
	5.2 Specialisation patterns in services.....	24
	5.3 Quality of specialisation	27
6.	Policy strategy for improving the impact of FDI and patterns of specialisation	28
7.	Conclusion and policy	30
	Annex.....	33

THE IMPACT OF FOREIGN DIRECT INVESTMENT ON PATTERNS OF SPECIALISATION IN THE CARIBBEAN

1. Introduction

The last two decades have seen unprecedented growth in foreign direct investment (FDI) and trade globally, driven primarily by transnational corporations (TNCs) with their web of foreign affiliates worldwide. According to the United Nations Conference on Trade and Development (UNCTAD) [2000], sales of foreign affiliates grew from US\$2.5 trillion in 1982 to US\$13.6 trillion in 1999. Their global exports rose from US\$637 billion in 1982 to US\$3.2 trillion in 1999, of which one third was intra-firm trade. The growing importance of international production has been facilitated by the liberalisation of foreign investment policy in virtually all the countries of the world including the Caribbean.

In line with trends at the global level, FDI flows to the Caribbean have grown considerably relative to the size of these countries. The impacts of such flows on trade specialisation patterns depend on the mode and the motive for investment, i.e. whether it is market-seeking or export-oriented type FDI. The former is undertaken mainly to provide goods and services to the local market while the latter aims to exploit particular and specific resources at relatively cheap cost and export the output back to the home country and/or other markets. Apart from FDI directed to the services sector, which were motivated by market access due to the relative non-tradability of services, the bulk of FDI flows to the subregion have been resource and efficiency seeking. The small size of many Caribbean countries may have precluded substantial market-seeking FDI flows. Generally, the most important factor for export-oriented FDI is resource endowment. It is therefore not surprising that the major recipients of FDI in the Caribbean have been the resource-rich countries such as Trinidad and Tobago.

The sectoral distribution of FDI reveals that there has been a significant shift in inward FDI flows away from the primary to the tertiary sector. This trend has been observed across the Caribbean. FDI inflows to the services sector have been directed to the tourism, telecommunications and finance industries. Very recently, some FDI has been directed to the information technology industry in some countries, most notably Jamaica. Apart from the shift to services some countries, such as the Dominican Republic, have seen substantial FDI inflows into the manufacturing sector, especially in the export processing zones. Trinidad and Tobago has also experienced remarkable growth in investment in the natural gas sector.

These FDI flows have impacted on the countries' specialisation patterns. In some countries, FDI inflows have reinforced the entrenched dominance of some sectors while in others they have contributed to the emergence of new areas of comparative advantage. This paper examines the impact of FDI on patterns of specialisation of Caribbean countries with particular reference to the Dominican Republic, Guyana, Jamaica, Saint Lucia and Trinidad and Tobago.

These countries represent primary commodity, natural resources, manufacture and services-based economies. This mix should provide insights into how location and country specific factors may have influenced the size and type of FDI flows into the Caribbean and how, in turn, these may have impacted on patterns of specialisation, and the evolution of such patterns over time. The structure of the paper is as follows: following a brief introduction, Section 2 provides the theoretical background for the paper, and focuses in particular on the relationship between FDI and trade. Section 3 reviews trends in FDI flows to the Caribbean as well as the sectoral composition of such flows. Section 4 of the paper discusses the factors influencing FDI inflows into the Caribbean. Section 5 analyses the impact of FDI on the structure of trade and output. Section 6 presents the main conclusion and policy recommendation of the paper.

2. FDI and trade inter-relationship: Some theoretical issues

The main focus of most of the literature dealing with the FDI-trade interrelationships has been on the question of whether FDI complements or substitutes for trade. Some theories consider FDI and trade as two alternative ways of delivering goods and services to a foreign market.¹ A firm can either produce at home for export or alternatively it can move capital abroad by establishing a commercial presence thus replacing exports by local sales. This holds different implications for home (investing) and host (receiving) countries. Some of the earliest theoretical approaches to trade such as the Heckscher-Ohlin (HO) model examined the relationship between FDI and trade. According to this model, trade and FDI are largely explained by differences in factor endowments.² The HO model, as it is sometimes called, postulates that a country that is well endowed with capital will produce and export capital-intensive products while a country that is relatively well endowed with labour will specialise in and export labour-intensive goods. If trade barriers are imposed, capital will move to the country less endowed in capital thereby replacing trade. However, if the production functions in two countries differ, then the movement of capital to the country less endowed in capital may not necessarily lead to a substitution of trade. In this case, FDI may lead to an increase in the production of a good in which the host country has a comparative advantage and a decrease in the production of goods in which the home country has a comparative disadvantage. This would lead to the creation of trade between the two countries. This has been confirmed by empirical evidence. Developed countries have been investing in developing countries' industries in which they do not have a comparative advantage, especially labour-intensive activities, and this had resulted in increased two-way trade.

Perhaps the best explanation of the FDI-trade interrelationship can be found in the approach utilised by Markusen and Venables (1995) as well as Dunning and Narula (1996). These approaches integrate theories of FDI with those on international production. The FDI theories distinguish between vertical and horizontal direct investment. The former emphasises

¹ See for example Fontagne and Pajot (1996)

² A detailed exposition of this theorem can be found in "World Trade and Payments: An Introduction by Caves and Jones.

the importance of trade cost and access to local markets as the primary motive for foreign direct investment while the latter recognises the differences in relative factor cost as the main motive for FDI. The complementarity of FDI and trade has been confirmed empirically in a number of studies.³

As pointed out earlier, the impact of FDI on trade depends on the motives of TNCs. Three types of motives are distinguished: efficiency, resource and market seeking FDI. Each has different implications for trade. Efficiency-oriented FDI clearly complements trade especially when the production of the foreign affiliates is vertically linked to or integrated with that of the parent company. Here vertical integration sometimes implies that the foreign affiliates source inputs and materials from the parent company. This, in addition to creating trade between the home and the host countries leads to intra-firm as well as intra-industry trade. United States firms' investment in the Caribbean is a good example of this type of investment. With respect to market seeking FDI, the aim is usually to serve the local market and in some instances to penetrate other markets.⁴ This may result in trade expansion and displacement (Weresa, 2000). Trade with the home country could most likely be displaced while new trade flows could be created with third countries. Resource-seeking FDI also tends to have a positive effect on trade.

Whether FDI complements or replaces trade, FDI inflows have played an important role in the economies of many Caribbean countries and have helped some countries in exploiting their existing comparative advantages or building entirely new areas of comparative advantage. The next section analyses trends in foreign direct investment inflows.

3. Trends in foreign direct investment inflows

Inward FDI flows into the Caribbean countries grew from US\$1196 million in 1990 to more than US\$3350 million in 1999, before declining to US\$1852 million in 2000. The largest recipients of inward FDI in the Caribbean have been the Dominican Republic, Trinidad and Tobago and Jamaica, in that order (*See Table I*). Underpinning this growth in FDI to the subregion has been the policy of liberalisation and deregulation, which have been embraced by virtually all the Caribbean countries. In addition to the adoption of liberal policies, the strategies of transnational companies have been critical in influencing the type of FDI flows to the countries of the Caribbean. With respect to the strategies of TNCs, the two major motives that have influenced FDI into the subregion have been the desire to have access to strategic resources and as well as the need to reduce production cost so as to gain competitiveness in an increasingly globalising world economy. It is, therefore, not surprising that the bulk of FDI inflows into the Caribbean has been directed to those countries that are deemed to have these advantages:

³ Examining the effects of Japanese FDI into South East Asia on bilateral trade flows, Goldberg and Klein (1999) found evidence of complementarity between capital flows and trade. Another study by the same authors on the effects of United States FDI to different sectors in Latin America on sectoral net export of these countries found some evidence of complementarity, especially for FDI into food related and chemical industries in Argentina and FDI directed to the chemicals, machinery and transport equipment in Brazil and Venezuela.

⁴ See UNCTAD (1998).

Trinidad and Tobago (petroleum and natural gas), Guyana (bauxite, gold and timber), Jamaica (bauxite and alumina) and the Dominican Republic -which seems to have attracted efficiency type of investment.

Table 1: Inward foreign direct investment flows to the Caribbean (US\$ millions)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Anguilla	10.7	6.3	15.5	6.6	11.1	17.5	33.2	21	28	38	39.1
Antigua & Barbuda	60.4	54.5	19.5	15.2	24.7	31.4	19.3	22.9	27.3	36.4	33
Bahamas	-8	9	3	42.2	42.9	27	88.2	209.6	146.4	149.1	249.6
Barbados	22.4	14.7	28.9	18.8	25.9	23.5	26.6	29.5	31.5	34.7	38.8
Belize	20.7	23.9	40	84.8	127.7	82.7	115.1	249.7	240.2	151.4	76.1
Dominica	12.8	15.2	20.5	13.1	22.5	53.9	17.7	21	6.5	17.9	10.8
Dominican Republic	576.2	582.9	758.4	772.3	798.9	798.9	873	989.1	1110	1430	
Grenada	12.8	15.2	22.5	20.2	19.2	19.9	19.3	33.4	48.5	41.4	35.6
Guyana	16.4	28	137	63.3	46.8	53.4	59.1	52.6	44.2	45.9	67.1
Haiti	0	-1.8	-2.2	-2.8	0	7.4	4.1	7	10.8	30	....
Jamaica	291	171.2	190.4	139.2	129.7	147.4	183.7	203.3	369.1	523.7	468.4
Montserrat	9.6	8	4.6	4.8	7.2	3	-0.3	2.5	2.5	8.2	3.4
St. Kitts & Nevis	9.6	8	4.6	13.7	15.3	20.4	35.1	19.6	31.8	57.5	95.9
St. Lucia	44.6	8	41.49	35.89	33.96	35.42	21.01	51.41	86.04	86.8	27.01
St. Vincent & Gren.	7.6	8.8	14.8	31.3	47.1	30.5	42.5	92.1	88.6	55.9	28.1
Trinidad & Tobago	109.4	144.1	171	372.6	520.9	295.7	356.3	999.6	731.9	643.3	679.5
TOTAL	1196.	1096	1470	1631.2	1873.8	1648.0	1893.9	3004.3	3004	3350	1852.4

Source: ECLAC, Subregional Headquarters for the Caribbean, Selected Statistical Indicators of Caribbean Countries, Various Issues.

Although FDI inflows into the Caribbean appear small in absolute terms, they are nonetheless substantial when viewed in relation to the size of these economies. The ratio of FDI to Gross Domestic Product (GDP) for selected Caribbean countries is shown in *Annex Table 1*. The ratio ranges from an average 0.87% for Haiti to an average 24.8% for Belize over the 1990-2000 period. When FDI/GDP ratios are compared to trade/GDP ratios it is clear that the former are much lower. This suggests that trade played a more significant role than FDI in the economies of Caribbean countries over the decade under review.

In terms of relative shares in inward FDI, the Dominican Republic accounted for average shares of 48.0% and 39.5% in 1990-94 and 1995-2000, respectively (*see Figures 1 and 2*). The share of Trinidad and Tobago in total inward FDI rose from 18.1% in the first half of the 1990s to 23.5% in the second half. FDI flows into Guyana, another resource-endowed economy, rose from a comparatively low level of US\$16 million in 1990 to US\$67.1 million in 2000. However, its share of total FDI inflows remained steady at 4%. In the Organisation of Eastern Caribbean

States (OECS) subregion, the largest recipients of FDI flows have been Saint Lucia and Saint Vincent and the Grenadines with average shares of 2% during the period 1995-2000. FDI flows into these countries have been directed mainly to the services sector in line with the increasing importance of services in economic activity.⁵

Figure 1: Average shares in total inward FDI flows (1990- 1994)

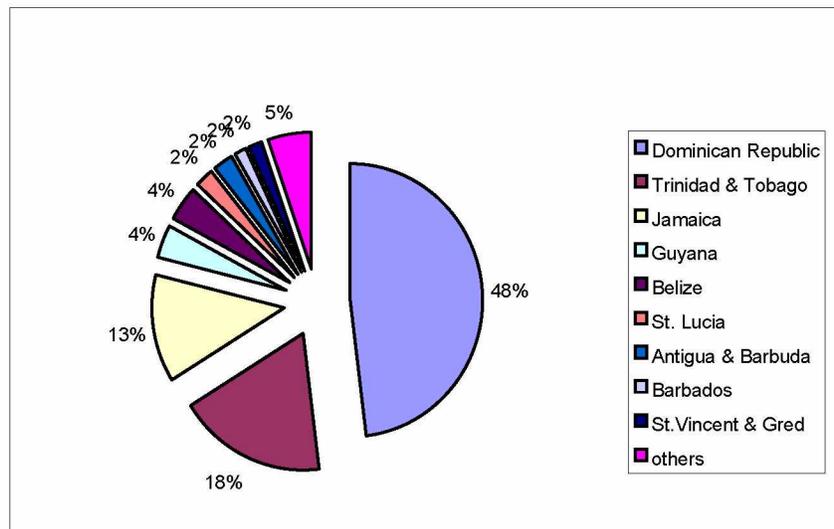
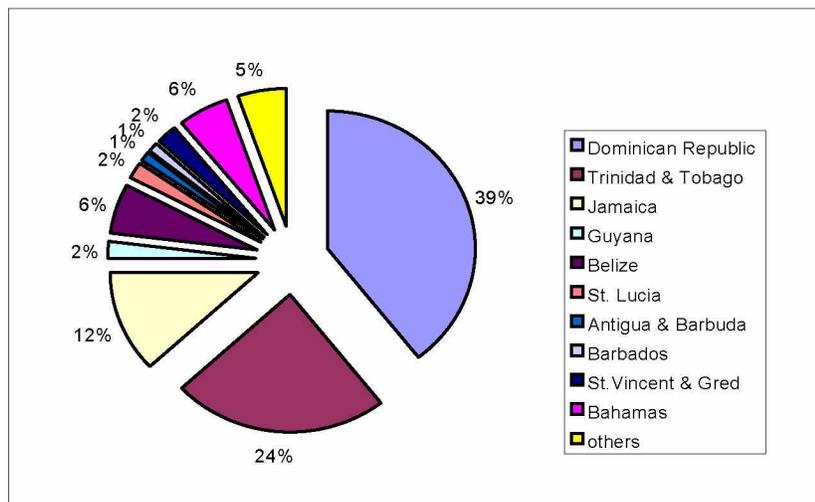


Figure 2: Average shares in total inward FDI flows (1995-2000)

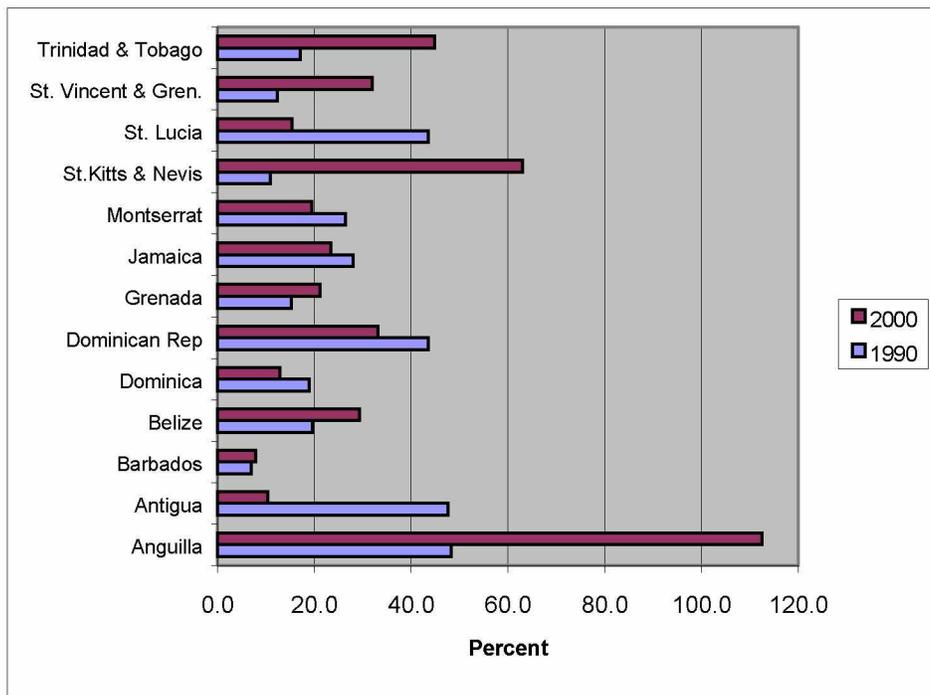


Source: ECLAC

⁵ Although virtually all the countries in the Caribbean have seen significant growth in the share of services in FDI inflows and economic output, the growth of the services sector in the OECS countries has been more pronounced.

The importance of FDI in the economies of Caribbean countries is illustrated in *Figure 3*. The contribution of FDI to domestic investment increased significantly for virtually all the countries, most notably Anguilla, Belize, Saint Vincent and the Grenadines, St. Kitts and Nevis and Trinidad and Tobago. In Anguilla, for example, FDI exceeded domestic investment by some 12% in 2000. In fact, FDI to Anguilla amounted to US\$39.1 million in 2000 compared to domestic investment of US\$34.5 million. The increasing importance of FDI in domestic investment is a reflection of persistent huge saving-investment disequilibria, which many Caribbean countries have been bedevilled with. This suggests that even though the Caribbean subregion receives relatively small amounts of FDI compared to other developing countries, such flows have played a significant role in financing domestic investment.

Figure 3: Share of FDI in gross fixed capital formation for selected Caribbean countries



Source: ECLAC, 2000

3.1 Breakdown of foreign direct investment inflows by sector

The sectoral distribution of FDI inflows is influenced by a number of factors:

- (a) The relative importance of a particular sector in a particular economy.
- (b) The motives and/or strategies of transnational companies.
- (c) The degree of liberalization and deregulation in the host country, especially the rights foreign operators/enterprises are accorded in a particular sector (UNCTAD, 1999).

Detailed analysis on the breakdown of FDI by sector for the Caribbean countries is hampered by lack of comprehensive time series data. Only a handful of countries provide information on FDI by sector and industry, and even for these countries the time series cover only a few years. Another difficulty is the differences in sector and industry classification among the reporting countries for which data are available. Nevertheless, an attempt is made to analyse the distribution of FDI, especially for the four countries that are the focus of this paper.

Table 2: Sectoral distribution of inward FDI for selected Caribbean countries

Sector	Dominican Republic			Guyana			Jamaica		Trinidad and Tobago		
	1990	1995	1999	1992	1995	1999	1998	2000	1990	1995	2000
Primary	3.51	2.49	1.58	90.5	35.6	74.9	43.0	38.4	58.5	90.0	90.3
Secondary	37.4	29.2	27.2	0.2	21.0	0.7	22.0	9.5			
Tertiary	59.1	68.3	71.2	9.3	43.4	24.4	34.0	52.7	39.7	11.4	15.3

Source: Compiled from national data

Perhaps the most striking trend in the Caribbean has been the increasing importance of the share of services in total inward FDI. This has been observed in all four countries, even in Guyana, where the primary sector still accounts for the lion's share of inward FDI. Despite the decline in its share of inward FDI, the primary sector continues to attract a disproportionate share of FDI inflows into Guyana. The country that has seen a significant growth in the share of services in FDI has been Jamaica. Although data on the sectoral distribution are only available for the period 1998-2001, inward FDI flows have shifted away from the primary sector in favour of the tertiary sector. The share of the tertiary sector rose steadily from 34% in 1998 to 53.7% in 2001, while that of the primary sector declined from 43% to 32% in the corresponding period.

The share of the secondary sector declined to 15% in 2001 from 22.0% in 1998. The increasing importance in the services sector in FDI flows has been observed across the globe, in line with the importance of the sector in international trade.

In the Dominican Republic, the bulk of FDI inflows has been directed to the tertiary and secondary sectors. The tertiary sector is the largest recipient of FDI inflows accounting for some 51.9% of inflows compared to 27.3% for the secondary sector. Inflows to the primary sector remain negligible. However, in Trinidad and Tobago the primary sector is the largest recipient of FDI inflows, with its share rising from 58.5% in 1990 to more than 90.3% in 2000. The exploitation of natural resources, namely petroleum and natural gas, seems to be the main motive for FDI flows in the country. This has enabled Trinidad and Tobago to diversify its production structure into petroleum based manufactures.

**Table 3: Direct investment capital in private sector enterprises by sector of activity
(US\$ millions)**

ITEM	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
				(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Petroleum Industries	64.0	125.1	153.2	348.9	275.1	266.0	334.7	954.2	599.7	467.7	613.7
Mining, Exploration and Production, Refineries,	57.2	118.2	144.6	348.7	290.0	253.6	320.6	947.6	585.3	449.0	613.9
Service Contractors, Marketing and Distribution	6.8	6.9	8.6	0.2	-14.9	12.4	14.1	6.6	14.4	18.7	-0.2
Food, Drink and Tobacco	4.9	2.7	-0.5	1.9	5.7	3.2	4.3	8.4	9.1	3.8	-21.3
Chemicals and Non-Metallic Minerals	-2.9	-0.5	0.3	0.1	128.7	1.7	2.3	2.3	2.2	2.9	1.8
Assembly Type and Related Industries	0	0.4	0.3	-0.4	-1.9	-0.4	0.7	-0.1	-0.1	0.1	-18.4
Distribution	0.5	-0.3	1.6	4.2	1.0	6.2	4.4	3.1	2.0	-0.5	1.7
All Other Sectors	42.9	16.7	16.1	17.9	112.4	19.0	9.9	31.7	119.0	169.3	102.0
TOTAL	109.4	144.1	171.0	372.6	521.0	295.7	356.3	999.6	731.9	643.3	679.5

Source: Central Bank of Trinidad and Tobago, Balance of Payments Report, Various Years

Note: Data have been recorded on a net basis, in keeping with IMF specifications for the capital account. "All other sectors" include textiles, printing, publishing and paper converters, miscellaneous manufacturing, construction, hotels, transportation and business services, etc., commercial banks, insurance companies and other financial institutions.

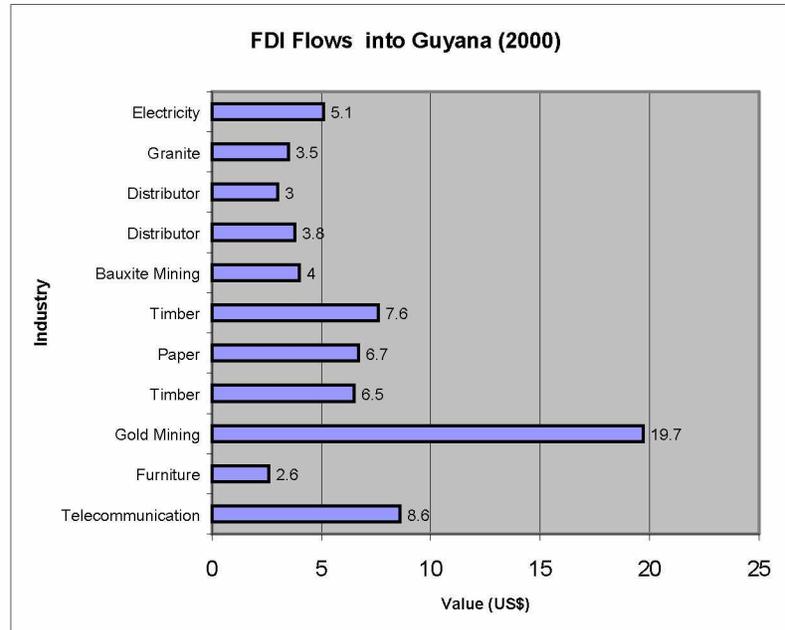
In terms of industrial patterns of FDI inflows in the Caribbean, there are marked variations across countries. In Trinidad and Tobago, the substantial amount of FDI continues to be drawn to the petroleum and petrochemical-based industries. Investments in the food processing and manufacturing activities including beverage and tobacco have also declined slightly during the period under review. Inward FDI into assembly type industries has seen the biggest decline (*see Table 3*). The share of primary products in total exports has declined substantially from 52.5% in 1985 to 29.2%, while that of natural resource-based manufactures has increased considerably from 36.8% to 47.6% in 1985 and 2000, respectively.

As was indicated in the previous section, most FDI inflows into Guyana have been directed to the primary sector, with mining and quarrying accounting for a disproportionate share of the inflows. However since 1994 the share of the mining and quarrying industries in total inward FDI has declined significantly. Agriculture, forestry and fishing have emerged as the largest recipients of FDI inflows into the country, followed by transport and communication (*Table 4*).

Table 4: Sectoral composition of FDI in Guyana (US\$ millions)

	1992	1993	1994	1995	1996	1997	1998	1999
Agricultural, Forestry & Fishing	12.9	23.3	25.1	19	23.6	31.3	31.3	21.3
Mining and Quarrying	111.1	18.9	15.1	0	12.2	10.2	0.8	13.1
Manufacturing	0.3	0.2	0.2	11.2	0.4	0.2	0.3	0.3
Wholesale and Retail Trade	0.7	10.5	0.9	12.8	10.6	0.5	0.5	0.1
Financial Services	0	0	0.4	0	0.1	0.1	0.2	0.2
Transport and Communication	11.9	10.3	5.1	10.4	12.1	10.3	10.9	10.9
Miscellaneous	0.1	0.1	0	0	0.1	0	0.2	0
TOTAL	137	63.3	46.8	53.4	59.1	52.6	44.2	45.9

Source: Central Bank of Guyana, Various Years.

Figure 4: FDI inflows into Guyana by industry (2000)

Source: Guyana Office of Investment

This trend was clearly reflected in FDI inflows into Guyana in 2000. FDI grew substantially to US\$67.1 million, the bulk (29.4%) being accounted for by the gold mining industry (*see Figure 4*). FDI inflows to companies involved in services activities were substantial, amounting to US\$22.0 million. This represented a significant 33.0% of total inward FDI flows. The bulk of these flows was directed to the utilities industry (telecommunication and electricity) and was linked to ongoing privatisation and deregulation of the sector.

In the Dominican Republic, the bulk of the FDI inflows have been directed to the services sector, especially transportation, storage and telecommunication, which accounted for an average 40.2% of FDI during the period 1990-2000. However, the share of the sector in total FDI inflows declined substantially from 46.0% in 1996 to 26.0% in 1999. The share of finance, real estate, insurance, commercial services and tourism has been significant averaging 16.0% during the period under review. Inward FDI flows to the chemical substances and products industry have also been substantial (*see Table 5*).

Table 5: Sectoral distribution of FDI flows to the Dominican Republic

Sector	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Agriculture & Fisheries	0.4									
Minerals	19.8	19.8	19.8	19.9	19.9	19.9	19.9	1.4	22.4	22.6
Food Products	93.7	94.8	97.8	101.3	101.6	101.6	107.5	111.4	137.2	151.5
Beverages & Tobacco	14.5	14.5	15.7	16.9	18.8	18.8	18.8	53.3	55	63.8
Textiles & Clothing	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Wooden activities	0.6	....	...	...	...	....	....	....	....	....
Chemical substances & products	81.7	81.7	85.3	85.8	87.2	87.2	90.7	129.2	148.1	148.7
Metal products, incl. machinery & equipment	21.4	21.4	21.4	21.4	22.1	22.1	22.1	22.1	22.1	22.1
Transportation, Storage & Communication	209.9	209.9	370.1	370.1	370.1	370.1	370.1	370.3	378.3	378.4
Finance, real estate, insurance, Commercial services & tourism	84.2	89.6	96.7	105.3	127.6	127.6	141.2	150.2	202.6	252.7
Trade	46.5	46.5	46.8	46.8	46.8	46.8	46.8	48.4	49.1	111.2
Others	....	1	1.3	1.3	1.3	1.3	52.4	79.3	91.9	275
TOTAL	576.2	582.7	758.4	772.3	798.9	798.9	873	989.1	1110	1430

Source: CEPAL, Desarrollo Económico y Social en la República Dominicana: Los Últimos 20 Años y Perspectivas para el Siglo XXI.

By and large, FDI into the Dominican Republic in the 1990s has been linked to the main activities of the free zones, tourism and telecommunication. The share of free zones in total FDI was not that significant. However, investments by foreign enterprises in the free zones represented approximately 71.0% of total FDI into the free zones.⁶ The main activities in the export processing zones have been linked to the strategies of American transnational companies and have been largely concentrated in the production of labour-intensive activities such as textile

⁶ See for example CEPAL, Desarrollo Económico Y Social en la República Dominicana: Los últimos 20 Años y Perspectivas para el Siglo XXI (LC/MEX/R.760/Rev.1), 2000.

and electronics.⁷ As we shall see in Section 6, these activities have enabled the Dominican Republic to build new areas of comparative advantage. Exports of agricultural goods, which used to be the largest earner of foreign exchange, have been overtaken by exports of non-factor services (tourism) and manufactured goods, especially clothing. Low technology manufactures have seen the largest increase in their share of exports, rising from 28.2% in 1985 to 62.7% in 2000. The effect of FDI on trade specialisation patterns will be discussed fully in Section 5.

Jamaica has had less success than the Dominican Republic in establishing a maquila industry. Although Jamaica managed to attract FDI into the free zones, especially in light manufacturing activities such as textile and apparel in the early 1990s, most of these activities have been relocated to Mexico and other Caribbean Basin Initiative (CBI) countries, which have competitive advantage over Jamaica in this area. As can be seen from *Table 6*, foreign investment into the manufacturing sector has declined considerably amounting to a mere US\$22.5 million in 2001 substantially down from US\$53.2 million in 1998. The industries to which FDI have been directed are information technology (44.2% of total FDI in 2001), mining (32.8%), and tourism (with 10% of total inward FDI).

Table 6: Sectoral and industrial composition of FDI flows to Jamaica

	1998	1999	2000	2001	1998	1999	2000	2001
	(US\$M)				Shares (%)	of FDI		
Primary	110.6	67.9	97.8	83.7	0.43	0.27	0.384	0.328
Agricultural	0.7	0.1	0	0	0	0	0	0
Mining	109.9	67.8	97.8	83.7	0.43	0.27	0.384	0.328
Secondary	56.3	47.8	24.3	38.2	0.22	0.19	0.095	0.15
Manufacturing	53.2	18.3	14.7	22.5	0.21	0.07	0.058	0.088
Minerals & Chemicals	3.1	29.5	9.6	15.7	0.01	0.12	0.038	0.062
Tertiary	87.9	102.4	132.6	137	0.34	0.4	0.52	0.537
Insurance	0	0	6	0	0	0	0.024	0
Tourism	2.7	52.8	69.4	24.3	0.01	0.21	0.272	0.095
Information Technology	85.2	49.6	57.2	113	0.33	0.19	0.224	0.442
Total	254.8	218.1	254.7	259				

Source: Central Bank of Jamaica, Various Issues

⁷ Exports of these products benefit from the production-sharing programme of the United States Tariff Code (USTC 9802), formerly 807 programmes. Under this programme, exports of textile and apparel from the CBI countries made with United States manufactured and cut fabric enter the United States market at reduced duty. They also enjoy preferential quotas under the guaranteed access levels (GALs).

In terms of origin of FDI flows into the Caribbean, the United States has been by far the largest investor in the Caribbean. Investment by United States firms, for example, accounted for an average 73.7% of total FDI into Trinidad and Tobago. The United Kingdom has been the second largest investor in Trinidad and Tobago, accounting for some 10% of total FDI. The United States has also been the largest investor in the Dominican Republic and Jamaica. An analysis of sectoral and industrial patterns of FDI by home country shows significant differences among countries. In Trinidad and Tobago, Jamaica and Guyana, the preference of United States companies has traditionally been the mining sector. However, in recent years a number of United States firms have been directing investment into the services sector of these countries. In the Dominican Republic, United States investment has been directed mainly towards the manufacturing and services sectors. Traditionally, Asian firms have not directed FDI into the Caribbean countries. However, in recent years they have been directing substantial amounts of investment into the subregion, especially in Guyana and Trinidad and Tobago. In the former, investments have come from South East Asia, particularly Malaysia, and have been concentrated in the agriculture, forestry and fishing industries. In Trinidad and Tobago, India has been the only Asian nation with investment in the country.

4. Factors influencing foreign direct investment into the Caribbean

FDI flows have been influenced by a number of factors. Chief among these have been policies pursued by various national governments such as economic liberalisation, which was the centrepiece of the Structural Adjustment Programme (SAP) of the 1980s. Besides national policy, and perhaps more importantly, the motives and strategies of TNCs have also critically influenced FDI flows. It is usually the combination of these locational advantages of host countries and ownership-specific advantages of TNCs that have influenced FDI inflows worldwide, including the Caribbean.⁸ This section briefly examines how these two sets of factors have influenced inward FDI into the Caribbean subregion.

4.1. National FDI policy framework

Since the mid-1980s, many Caribbean countries have undertaken a number of economic reforms aimed at increasing the openness of their economies to trade and investment. The liberalisation of the FDI regime featured prominently in these reforms. Generally, such regimes comprise specific rules and regulations governing entry and operations of foreign investors as well as the treatment accorded them in a particular country, sector or industry. In the Caribbean liberalisation involved the removal of barriers to entry for foreign investors as well as extending national treatment and Most Favoured Nation (MFN) status to foreign investors. Most Caribbean countries have revised legislation dealing with foreign investment. In Jamaica, for example, the Foreign Exchange Control Act, which imposed restrictions on capital outflows and prohibited

⁸ See Dunning (1993), "Multinational Enterprises and the Global Economy", Workingham: Addison-Wesley)

foreign operators in certain industries and sectors, was revised in the 1980s making the country more conducive to foreign investment. However, some restrictions are still in place, specifically relating to national security, credit worthiness of investing firms and environmental protection.

In the Dominican Republic, the government introduced new FDI legislation in 1996, which was intended to bring the country's rules and regulations on FDI in line with its schedule of specific commitments on services. Trinidad and Tobago's Foreign Investment Act of 1990 has been replaced by the new Investment Promotion Act.⁹ Other countries in the Caribbean, such as Guyana and Saint Lucia, have also undertaken similar measures. In addition the General Agreement on Trade in Services (GATS) of the World Trade Organization (WTO) has facilitated investment in the services sector.¹⁰

Apart from liberalising core FDI policy, many countries in the Caribbean have also sought to attract FDI inflows through providing fiscal incentives to foreign investors. The most common incentives across the Caribbean have been tax holidays and exemptions. These have been used extensively in Barbados, Belize, Jamaica and the OECS countries. The latter group of countries provides the most generous fiscal incentives of all the Caribbean Community (CARICOM) countries. This is probably intended to compensate for the disadvantages associated with the small size of their economies, which makes it difficult to exploit economies of scale.

Besides tax and duty concessions, many Caribbean countries have attracted TNCs through granting generous incentives to foreign affiliates in export processing zones. Generally, incentives included the following: exemption from import licenses and custom duties on capital goods and raw materials, favourable labour legislation and serviced industrial estates. Some of the countries that have been active in promoting FDI through Export Processing Zones (EPZs) or free zones have been the Dominican Republic, Jamaica, Saint Lucia and Haiti. The Dominican Republic has had more success with its export processing zones compared to the CARICOM countries. The zones have been critical in positioning the country in international markets. Export processing zones in the CARICOM subregion, especially Jamaica, have had less success. After growing considerably in the 1980s, production in exports from EPZs declined in the early and mid-1990s.

Other policy measures undertaken under the aegis of structural adjustment programmes have also enhanced the attractiveness of Caribbean countries to foreign investment. Two such policy measures that deserve special attention are trade liberalisation and privatisation. They have been crucial in attracting export-oriented FDI. The major thrust of trade policy reform in the CARICOM subregion has been the Common External Tariff (CET), which has been

⁹ See WTO, Trade Policy Review for Trinidad and Tobago (1999), at website <http://www.wto.org/trp>

¹⁰ It is worth noting that although many Caribbean countries have accepted commitments to liberalise their services sector, they still maintain numerous restrictions on market access and national treatment across services sectors and mode of supply. Market access for the supply of services through commercial presence (Mode 3) and movement of natural persons (Mode 4) tends to be subject to more restrictions.

implemented in four phases since 1992. In terms of the structure of the CET, agricultural products face the highest level of protection while inputs and capital goods face the lowest protection. State trading has also been opened up to private enterprise, both domestic and foreign. This, coupled with privatisation programmes has had significant impact on inward FDI. For example, FDI directed to the telecommunications sector in the subregion has been in response to the privatisation and deregulation of that sector. In Jamaica, approximately one third of inward FDI flows in 1999 was linked to privatisation. Other measures, such as exchange rate liberalisation and financial and public sector reforms, have complemented liberalisation of core FDI policy as locational determinants of FDI flows into the Caribbean.

The establishment of trade and investment liberalisation agreements between the Caribbean and other countries has also complemented FDI policy in the determination of inward FDI. Equally important have been agreements within the framework of the WTO. Caribbean countries have also been very active in concluding bilateral investment treaties with other countries thus further opening the subregion to trade and investment. And within the CARICOM subregion the establishment of the CARICOM Single Market and Economy (CSME), which has given the subregion a more outward orientation, has been influencing investment, especially intraregional investment flows.

Furthermore, to increase the attractiveness of their countries for trade and investment, some Caribbean governments have introduced a number of measures ranging from investment promotion to reducing bureaucratic red tape, improving infrastructure (roads, ports, telecommunication and electricity) as well as reducing/eliminating corruption. All these measures have influenced FDI flows to the Caribbean. However, only few countries have attracted substantial flows. It has been argued that a process of diminishing returns has set in with respect to FDI policies and hence they have lost their effectiveness. The declining effectiveness of FDI policy has been attributed to the increasing worldwide acceptance of these policies, which have resulted in differences among countries becoming blurred. Caribbean countries would therefore have to be more proactive and creative in attracting foreign investment.

4.2. Strategies of transnational corporations in the Caribbean

Traditionally, investments by transnational firms have been influenced by three main economic determinants, each reflecting the principal motivations of TNC investment in foreign countries. These are: resource seeking, market seeking and efficiency seeking FDI.

Table 7: Strategies of transnational corporations in the Caribbean in the 1990s

Corporate Strategy	(A) Resource-Seeking	(B) Efficiency	(C) Market-Seeking
Sector			
Primary	Oil/Gas (Trinidad and Tobago) Bauxite (Guyana and Jamaica) Aluminium (Jamaica) Gold (Guyana) Timber (Guyana)		
Manufacturing		Apparel (Jamaica, Dominican Rep, and Haiti)	
Services			Financial (Jamaica, Barbados, Bahamas, St. Lucia etc.) Tourism (Jamaica, Barbados, Bahamas, OECS,) Telecommunication (OECS, Guyana, Jamaica, Trinidad, Dominican Republic Electricity (Dominica Rep, Guyana, etc.) Information technology (Jamaica)

Source: Adopted from ECLAC, Foreign Investment in Latin America and the Caribbean (2000).

Historically, FDI inflows into the Caribbean were influenced by the need to have access to strategic resources. FDI flows were directed mainly to countries that were relatively rich in natural resources such as bauxite and gold and timber in Guyana, aluminium and bauxite in Jamaica and petroleum in Trinidad and Tobago. Although the relative importance of the primary sector¹¹ has declined over the years, a considerable amount of FDI still continues to be directed to the mining sector, especially in Trinidad and Tobago and Guyana. The liberalisation of trade coupled with the opening up of the natural-resource extraction industries in countries such as Trinidad and Tobago and Guyana have provided a further fillip to FDI in the sector. These inward FDI flows to the mining sector have reinforced the entrenched dominance and specialisation of this sector in trade.

¹¹ According to UNCTAD, the share of the primary sector in outward FDI of major investing country declined from 25% in 1970 to 11% in 1990.

TNCs directed market-seeking FDI to many Caribbean economies during the heyday of import substitution industrialisation in the 1960s. However, since the 1980s TNCs, especially those which have the United States as their home country, have focused on efficiency seeking investment in order to gain competitiveness in the face of mounting pressure from Asian competitors. One of the chief strategies pursued by these TNCs has been production rationalisation¹² through investment in production sharing operations. The production-sharing programme of the United States Tariff Code (USTC 9802) has facilitated this process by allowing CBI countries to export duty free apparel made with United States cut fabric.¹³ The production-sharing programme has influenced much of the textile and apparel industries that developed in the Dominican Republic, Haiti and Jamaica. The pattern of specialisation in the Dominican Republic has changed significantly over the years as a result of that programme.

In recent years the strategies of TNCs have been focused particularly on the services sector. As indicated in Section 2, FDI inflows into the services sector have grown considerably in the 1990s, even in resource-rich economies. This robust growth in services FDI is a reflection of the liberalisation of the services sector, which has contributed to its increased tradability. The dominant strategy pursued by TNCs in the sector has been the acquisition of privatised enterprises, notably in telecommunications and power. Regional TNCs, with home country being Jamaica, Trinidad and Tobago or Barbados, have also directed investment into the services sector, specifically in tourism and financial services. The development of these regional TNCs has been facilitated by the process of mergers and acquisitions, which characterised much of the FDI in the services sector in the latter part of the 1990s.

5. The impact of FDI on patterns of specialisation in the Caribbean

Structural changes induced by FDI

Caribbean economies have been historically export-oriented economies. Their early integration into the global economy was as a result of them being locations for the production and export of primary commodities. This early pattern of specialisation can be explained by traditional comparative advantage theory, that countries produce and trade products for which they have relatively abundant factors of production. In line with the theory, Caribbean countries specialised in the production and export of primary, resource-based products, notably sugar, bananas, cotton, rice and cocoa, bauxite and alumina and petroleum products (in Trinidad and Tobago). On the other hand, imports comprised largely of commodities in which the subregion had a comparative disadvantage, notably capital goods (plant and machinery), consumer durables and other finished products and profession services such as management services.

¹² This refers to a series of production processes at different locations that exploits locational-specific advantages such as cheap labour, etc.)

¹³ See USITC (1999), "Production sharing: Use of U.S. components and materials in foreign assembly operations", Publication Number 3265.

Foreign capital and management have historically been important drivers of production and exchange in Caribbean economies, with the domestic economies providing largely labour and natural resources. This has been particularly the case in export-driven activities in agriculture, mineral processing, manufacturing and services, such as tourism and telecommunications. On the other hand, domestic investors have concentrated mainly on non-tradable activities in the areas of agriculture and services. These tend to be relatively lower risk activities with a fairly captive market. Foreign investors that have established international production chains and mastered the tricks of the trade have led the way in production for export.

FDI is a major determinant of the changes in the patterns of specialisation and trade in the Caribbean. In fact, the evolution of specialisation patterns based on primary goods in countries such as Guyana and Belize, light manufacturing in the Dominican Republic (especially textiles) and services in the Bahamas and countries of the OECS, for example, have been shaped largely by the preference of foreign investors. Comparative advantage based on resource endowments has no doubt been an important determinant of specialisation patterns. However, the central feature of the FDI-specialisation nexus seems to be the role of FDI in reinforcing relatively low value, low technology intensity production in the subregion. This in conjunction with a conservative policy environment precluded the development of more dynamic segments of international production and trade.

Although FDI has generally reinforced stagnant specialisation, there is evidence of dynamism in some sectors in some countries of the subregion. Among these activities are electronic and electrical parts assembly in Jamaica, the Dominican Republic and St. Kitts and Nevis, downstream activity such as methanol, urea and steel in the petrochemical sector in Trinidad and Tobago and information and communications technology in Jamaica and Trinidad and Tobago.

5.1 FDI and structural change: the evolution of specialisation patterns

Early specialisation in the Caribbean was focused on the production of primary commodities. It was however recognised that primary production did not hold the potential for structural change needed to generate high quality employment and to provide the foundation for more egalitarian societies. Import substitution industrialisation, adapted from the model developed by the Saint Lucian economist, Sir Arthur Lewis, and based on enclave (assembly type) industries was therefore promoted. The rationale of the Lewis model was to foster labour-intensive industries, with the assistance of foreign capital, to absorb the surplus labour in Caribbean societies. This would be done behind trade barriers in order to build domestic capacity before export activity was undertaken. Unfortunately, export activity was not developed until after the failure of the import substitution model.

Table 8: CARICOM: Sectoral and industrial recipients and sources of FDI inflows

Country	Main Sectoral and Industrial Recipients of FDI	Main Sources of FDI
The Bahamas	Tourism, Financial services, Infrastructure	Belgium, France, Germany, USA, Hong Kong, UK, USA, Netherlands
Barbados	Tourism, agriculture, manufacturing, financial services and informatics	Canada, UK, USA
Belize	Agriculture/mariculture (shrimp farming), Manufacturing, (agro-processing), tourism, Infrastructure (telecommunications)	China, Taiwan, UK, USA
Guyana	Mining (gold), forestry, infrastructure (power and telecommunications), trade	Canada, South Korea/Malaysia, UK, US Virgin Islands
Jamaica	Tourism, mining and manufacturing	Canada, UK, USA
OECS	Agriculture, tourism, manufacturing	Caribbean, USA, UK, other European countries, particularly Italy
Suriname	Mining, manufacturing	The Netherlands, USA
Trinidad and Tobago	Energy (petroleum and petrochemicals, natural gas), Electricity, transportation and communications, manufacturing	Asia, Spain, UK, USA

Source: CARICOM based on National Data

As shown in *Table 8* above, FDI inflows into different sectors have shaped a mixed pattern of specialisation among the countries. The broad typology ranges from the nearly pure service economy of the Bahamas, to mixed structures in Jamaica and Trinidad and Tobago (services and industry) and in the OECS (services and agriculture) and to the almost pure natural resource economy of Guyana.

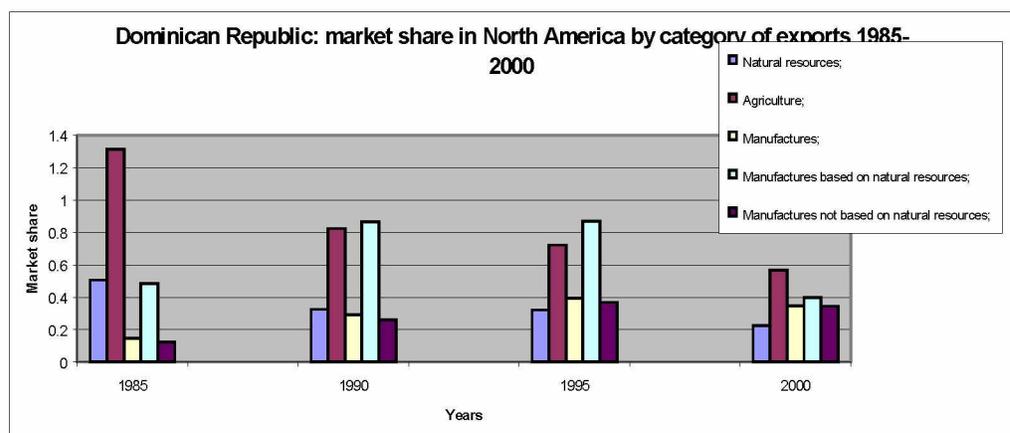
Changes in market share and structure of exports in different countries in the subregion provide some indication of the impact of FDI on specialisation patterns. FDI flows have fostered growth in a number of activities, especially at the lower-end. However, there are no a priori reasons why these activities should have been promoted at the expense of others. Actual specialisation patterns reflect the confluence of a number of factors including investor strategy, regional competitiveness in areas such as infrastructure, skills and technology and competition

from other countries and regions. Influenced by FDI, particularly in the tradable sector, the structure of the economy of the Dominican Republic has changed over time from dependence on agriculture to manufacturing and services. Value added in industry expanded on average by 7.3% between 1991-2001, compared with growth of 3.8% between 1981-1991. Manufacturing output increased by 4.8% in the 1990s, compared with growth of 2.9% in the 1980s. Meanwhile, growth in services averaged 6.2% in the 1990s, compared with 3.2% during the 1980s. On the other hand, although agriculture recovered from the slump of the 1980s to grow by 3.9% in the 1990s, it has still been losing ground to industry and services.

The structure of exports is also directly influenced by FDI, which is concentrated in the tradable goods sector. The Dominican Republic's share¹⁴ of natural resources on the world market declined from 0.11% in 1985 to 0.06% in 2000 (see Figure 5 below). Within the natural resources group, market share of agriculture fell from 0.26% to 0.12%, while that of manufactures increased from 0.05 to 0.1%. Similarly, the percentage of exports based on natural resources declined steadily from 46.2% in 1985 to 12.7% by 2000. Meanwhile, the contribution of manufactures to the Dominican Republic's exports to the world doubled between 1985 and 2000.

The remarkable shift in the specialisation of the Dominican Republic is indicated in the country becoming three times as specialised in the export of textiles as sugar and honey in 2000.

Figure 5: Dominican Republic: Market share in North America by category of exports 1985-2000



Source: CAN Trade database

Exports to the important North American market displayed a similar trend to that of the world as a whole. The market share of natural resources declined whereas that of manufactures

¹⁴ Market share is given by: $MS = M_{ij}/M_i$, where MS equals market share; M_{ij} is the value of imports of commodity i from exporter country j ; and M_i is the value of imports of commodity i .

increased over the period 1985 to 2000. Crude specialisation¹⁵ indices, which provide a rough indicator of revealed comparative advantage, support other evidence of a changing pattern of specialisation propelled largely by FDI. There has been a clear shift in specialisation away from agriculture (sugar, coffee, cocoa and tobacco) and minerals, such as nickel, towards light manufactures, in particular textiles that are produced in the EPZs.

Around the mid-1980s, the Dominican Republic implemented a trade strategy centred on the development of EPZs under the CBI. This strategy attracted significant inflows of efficiency seeking North American FDI. This accounts for the more than doubling of its market share of manufactures in North America between 1985 and 2000. In fact, the Dominican Republic is now the fourth largest export processing economy in terms of number of firms and employment¹⁶.

As a result of low levels of domestic investment in export producing sectors, FDI plays quite a strong role in specialisation and trade in Guyana. Guyana is a classic natural resource-based economy, which has nevertheless experienced some structural change over time. The share of agriculture in GDP rose from 22% in 1981 to 38.4% in 1991 and then declined to 31.3% in 2001. The longer-term trend points to a decline in the share of agriculture in GDP. The share of industry fell slightly from 30.5% in 1981 to 28.3% in 2001. Industry, in particular gold and bauxite, is an important contributor to both domestic value added and exports. In recent years there have been substantial inflows of FDI (almost US\$28 million in 2000) into gold mining and timber and bauxite production.

Unlike the Dominican Republic and other countries that have made some breakthrough in enclave manufacturing, Guyana remains heavily specialised in the production and export of natural resources. FDI has helped to lock in static resource based comparative advantage. Guyana's share in the world market for natural resource products fell marginally from 0.04% in 1985 to 0.033% in 2000. Natural resources' share in total exports contracted from 86.5% in 1985 to 64% in 2000. However, the share of manufactures based on natural resources increased from 1.3% to 6.6%.

¹⁵ The specialisation index, derived from the Competitive Analysis of Nations (Trade CAN) software, is given by the following formula:

Specialisation (SP) = $(M_{ij}/M_i)/(M_j/M)$, where:

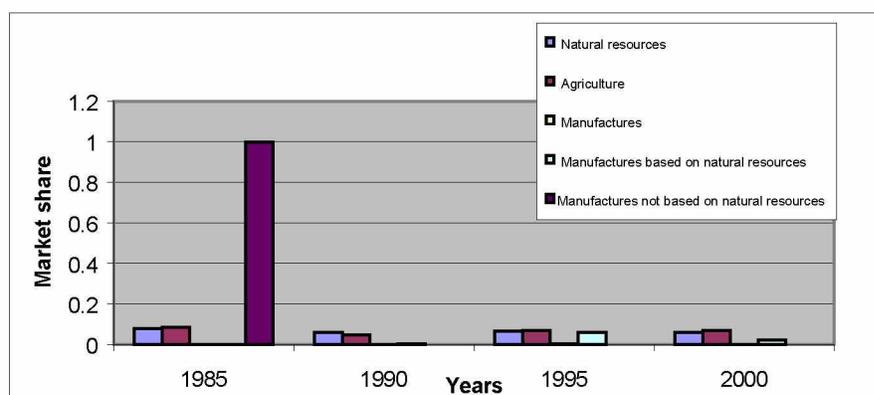
M is total import value

M_j is the value of imports originating in Exporter Country j, and

M_i is the value of imports of commodity i.

¹⁶ See "Foreign direct investment in Tamil Nadu: Review and comparison across host sites"

Figure 6: Guyana: Market share in North America by category of exports 1985-2000



Source: CAN Trade database

FDI in Guyana has reinforced production and export of crude resource-based products, including timber, gold, rice and sugar. The collapse of production in the 1980s and low level of technology and skills have not encouraged foreign investors to engage in high value added, technology-intensive production. The reality is that until Guyana can develop the cluster of services and technology required, foreign investors will not have the incentive to undertake further processing of natural resources in the country. This is especially so today given the propensity of transnational firms to locate production within intra-firm nodes of production based on country advantages.

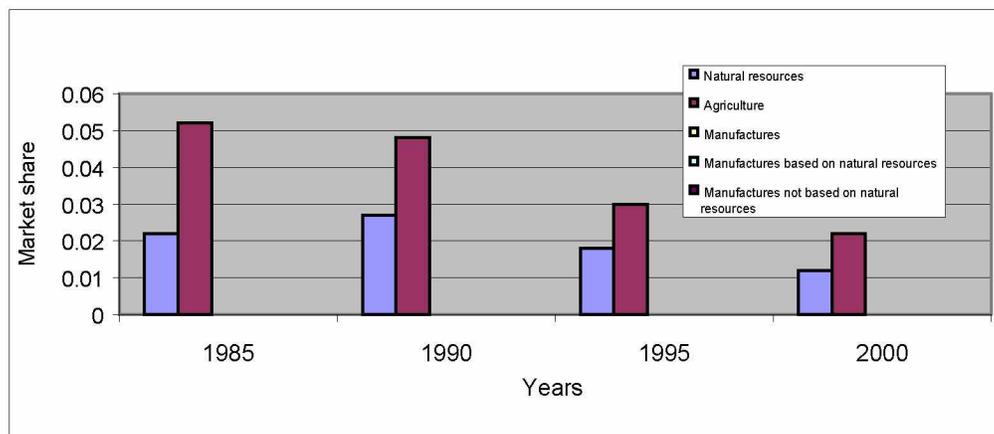
FDI in Jamaica has maintained the static structure of production in most of the goods producing sectors, but has also led to some dynamism in services. Jamaica's share of exports of natural resources in the North American market fell from 0.4% in 1985 to 0.16% in 2000. The percentage contribution of natural resources to total goods exports declined from over 76% to 41%, but the share of manufactures expanded from 21% to over 55%.

With the impetus provided by government policy and FDI, Jamaican manufacturing has been transformed from enclave import substitution to export promotion based largely on "free zone" assembly of textiles. In this respect structural transformation of manufacturing in Jamaica has been a classic case of static shift from one area of specialisation to another. Jamaica has been increasing its share of textile and apparel products, which are falling in relative share in the United States market. Moreover, the fact that the bulk of the intermediate products used in production (yarn and fabric) is from the United States means that local value added is rather low. Specialisation in this segment of the United States integrated production chain, therefore, reinforces low wage levels and foreign exchange earnings in manufacturing.

Typical of the OECS economies, export specialisation in Saint Lucia has been influenced by inflows of FDI in particular activities. Saint Lucia's share of manufactures to the North American market fell marginally between 1990 and 2000. Although the shares were relatively

small in the early 1990s, they represented a significant part of foreign exchange earnings, and the production of clothing, textiles and electrical machinery parts (such as thermistors, resistors and transformers) generated important employment for low skilled workers. In recent years, FDI inflows into wearing apparel and textiles have slackened considerably and a number of operations have closed down as competition from cheaper labour economies, such as Mexico, reduced the attractiveness of Saint Lucia. Indeed, between 1996 and 2001, the share of textile and apparel in total manufacturing output fell sharply from 11.4% to 2.3% leading to a drastic reduction in employment in the sector.

Figure 7: Saint Lucia's market share in Western Europe by category of exports 1985-2000



Source: CAN Trade database

Figure 7 above shows that Saint Lucia penetrated the European market for only natural resource products, primarily agriculture (bananas). However, the decline in the banana industry is reflected in the fall in the market share of agriculture from 0.052% in 1985 to 0.022% in 2000. The banana sector has been plagued by productivity and competitiveness problems that have resulted from inadequate farm management systems and poor research and development in the sector.

Trinidad and Tobago has been probably the most dynamic economy in the subregion in terms of structural change and specialisation. Its dynamic transformation has been based on value added in the oil and gas industries, particularly downstream activity and non-oil manufacturing. In fact, it is fair to say that Trinidad and Tobago is the only CARICOM country which has industrialised in a meaningful way, although natural resources remain the main contributor to exports. The country's share of natural resources in the North American market slipped from 1.04% in 1985 to 0.6% in 2000, while the share of natural resources in total exports declined from 86.6% to 63% over the same period. In the natural resources subgroup, the production of liquid natural gas (LNG) recorded a fivefold increase during the 1990s.

Specialisation indices for Trinidad and Tobago suggest a fair degree of change in its specialisation patterns over the last two decades. Trinidad and Tobago's market share of oil and crude petroleum products declined from 0.55% of world market share in 1985 to 1.78% in 2000. Meanwhile, the shifting specialisation in natural gas and downstream products was marked by an increase in market share for natural gas from 0.045% in 1990 to 0.62% in 2000 and growth in the share of inorganic chemicals and oxides from 1.95% in 1985 to 2.21% in 2000.

The evolution of market share for other products, including fertilizers, iron and steel,¹⁷ clearly shows some shifting of comparative advantage in the petrochemical sector towards downstream activities. The interesting feature, though, is that there has been no real breakthrough into the high value added segments of the industry such as plastics and esters. Moreover, although activity in the non-oil-manufacturing sector increased in the 1990s, the linkages between this sector and the petrochemical sector remain limited. A segment of non-oil manufacturing involves the Free Zone Programme, which is operated by private investors and tends to provide higher quality jobs on average than in Jamaica. A major weakness of the industrial sector is the failure to develop linkages between petrochemicals and non-oil manufacturing that could have led to an integrated competitive cluster promoting innovation and change as in Silicon Valley in the United States and the iron and steel sector in Brazil.

Furthermore, although proposed a long time ago, FDI has not fostered the production of ethylene-based products such as PVC solvents, detergents and plastics and other products such as urea, methylamines, acetic acid and glass. Therefore, change in the petrochemical sector has largely entailed movement from one set of stagnant products to another, since ammonia and steel are not the dynamic areas of world demand in the sector. Policy makers need to carefully assess the reasons why, with the potential that exists, FDI has not undertaken the challenge to engage in high value added production. This diagnostic evaluation would provide the road map for remedial action.

5.2 *Specialisation patterns in services*

Although specialisation in services is in some respects similar to goods, there are enough differences for the sector to be considered separately. FDI has contributed importantly to the evolution of value added and exports in the services sector in the subregion. The dynamic growth in FDI in services has contributed significantly to the rising specialisation in the sector, especially in economies such as Barbados and the OECS. Traditional activities, such as banking, insurance and trading services, have long attracted important FDI inflows, along with tourism. But with the acceleration of trade liberalisation, privatisation and deregulation, other services, including electricity, telecommunications, distribution and education have attracted significant inflows of FDI. Foreign investors have been attracted to these areas because of the improved scope for capturing economic rent and the increasingly favourable investor climate.

¹⁷ Steel exports, though very competitive, have been affected by the recent hike in US tariffs on steel imports from a number of countries.

Although a number of areas are utilities that contribute to the production process and are not strictly tradable in their own right, other areas such as telecommunications, in particular, and education have become increasingly tradable. Telecommunications occupies a crucial strategic position in that it is both a productivity-enhancing input and a final export. As such FDI in this sector holds the potential for catapulting the revitalisation of relatively stagnant areas such as traditional tourism and enclave manufacturing. But the sector could add dynamism to specialisation patterns in its own right through the export of software and information services – two dynamic aspects of world trade.

**Table 9: CARICOM: Value and distribution of exports of services
1992-2000**

	1992	1993	1994	1995	1996	1997	1998	1999	2000	1992-00
Exports of services	3246.7	4884.3	5254.7	5529.8	5744.9	6029.4	6319.8	6781.9	6978.1	5641.1
Transportation	517.8	517.8	566.1	623.8	588.8	643.9	675.6	699.9	733.9	618.6
Travel	2111.8	3603.1	3810.9	3923.9	4140.6	4303.1	4408.5	4722.3	5050.1	4008.3
Commercial services	490.8	609.6	744.3	861.1	908.4	972.1	1030.7	1222.6	1041.7	875.7
of which: Insurance services	88.7	71.7	259.5	104.9	111.6	123.0	137.2	284.7	181.6	151.4
Financial services	...	...	4.3	55.9	65.2	76.4	101.2	113.7	122.8	77.1
Other business services	402.0	527.9	480.5	700.3	731.7	772.6	792.4	824.2	737.3	663.2
Government services	126.4	153.8	133.4	120.9	107.1	110.3	205.0	137.1	152.4	138.5
Imports of services	1798.0	2496.3	2715.8	2911.9	3057.5	3377.9	3661.7	3746.7	3973.1	3082.1
Transportation	734.8	900.5	931.1	1056.1	1088.5	1210.2	1277.0	1245.5	1351.9	1088.4
Travel	298.7	480.2	513.3	609.1	651.2	683.0	713.5	840.3	883.8	630.3
Commercial services	660.6	976.2	1130.2	1127.7	1166.4	1328.5	1485.6	1481.8	1550.6	1212.0
of which: Insurance services	181.0	250.5	314.7	333.5	309.2	287.6	281.9	288.0	328.1	286.1
Financial services	...	...	3.1	8.9	7.1	6.8	7.6	8.4	24.7	9.5
Other business services	479.6	725.7	812.4	758.3	850.0	1034.0	1196.1	1185.5	1197.8	915.5
Government services	103.9	139.4	141.2	119.1	151.3	156.3	185.7	179.0	186.8	151.4
Balance of services	1448.6	2388.0	2538.8	2617.9	2687.4	2651.4	2658.2	3035.3	3005.0	2559.0
Transportation	-217.1	-382.7	-365.0	-422.3	-499.7	-566.3	-601.4	-545.7	-618.0	-468.7
Travel	1813.0	3122.8	3297.5	3314.9	3489.3	3620.1	3695.1	3882.0	4166.3	3377.9
Commercial services	-169.9	-366.6	-385.9	-266.6	-258.0	-356.4	-454.8	-259.2	-508.9	-336.3
of which: Insurance services	-92.3	-168.8	-55.2	-228.5	-197.7	-164.6	-144.7	-3.3	-146.5	-133.5
Financial services	...	...	1.2	47.0	58.0	69.6	93.6	105.3	98.1	67.5
Other business services	-77.6	-197.8	-331.9	-85.0	-118.4	-261.4	-403.8	-361.2	-460.5	-255.3
Government services	22.5	14.4	-7.8	1.9	-44.2	-46.0	19.3	-41.9	-34.4	-12.9

Source: CARICOM's Trade in Services 1990-2000, Caribbean Community Secretariat

CARICOM's total exports of services, including government services averaged 5.64 billion from 1992 to 2000 (*see Table 9 above*). Exports of services posted average growth of almost 11% over the period. In broad categories, most areas of service exports showed some dynamism, except the traditional travel category, which largely reflects tourism services.

Generally, FDI in tourism has not led to the creation of dynamic competitive advantage in the sector. Regional tourism remains plagued by market saturation, an inordinate focus on natural resources (sun, sea and sand) and a lack of creative and innovative strategies for attracting new and repeat visitors. In fact, the only major innovation in the sector in the decade has been the development of the all-inclusive model by the Jamaican Hotel Chain, Sandals.

In spite of the weakness in tourism, there has been some intensification of specialisation in other services to capture competitive niches. Offshore financial services, in particular, have recorded very robust growth in latter part of the 1990s. However, the sector has come under pressure from the Organization for Economic Cooperation and Development (OECD) and Financial Action Task Force (FATF) for alleged harmful tax competition and money laundering due to inadequate regulation. Generally, the jurisdictions have done much to strengthen prudential regulation to prevent unscrupulous business. Other business services also registered fairly strong growth of over 9% per year.

On the import side, the crucial transportation services, especially air and sea travel, grew by 11.1%, while travel payments grew strongly by 16%. The surplus on trade in services grew on average by 11% between 1992 and 2000. This reflects, in part, the growing specialisation in the sector in a number of countries and the generally higher quality of the value added in services, compared with goods.

In Jamaica, services exports averaged US\$1.52 billion between 1990 and 2000. The surplus on trade in services grew by 2.6% over the period. Tourism has remained one of the more dynamic sectors of the Jamaican economy. Domestic investment has grown over the years, but FDI remains a crucial contributor to value added and foreign exchange receipts in the sector. Investors have responded to external competition by focusing on niches, such as conference tourism, but the only important structural change has come through the all-inclusive concept, which has proved to be relatively dynamic.

Jamaica liberalised earlier than most other Caribbean countries as a result of the structural adjustment programmes of the 1980s. Liberalisation has attracted FDI in areas such as financial and telecommunication services. In the telecommunications sector, there has been significant investment in cellular telephony, as consumers increasingly value the convenience of this service. In 2000, for example two United States firms invested around US\$100 million in the cellular subsector. Of crucial importance is the fact that FDI investment, especially improved plant and technology, has the potential to reduce rates and improve the quality of service over time. This is crucial to the development of informatics including data processing and higher value-added activities in the sector.

FDI has been quite instrumental in the evolution of the Saint Lucian economy from a strictly goods producing economy (based on bananas) to a more diversified one with other activities such as light manufacturing and tourism. Saint Lucia's exports of service averaged over US\$266 million from 1992 to 2000. The balance of trade in services averaged a surplus of US\$ 152. Importantly, the balance on services grew on average by over 7% during the period. Travel, which largely reflects the vital tourism sector, registered export growth of 6.8%, with

receipts averaging US\$233 million over the period. In fact, tourism is now Saint Lucia's main generator of foreign exchange.

Although Trinidad and Tobago has been specialising largely in the production of goods, services are an important contributor to value added. The contribution of services to value added increased from 39% in 1981 to almost 54% in 2001. Meanwhile, value added in services grew on average by 3.8% between 1981-1991 and 3.2% between 1991-2001. Therefore FDI and other factors have led to increasing specialisation in services in domestic production and specialisation in goods -largely petrochemical products- in export markets. This undoubtedly reflects differences in competitiveness between both types of activities. Productivity growth has been more rapid in goods producing sectors, which are closer to international standards than services.

Per capita commercial services' exports are relatively high for most countries, except the more resource-based economies of Guyana, Belize and Trinidad and Tobago. A number of OECS countries have adjusted their specialisation patterns to give greater weight to informatics, but unfortunately the focus so far has been on relatively low-end data processing exports. Although in a nascent stage, FDI has been fostering transformation in the services sector in Jamaica, mainly telecommunications such as cellular mobile telephony and call centres.

5.3 *Quality of specialisation*

It is well accepted by economists that technological intensity is an important factor determining the quality of specialisation and jobs that result from the production process (see Helpman and Krugman and Cohen). New technology allows producers to provide new and improved products and services, which create a demand for high quality labour and enhance economic growth. The relatively low quality of regional production and exports is depicted by the technological intensity of exports (*see Table 10 below*). For CARICOM, as a whole, crude primary products accounted for 41.7% of exports in 1985 and 37.4% in 2000. Meanwhile, the share of low technology goods almost doubled to 10.2% of exports between 1985 and 2000. By contrast, high technology manufactures recorded a sharp decline to account for only 1.4% of exports by 2000.

Among the countries that are the main focus of this study, exports of high technology manufactures increased in Saint Lucia and the Dominican Republic only. Both countries, like St. Kitts and Nevis, benefited from United States FDI for the outsourcing of electrical equipment, aeroplanes and other machine parts, some of which are relatively high-tech products. The interesting question is why the subregion has not been able to attract more of this type of FDI instead of the low-end free zone textile production. This probably has much to do with foreign investor perception of the Caribbean as a cheap labour destination. In addition, the State and private sector in the subregion has not implemented an integrated strategy for positioning the subregion as an area for high-value added productivity seeking FDI.

**Table 10: Export structure by category of technological intensity 1985 and 2000
(Percentage of exports)**

Countries/Region	Primary Products		Natural resource-based manufactures		Low technology manufactures		Intermediate technology manufactures		High technology manufactures		Unclassified products	
	1985	2000	1985	2000	1990	2000						
CARICOM	41.7	37.4	39.3	34.9	5.4	10.2	5.7	11.6	6	1.4	1.9	4.6
Antigua & Barbuda	23.8	41.1	6.4	7.3	43.9	2.6	21.5	46.1	2.7	1.6	1.7	1.3
Bahamas	6.8	20.6	73.9	46.4	1.3	1.9	5.1	21	11.1	3.7	1.8	6.4
Barbados	2	14.3	17.5	41.5	15.5	14.1	12.5	17	49.7	8.9	2.9	4.2
Belize	17.6	60.4	54.5	25.8	17.6	6.4	7.2	3.8	0.8	2	2.3	1.6
Dominica	61.7	28.1	11.1	12.5	4.1	7.2	22.1	40.2	0.6	5.9	0.5	6.3
Grenada	88.9	42.8	3.8	8.8	3.9	6.1	1.3	32.8	1.2	1.4	0.8	8.1
Guyana	50.2	33.1	37.7	37.6	1.7	3.3	6.1	2.1	0.8	0.5	3.5	23.5
Jamaica	58.8	46.3	21.8	22.6	11.7	25.6	5.3	2.9	0.7	0.4	1.6	2.2
Montserrat	16	26	33.7	10.4	13.8	12.8	11.5	14.3	4.9	34.1	20.1	2.4
St. Kitts/Nevis	17.2	0.9	27.5	19.8	30.2	8.2	8.3	41.7	10.3	24.8	6.6	4.6
St. Lucia	86.8	55.1	4	9.3	8	15.3	0.9	7.3	0.2	7.4	0.2	5
St. Vincent/Grenad.	83.2	42.7	7	5	6	5.2	2.7	42.1	0.4	1	0.8	4
Suriname	83.7	81.3	12.9	5.6	0.9	0.9	0.9	2.2	0.2	0.5	1.4	9.5
Trinidad/Tobago	52.5	29.2	36.8	47.6	2.9	7.9	5.9	13.4	0.6	0.3	1.4	1.5
Others												
Cuba	35.7	22.2	55	69.2	4.5	1.7	3.1	3.5	1.1	1.7	0.6	1.6
Haiti	18.4	8.9	4.5	2.9	52.8	85.2	14.3	1	7.5	0.3	2.5	1.6
Cayman Islands	53.9	2.3	2.1	7	2.7	1	36.3	85.3	1.1	2.6	3.9	1.9
Dominican Republic	23.7	4.9	24.3	8.6	28.2	62.7	9.9	17.5	1.1	3.5	12.8	2.9
Memo:												
Costa Rica	67.2	29.1	7.9	8.5	14.5	17.1	6.5	8.3	3.2	34.3	0.7	2.8
Taiwan Republic of China	5	1.3	9.1	4.8	48.2	21.8	20.7	25	15.9	45.5	1.2	1.5

Source: ECLAC, based on data from the Competitive Analysis of Nations (Trade CAN)

6. Policy strategy for improving the impact of FDI and patterns of specialisation

As noted, standard theory postulates that FDI by transferring technology, improving human capital and intensifying competition in the domestic market leads to a higher level of specialisation (higher value added production and trade) over time. Undoubtedly, this has occurred in a number of countries including the Asian Newly Industrialized Countries (NICs) and Ireland. However, improvement of the quality of specialisation in these countries was due to a confluence of factors, of which FDI was only one. Indeed, success was due to the harmonious combination of these factors more than anything else. Among other factors are stable macroeconomic environments, incentives for or explicit demands for tangible transfer of technology and know-how and a competitive economy in terms of the quality of education and

training, utilities (e.g. electricity and telecommunications) and legal and institutional frameworks.

A decade after the dynamic resurgence of FDI inflows in the subregion, the time is ripe for a critical appraisal of the benefits of FDI. The real question is whether FDI has led to the kind of specialisation, trade and employment that is conducive to high quality development. Although it has facilitated structural change, FDI has contributed little to dynamic specialisation. This is an indictment both of the mode of operations of foreign investors in the subregion, and the lack of readiness of the subregion to maximise the potential benefits of FDI. Lougani and Razin¹⁸ have suggested that FDI is higher in riskier economies with weak institutions. This is because in countries with inefficient or missing markets, foreign investors try to increase their knowledge of the market by setting up locally instead of relying on local suppliers.

It is clear that although the Caribbean has a relatively high transnationalisation index (FDI/GDP ratio). FDI has not facilitated much dynamic structural change into high value added production and trade. Generally, the benefits of FDI have fallen short of expectations. Systemic competitiveness has been constrained by limited knowledge transfer in high quality downstream segments of production and weak research and development spillovers. Onerous terms of technology contracts created long-term dependence on foreign suppliers of technology and secrecy and proprietary clauses, including intellectual property rights, have prevented use of the technology after the expiry of contracts. Moreover, as inferred by Krugman¹⁹, FDI that involves the transfer of ownership during a crisis, may not lead to competitive production, since the foreign corporation may not be taking control of domestic firms because of competence, but because they have the cash to buy them that locals do not have.

A major problem with FDI in the subregion is that it tends to accentuate economic dualism. Be it investment in petroleum in Trinidad and Tobago, bauxite in Guyana and Jamaica, or tourism in the Bahamas, the nature of FDI, coupled with the prevailing economic structure, limited the development of competitive linkages with the rest of the economy. Foreign Investment Enterprises (FIEs) in the Caribbean are largely local enclaves. They are integrated more into international rather than domestic production networks (see Sengenberger for a similar case in Transition Eastern Europe).

To derive a higher level of specialisation based on FDI, certain conditions would have to be met. Given that competitiveness today is based more on human and social capital than on natural resources, a clear strategy must be designed to develop a competitive education and training system. In the Hirschian²⁰ tradition, education must put a premium on the depth, breath and accuracy of knowledge, as well as independence of thought. Importantly, a greater and

¹⁸ See Lougani, Prakash and Razin, Assaf, "How Beneficial is Foreign Investment for Developing Countries?", *Finance and Development*, Vol. 38, No. 2, June, 2001.

¹⁹ Krugman, Paul, (1998), "Firesale FDI," Working Paper, Massachusetts Institute of Technology.

²⁰ See Hirsch Jr, E. D., "Why America's Universities are Better than its Schools," in *The McGraw-Hill Reader*, (2000), Mc Graw-Hill.

clearer focus should be placed on training in science and technology, especially information and communications technology (ICT), business management and entrepreneurship. Also a practical balance between academic and vocational skills should support these programmes.

The quality of institutions and supporting services must be made more effective and efficient to reduce transactions costs in the subregional economy. Policy should focus on eliminating bottlenecks in investment approval, customs and legal and regulatory frameworks, among other things. For instance, countries should set up a one-stop shop to rationalise the approval process for new investment.

Government policy should aim to obtain better terms and conditions from foreign investors. To the extent that they conform to WTO requirements (Trade-related Investment Measures or TRIMS), local content requirements should be used to ensure better use of local inputs. Also, benchmarks for the transfer of technology and training of local managerial and technical staff should be adopted, as was done by the Asian NICS to facilitate the transfer of knowledge and skills in order to ensure that prospective local entrepreneurs learn the “tricks of the trade.”

Employment policy should focus both on quantity and quality of jobs. In the face of high unemployment, policy makers tend to see better quality jobs as conflicting with more jobs, the latter being the overwhelming focus. But if FDI is to create a virtuous circle of higher wages, increased demand and a better quality workforce, then higher wages based on improved worker productivity should be the strategy to follow. Furthermore, as Trinidad and Tobago has shown, a focus on downstream activities and supplier networks, which tend to be more labour intensive, can help to alleviate the unemployment situation in capital-intensive sectors such as petrochemicals, bauxite and forestry. In tourism also, a more creative and concerted drive should be made to strengthen backward linkages with agriculture through the purchase of fresh food, meats, crafts and cottage tourism.

7. Conclusion and policy

There has been a significant resurgence in growth in FDI over the last decade, driven essentially by transnational corporations. This has been the hallmark of the contemporary globalisation process and has affected all the countries around the world, albeit in varying degrees. Robust growth in FDI has been triggered by economic reforms, financial liberalisation, tax, subsidies and other incentives in recipient countries, including the Caribbean. The Caribbean subregion has also seen a significant growth in FDI. Although these FDI flows appear small in absolute terms, they are substantial when viewed in relation to the size of many Caribbean countries.

In terms of sectoral composition of FDI inflows, the most salient trend has been a decline in the relative importance of the primary sector in inward FDI flows to the Caribbean. This shift has been observed in most of the Caribbean countries, even in countries where the primary sector still accounts for the lion's share of inward FDI. The countries that have seen significant growth in services FDI have been Jamaica, the Dominican Republic and the OECS countries, most

notably Saint Lucia. However, in Trinidad and Tobago substantial FDI has been directed to the natural gas and hydrocarbon industries. The Dominican Republic has also seen a significant growth in FDI to the manufacturing sector especially textile and apparel activities in export processing zones.

It would seem from the foregoing that FDI flows have been directed to areas in which countries have comparative advantage as well as in new areas. FDI flows to Guyana have remained concentrated in traditional sectors, particularly mining and forestry. These flows have reinforced the entrenched specialisation in primary commodities. In other countries, notably Jamaica, Trinidad and Tobago, Saint Lucia and the Dominican Republic, FDI flows have been directed to new areas such as manufacturing, services and hydrocarbon. These have contributed to the building of new areas of comparative advantage. The share of the primary sector in total exports has declined considerably while the share of the manufacturing sector has increased considerably over the years. This has been observed across most Caribbean countries, although the magnitude varied. The Dominican Republic has seen the most significant changes in trade specialisation patterns.

With respect to specialisation patterns, the critical issue has been the failure of FDI to lead to any significant dynamism and structural transformation of patterns of production and trade. To a large extent, FDI has reinforced static comparative advantage in resource-based activities, particularly mining, agriculture and even tourism. Unfortunately, though, there has been little specialisation in the high value segments of these activities. Further, in the newer areas of specialisation, such as EPZs and services, including telecommunications, the subregion seems again to be focusing on low quality specialisation that recycles low wage jobs.

Although foreign investors have often been less than benevolent in their strategies in developing countries, including the Caribbean, the weak structural change that has resulted from FDI owes much to inappropriate policies in the subregion. The reality is that the subregion has focused inordinately on competing for a larger quantity of FDI through tax and other incentives, rather than on better quality FDI and infrastructure and institutional development to maximise the benefits of FDI. Studies on a number of countries including China, Ireland and the Asian NICs suggest that FDI is most likely to lead to structural change and dynamic comparative advantage in countries with good infrastructure, human capital and institutions. In the Caribbean, the policy focus has been tantamount to putting the “cart before the horse”, in that countries focused on attracting the maximum amount of FDI without considering their absorptive capacity and the quality of institutions and the workforce to optimise the benefit from these inflows. Much of intra-industry inflows of FDI are attracted not so much by traditional incentives, but by clusters of services and human capital that provide a platform for productivity and competitive production and trade.

This suggests that Caribbean countries provide the same incentives for domestic investment as for FDI. Instead of concentrating on offering generous tax incentives, countries in the subregion should focus on building strong competitive systems and institutions to encourage FDI in high value added activities. This would entail building comparative advantage in new dynamic activities based on a careful strategy for human capital development, partnerships between the private sector and training institutions and efficient public service and supplier

service networks. It is expected that much of the impetus for dynamic specialisation would come from the services sector, particularly information and communications services, tourism and financial services.

To promote balanced development, however, the goods producing sectors should not be ignored. Countries should provide incentives to increase linkages from, for example, ICT to manufacturing and agriculture in order to raise productivity in these sectors. In addition, FDI needs to be better managed to ensure adequate transfer of technology, know how and learning to indigenous workers and firms.

Annex

Table 1
The ratios of foreign direct investment to GDP

FDI to GDP Ratios for Selected Caribbean Countries (1990-2000)											
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bahamas	-0.26	0.29	0.10	1.32	1.31	0.80	2.51	....	....	....	....
Barbados	1.31	0.87	1.83	1.15	1.49	1.26	1.33	1.35	1.34	1.39	....
Belize	6.11	6.57	9.71	18.79	27.47	16.79	22.62	47.76	62.98	37.30	16.97
Guyana	4.69	9.31	42.75	16.71	10.56	10.15	10.15	8.44	7.93	8.12	10.61
Jamaica	7.66	8.19	5.49	4.53	3.25	3.43	3.15	3.35	5.10	7.51	6.63
Trinidad & Tobago	2.16	2.54	3.14	8.85	10.54	5.60	6.41	17.03	12.54	9.50	8.52
Dominica	9.35	10.07	12.70	7.75	12.30	28.53	8.79	10.18	4.24	10.73	6.46
Grenada	7.24	8.29	12.14	11.03	10.15	10.20	9.62	15.98	21.62	17.16	13.87
St. Kitts & Nevis	7.19	5.86	3.27	9.24	9.79	12.61	20.49	10.66	17.13	29.85	46.29
St. Lucia	11.81	1.91	9.85	8.14	7.16	7.36	4.27	9.86	15.30	14.20	4.67
Dominican Republic	10.04	7.34	8.60	8.04	7.64	6.69	6.55	6.61	7.25	8.22	0
Haiti	0	-0.09	-0.13	-0.15	0.00	0.34	0.14	0.23	0.30	0.79	....
St. Vincent and the Grenadines	1.68	1.92	3.01	6.26	9.70	5.80	7.99	16.79	15.28	9.25	4.55
Montserrat	16.48	17.17	9.35	9.26	13.20	5.82	-0.72	7.05	7.62	27.57	12.08

Source: ECLAC, Selected Statistical Indicators of the Caribbean Countries (LC/CAR/G.666), Vol. XIV, 2001

Table 2
FDI inflows as a percent of gross fixed capital formation

Country	1990	1995	1999	2000
Anguilla	48.2	80.7	109.3	112.5
Antigua & Barbuda	47.5	17.2	12.4	10.3
Barbados	6.9	8.0	7.6	7.8
Belize	19.5	64.2	74.3	29.3
Dominica	18.9	78.1	24.1	12.9
Dominican Republic	43.5	34.5	33.1	33.1
Grenada	15.2	22.5	27.3	21.2
Jamaica	28.0	10.1	27.8	23.4
Montserrat	26.4	14.1	37.7	19.4
St. Kitts & Nevis	10.9	19.1	52.9	63.1
St. Lucia	43.5	26.0	46.8	15.4
St. Vincent & Gren.	12.3	38.2	52.2	31.9
Trinidad & Tobago	17.1	26.7	44.9	44.9

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