

**POLICY COMPETITION FOR FOREIGN DIRECT INVESTMENT
IN THE CARIBBEAN BASIN: COSTA RICA,
THE DOMINICAN REPUBLIC
AND JAMAICA**

Michael Mortimore and Wilson Peres

January 1998

Michael Mortimore (mmortimore@eclac.cl) is the Officer-in-Charge of the Unit on Investment and Corporate Strategies. Wilson Peres (wperes@eclac.cl) is the Chief of the Joint ECLAC/UNIDO Industrial and Technological Development Unit. Both units are in the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) headquarters in Santiago, Chile. Zaida Soto (ECLAC) and María de los Llanos Martínez prepared the tables based on the Competitive Analysis of Nations (CANPLUS) software.

CONTENTS

| | <i>Page</i> |
|--|-------------|
| ABSTRACT | 5 |
| RESUMEN | 7 |
| 1. INTRODUCTION | 9 |
| 2. THE CARIBBEAN BASIN IN A GLOBAL CONTEXT | 11 |
| 3. THE SECTORAL AND COMPANY LEVELS | 21 |
| 4. POLICY COMPETITION: HOW COUNTRIES COMPETE..... | 33 |
| 4.1 THE LEGAL FRAMEWORK FOR FOREIGN DIRECT INVESTMENT | 33 |
| 4.2 SELLING A COUNTRY'S IMAGE | 36 |
| 4.3 INVESTMENT IN EXPORT PLATFORMS..... | 39 |
| 4.4 COMPETITIVENESS POLICIES..... | 44 |
| 5. MEASURING POLICY COMPETITION | 49 |
| 6. THE DYNAMICS OF POLICY COMPETITION AND THE LIMITS OF NATIONAL POLICY | 53 |
| 6.1 THE EXTENT OF POLICY COMPETITION | 53 |
| 6.2 IS POLICY COMPETITION INTENSIFYING?..... | 55 |
| 6.3 THE IMPACT OF POLICY COMPETITION | 56 |
| 6.4 POLICY IMPLICATIONS..... | 59 |
| 7. CONCLUSIONS | 63 |
| 8. BIBLIOGRAPHY | 67 |
| TABLES AND FIGURE | |
| Table 1: Caribbean basin countries: economic indicators, 1994 | 10 |
| Table 2: OECD total imports, by source regions, 1980-1994..... | 12 |
| Table 3: OECD imports of natural resources, by source regions, 1980-1994 | 13 |
| Table 4: OECD imports of manufactures, by source regions, 1980-1994 | 14 |
| Table 5: Western European imports of manufactures, by source regions, 1980-1994 | 15 |
| Table 6: North American imports of manufactures, by source regions, 1980-1994 | 16 |

| | <i>Page</i> |
|--|-------------|
| Table 7: Japanese imports of manufactures, by source regions, 1980-1994 | 17 |
| Table 8: The Caribbean basin's international competitiveness, in the North American market, 1980, 1985, 1990 and 1994..... | 18 |
| Table 9: United States imports for consumption from developing countries under HTS provision 9802.00.80, 1989 and 1993..... | 20 |
| Table 10: Structure of North American imports of garments (SITC 84), by source regions, 1980-1994 | 22 |
| Table 11: Dominican Republic: aspects of its international competitiveness in the North American market 1980, 1985, 1990 and 1994..... | 23 |
| Table 12: Costa Rica: aspects of its international competitiveness in the North American market 1980, 1985, 1990 and 1994 | 24 |
| Table 13: Jamaica: aspects of its international competitiveness in the North American market 1980, 1985, 1990 and 1994 | 25 |
| Table 14: Structure of North American imports of men's and boys' outer garments of textile fabrics, by source regions, 1980-1994 | 27 |
| Table 15: Structure of North American imports of knitted or crocheted undergarments, by source regions, 1980-1994 | 28 |
| Table 16: Foreign investment regimes in Latin America and the Caribbean | 32 |
| Table 17: Export incentives in Costa Rica, 1997 | 38 |
| Table 18: Variables included in the capability to attract investment (CAI) index..... | 48 |
| Table 19: The main components of Caribbean basin countries' CAI..... | 49 |
| Table 20: The climate for foreign investment in Caribbean basin countries | 50 |
| Table 21: Real exchange rate for exports..... | 52 |
| Figure: Real exchange rate for exports..... | 52 |

ABSTRACT

The globalization process based on more intense trade competition among countries coupled with a process of transnationalisation, in which TNCs adapt by establishing international systems of integrated production, produces the result that countries also compete more for foreign direct investment. Countries realize that the attraction of a substantial element of a TNCs international system of international production —specially one that is export intensive— can represent a very meaningful way for a country to adapt to the globalization process. This is particularly the case for small countries lacking a indigenous industrialization process.

Countries compete for FDI through (1) incentives, that is, the provision of direct or indirect subsidies, tax holidays and other financial incentives, (2) rules, that is, the strengthening of a market economy with an adequate legal system, labour and environmental standards, intellectual property rights and regional integration agreements, and (3) factors, that is, the development of production factors and infrastructure needed for an efficient economic performance. Depending on whether countries fall prey or not to “bidding wars”, policy competition for FDI can result in either positive- or negative-sum games.

An examination of this situation in the Caribbean Basin, based on the experiences of important FDI recipients like Costa Rica, Dominican republic and Jamaica, suggests that policy competition for FDI has intensified and both the positive and negative aspects have become evident. These case studies all use export processing zones as their principal incentives and the main linkage between these small Caribbean countries and their principal export market is found in the assembly of apparel in EPZs. An analysis of their experiences, based on questionnaires administered to some of the most important firms operating in these industries coupled with an evaluation of national benefits, suggests that a kind of bidding war exists there and that just keeping up with what other countries offer as incentives to TNCs often backfires and that unfocused incentives often produce unpredictable results. Based on these experiences, this studies suggests that integral, active policies focused on wider national goals are required to better target relevant TNCs in a more functional way. The success of Costa Rica in attracting a huge investment by the United States semiconductor TNC, Intel, based more on the provision of a skilled and capable work force rather than sheer incentives, would appear to be a practical example to follow in this regard.

RESUMEN

Las empresas transnacionales (ETs) se han adaptado a la globalización de los mercados mundiales estableciendo sistemas internacionales de producción, lo que ha llevado que los países en desarrollo compitan por captar mayores afluencias de inversión extranjera directa (IED). Esos países son conscientes que lograr que una ET los incluya en su sistema de producción internacional puede representar una vía importante para incorporarse al proceso de globalización, siendo este mecanismo especialmente importante para países pequeños.

La competencia por IED opera mediante: i) subsidios directos e indirectos, incentivos financieros y exención tributaria; ii) el desarrollo de una economía de mercado con un marco regulatorio adecuado, estándares laborales y ambientales, derechos de propiedad intelectual y acuerdos de integración regional; y iii) la creación de factores de producción y de infraestructura para un desempeño económico eficiente. Dependiendo si los países optan por una “guerra de incentivos” o por fortalecer la creación de factores productivos, las políticas para competir por la IED pueden resultar en juegos de suma negativa o positiva.

La revisión de la competencia por IED en la Cuenca del Caribe, basada en las experiencias de Costa Rica, República Dominicana y Jamaica, indica que las políticas para atraer la IED se han vuelto más intensivas en incentivos, siendo uno de los principales la posibilidad de operar en zonas de procesamiento de exportación (ZPE). Considerando que el principal nexo entre esos países y su mayor mercado de exportación (el de Estados Unidos) se encuentra en ensamblar prendas de vestir en ZPE, se evalúa esa industria en cada uno de ellos. Un análisis de estas experiencias, basadas en encuestas realizadas a algunas de las empresas más importantes que operan en esa actividad, junto con una evaluación de costos y beneficios a nivel nacional, permite concluir que el mero equiparar lo que otros países ofrecen no necesariamente trae los beneficios deseados y que incentivos poco claros generalmente producen resultados imprevisibles. Para mejorar la eficacia de la política para atraer a ETs particulares, es necesario ubicarla en el marco de políticas activas e integrales enfocadas hacia metas nacionales de competitividad. El éxito de Costa Rica en atraer inversiones —en particular de Intel, empresa líder en microprocesadores— se ha basado más en ofrecer una fuerza laboral competente y capacitada que en igualar los incentivos ofrecidos por sus competidores. En este sentido es un ejemplo a seguir.

1. INTRODUCTION

Policy competition is rapidly becoming a relevant issue in Latin America and the Caribbean in the mid-1990s. Renewed interest in active government policies which foster industrial and economic competitiveness in the region has naturally given rise to a growing interest in the impact those policies will have and in whether policies undertaken by different countries, or regions within a country, complement or compete with each other (Peres, 1996). Consequently, there is a growing concern about the effects that potential or actual "bidding wars" may have, particularly in larger countries, while considerations to prevent unfair policy competition and to benefit from synergy are at least incipient in most free-trade agreements.

This paper considers three main categories of policy competition for foreign investment: (a) competition through the provision of direct and indirect subsidies, tax holidays and other similar financial incentives (incentives-based competition), (b) competition through the strengthening of a market economy with an adequate legal system, labour and environmental standards, intellectual property rights and regional integration agreements (rules-based competition) and (c) competition through the development of production factors and infrastructure needed for an efficient economic performance (factor-creation competition).¹ Each of these forms of policy competition may result in positive- or negative-sum games.

Studying the main characteristics of policy competition for foreign investment in the Caribbean Basin countries enables us to see such competition at work among small countries with relatively similar economic structures and performances in the last decades.² The paper focuses on Costa Rica, Jamaica and the Dominican Republic. These three countries are among the largest in the area and are quickly shifting away from natural resource enclaves (e.g., bananas, coffee, sugar and metallic ores) to more diversified economies, increasingly based on export processing zones (EPZs),³ tourism and a somewhat significant domestic market, at least for basic food products and other non-durable consumer goods. Table 1 presents some of the main economic indicators for those countries.

This paper is divided into seven sections. After the introduction, section 2 presents the main characteristics of the Caribbean Basin integration into the global economy. This is followed in section 3 by an analysis at the sectoral and company levels which shows how that integration has shaped enterprise and industry development.

¹ These categories are based in Oman (1996), but they include more components in rules-based competition (the strengthening of a market economy and an independent judiciary) and develop the new category of factor-creation competition, which is pertinent for countries with active competitiveness policies.

² The Caribbean Basin countries include the 24 Central American and Caribbean countries which are beneficiaries of the United States Caribbean Basin Economic Recovery Act (USITC, 1995a). Cuba is not included.

³ In 1995, EPZs accounted for 71% of total exports in the Dominican Republic, 30% in Jamaica and 20% in Costa Rica. The corresponding figure for Mexico was 47%.

Section 4 considers the main issue of this paper: how countries compete for foreign direct investment (FDI). This analysis takes into account four dimensions of such competition: the legal frameworks for foreign investment, the process of selling a country image to attract investors, competition for investment in export platforms and the role of competitiveness policies. These dimensions are discussed in detail for the three countries that are the focus of our analysis, although other Latin American and Caribbean countries are considered for comparison. Section 5 presents a quantitative index of how attractive a country is to foreign investors, with detailed information about the main components of the index. Section 6 provides a broad view of the dynamics of policy competition, presenting cases of outcomes that imply negative- and positive-sum games. Finally, the paper concludes with some considerations about what can be learned from policy competition in the Caribbean Basin and the debate on the impact that such competition has had on the economic performance of the countries in the region.

Table 1

CARIBBEAN BASIN COUNTRIES: ECONOMIC INDICATORS, 1994

| Countries | Area (km ²) | Population (Millions) | Gross domestic product (Billions of United States dollars) | Per capita GDP (United States dollars) |
|-----------------------|-------------------------|-----------------------|--|--|
| Barbados ^a | 430 | 0.4 | 1.8 | 4,180 |
| Costa Rica | 51,100 | 3.3 | 8.3 | 2,400 |
| Dominican Republic | 48,308 | 7.6 | 10.4 | 1,330 |
| El Salvador | 21,041 | 5.6 | 8.1 | 1,360 |
| Guatemala | 108,889 | 10.3 | 12.9 | 1,200 |
| Haiti | 27,750 | 7.0 | 1.6 | 230 |
| Honduras | 112,889 | 5.8 | 3.4 | 600 |
| Jamaica | 10,991 | 2.5 | 4.2 | 1,540 |
| Trinidad and Tobago | 5,130 | 1.3 | 4.8 | 3,740 |

Source: The World Bank, *World Development Report 1996*, London, Oxford University Press, 1996, and AXIS Estrategias Empresariales, Caracas, 1994.

^a Data for 1993.

2. THE CARIBBEAN BASIN IN A GLOBAL CONTEXT

The major changes in the economic situation of the Caribbean Basin are better understood by placing them in a global context, because for the most part they have been induced by the globalization process rather than by national policy initiatives. The globalization process is characterized by the intensification of international competition and by the transnationalization of the process via foreign direct investment or technology transfer. In this context, corporations with global sourcing strategies are the economic agents which most influence trade outcomes (Mortimore, 1995a). The situation is clearest with regard to the international competitiveness of countries, as measured by their foreign trade performance. This can best be depicted by making reference to a number of tables based on results of the Competitive Analysis of Nations (CANPLUS) software.⁴ The principal objective of these tables is to demonstrate major changes in the international competitiveness of the distinct regions or countries, based on international the dynamic of their market shares.

The member countries of the Organization of Economic Cooperation and Development (OECD) account for about 70 percent of total world imports. Table 2 indicates that the source countries for OECD imports changed significantly in 1980-1994.⁵ A first observation is that the OECD countries imported more from each other during this period (reaching almost three-quarters of their total imports in 1990), although there was a relative decline in 1990-1994. Evidently, if the OECD members traded more among themselves, their imports from developing countries and transition economies declined in relative terms. That is evident in table 2 with regard to Latin America (from 5.3% to 4.8% of OECD imports), Africa (from 5.9% to 2.2%) and Eastern Europe (from 1.3% to 0.9%). However, it is definitely not the case for developing Asia (from 7.8% to 14.1%) or Turkey (from 0.2% to 0.4%). Thus, among developing countries, market share gains were very much concentrated in developing Asia.⁶

This phenomenon can be further elaborated by distinguishing the situation of natural resources from that of manufactures. Table 3 demonstrates that natural resources are definitely not dynamic elements of world trade. As a proportion of all OECD imports, they declined about one-half over 1980-1994, from 44% to 23% of the total. The developing countries varied somewhat in their performance: developing Asia gained OECD import market shares (from 8% to 9%), Latin America maintained its share

⁴ The Competitive Analysis of Nations (CANPLUS) software has been developed by the Division of Production, Productivity and Management of the United Nations Economic Commission for Latin America and the Caribbean (ECLAC). For an example of its potential, see Mortimore (1995b).

⁵ Data for 1994 do not include Mexico as an OECD member country.

⁶ Developing Asia includes China, the Republic of Korea, Hong Kong, India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines, Singapore, Taiwan (Province of China) and Thailand.

(at 9-10%) and Africa lost market shares (from 12% to 7%), as did the transitional economies of Eastern Europe (from 1.3% to 0.9%). Some differentiation took place within regions. For example, China and the Asian Tigers (i.e., the Republic of Korea, Chinese Province of Taiwan, Hong Kong and Singapore) gained, while the rest of developing Asia lost market shares, and while the rest of Latin America gained, the Caribbean Basin lost market shares. In other words, although natural resources represented a declining share of OECD imports, some developing countries were able to improve their competitive position. However, most did not.

Table 2
OECD TOTAL IMPORTS, BY SOURCE REGIONS, 1980-1994
(Percentages)

| | 1980 | 1985 | 1990 | 1994 | Change 1980-1994 |
|--------------------------------------|-------|-------|-------|-------|---------------------|
| OECD | 64.55 | 70.56 | 74.22 | 70.86 | 10 |
| North America | 14.98 | 16.09 | 14.87 | 16.02 | 7 |
| Western Europe ^a | 44.66 | 46.09 | 51.62 | 46.74 | 5 |
| Japan | 4.86 | 8.16 | 7.40 | 7.66 | 58 |
| Turkey | 0.16 | 0.27 | 0.38 | 0.40 | 154 |
| Developing Asia | 7.80 | 9.80 | 11.11 | 14.05 | 80 |
| China | 0.67 | 1.03 | 1.85 | 3.44 | 411 |
| Tigers ^b | 3.48 | 5.30 | 5.76 | 5.88 | 69 |
| Rest of Developing Asia ^c | 3.65 | 3.47 | 3.50 | 4.73 | 30 |
| Latin America and the Caribbean | 5.30 | 5.70 | 4.54 | 4.84 | -9 |
| Caribbean Basin | 0.88 | 0.69 | 0.52 | 0.58 | -34 |
| Mexico | 1.26 | 1.77 | 1.50 | 1.95 | 55 |
| Rest of Latin America | 3.15 | 3.24 | 2.52 | 2.31 | -27 |
| Africa | 5.99 | 4.02 | 2.68 | 2.23 | -63 |
| North Africa | 2.84 | 1.87 | 1.27 | 1.09 | -62 |
| Rest of Africa | 3.15 | 2.15 | 1.41 | 1.14 | -64 |
| Eastern Europe | 1.25 | 1.13 | 1.09 | 0.90 | -28 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Includes some non-OECD countries.

^b Hong Kong, the Republic of Korea, Singapore and Chinese Province of Taiwan.

^c India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines and Thailand.

The situation of manufactures is shown in table 4. In 1980-1994, manufactures represented the most dynamic element of foreign trade, rising from about one-half to about three-quarters of all OECD imports. The OECD countries imported increasingly less from each other (76% in 1994, down from 85% in 1980) and progressively more from developing countries, making the export of manufactures a very dynamic way for developing countries to improve their integration in the international economy. Developing Asia was the principal beneficiary of this structural change (from 8% to 16% of all OECD imports of manufactures), Latin America made some gains (from 2% to 3%) and Africa and the transitional economies of Eastern Europe lost ground (from 1.3% to 0.8% and from 1.3% to 0.9% respectively).

Table 3
OECD IMPORTS OF NATURAL RESOURCES, BY SOURCE REGIONS, 1980-1994
(Percentages)

| | 1980 | 1985 | 1990 | 1994 | Change 1980-1994 |
|---|-------|-------|-------|-------|---------------------|
| OECD | 38.80 | 46.67 | 53.51 | 54.84 | 41 |
| North America | 11.72 | 12.48 | 13.61 | 14.64 | 25 |
| Western Europe ^a | 25.71 | 32.42 | 37.64 | 37.55 | 46 |
| Japan | 0.18 | 0.28 | 0.23 | 0.24 | 32 |
| Turkey | 0.26 | 0.45 | 0.50 | 0.46 | 76 |
| Developing Asia | 7.93 | 9.29 | 8.84 | 9.38 | 18 |
| China | 0.89 | 1.47 | 1.60 | 1.82 | 105 |
| Tigers ^b | 1.04 | 1.48 | 1.58 | 1.58 | 52 |
| Rest of Developing Asia ^c | 6.00 | 6.34 | 5.66 | 5.98 | - |
| Latin America and the Caribbean | 9.37 | 11.46 | 9.89 | 9.95 | 6 |
| Caribbean Basin | 1.72 | 1.52 | 1.26 | 1.30 | -24 |
| Mexico | 1.94 | 3.06 | 2.03 | 1.92 | - |
| Rest of Latin America | 5.71 | 6.88 | 6.59 | 6.73 | 18 |
| Africa | 11.76 | 9.72 | 7.77 | 6.75 | -43 |
| North Africa | 6.24 | 5.10 | 4.00 | 3.37 | -46 |
| Rest of Africa | 5.52 | 4.62 | 3.77 | 3.38 | -39 |
| Eastern Europe | 1.25 | 1.52 | 1.43 | 0.93 | -26 |
| Natural resources as % of total imports | 43.7 | 33.7 | 24.9 | 22.8 | -48 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Includes some non-OECD countries.

^b Hong Kong, the Republic of Korea, Singapore and Chinese Province of Taiwan.

^c India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines and Thailand.

Again, certain intraregional differences were apparent. In developing Asia, China (from 0.5% to 4%) and the rest of developing Asia (from 2% to 4%) were the principal winners, while the previously spectacular growth of the Asian Tigers stagnated after 1985. Within Latin America, Mexico (from 0.7% to 1.9%) and the Caribbean Basin (from 0.20% to 0.36%) made important advances while the rest of the region lost ground. In sum, a relatively large group of Asian developing countries and a relatively small group of Latin American ones proved capable of taking advantage of this opportunity to grow faster and become better integrated into the international economy.

Table 4
OECD IMPORTS OF MANUFACTURES, BY SOURCE REGIONS, 1980-1994
(Percentages)

| | 1980 | 1985 | 1990 | 1994 | Change 1980-1994 |
|--------------------------------------|-------|-------|-------|-------|---------------------|
| OECD | 85.38 | 83.26 | 81.42 | 76.17 | -11 |
| North America | 17.26 | 17.50 | 15.07 | 16.31 | -6 |
| Western Europe ^a | 60.25 | 53.70 | 56.65 | 49.96 | -17 |
| Japan | 8.74 | 12.53 | 9.99 | 10.12 | 16 |
| Turkey | 0.08 | 0.19 | 0.35 | 0.39 | 393 |
| Developing Asia | 7.79 | 10.26 | 12.06 | 15.80 | 103 |
| China | 0.52 | 0.81 | 1.98 | 4.04 | 680 |
| Tigers ^b | 5.40 | 7.39 | 7.25 | 7.30 | 35 |
| Rest of Developing Asia ^c | 1.87 | 2.06 | 2.83 | 4.46 | 139 |
| Latin America and the Caribbean | 2.07 | 2.68 | 2.72 | 3.29 | 59 |
| Caribbean Basin | 0.20 | 0.24 | 0.26 | 0.36 | 80 |
| Mexico | 0.71 | 1.09 | 1.29 | 1.93 | 173 |
| Rest of Latin America | 1.16 | 1.34 | 1.16 | 1.00 | -14 |
| Africa | 1.30 | 0.96 | 0.82 | 0.76 | -41 |
| North Africa | 0.21 | 0.23 | 0.30 | 0.37 | 77 |
| Rest of Africa | 1.09 | 0.73 | 0.52 | 0.40 | -64 |
| Eastern Europe | 1.28 | 0.96 | 1.00 | 0.92 | -28 |
| Manufactures as % of total imports | 54.5 | 63.9 | 72.7 | 74.4 | 37 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Includes some non-OECD countries.

^b Hong Kong, the Republic of Korea, Singapore and Chinese Province of Taiwan.

^c India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines and Thailand.

Table 4 highlights the more recent success of Asian countries in exporting manufactures to the OECD countries. This dramatic success began long ago with Japan and was later followed by the Asian Tigers; only later still did other Asian developing countries attain similar success. The astounding success of Japan and the Asian Tigers, often led by upstart national companies, produced a severe reaction from the OECD-based corporations that were losing market shares. As of 1985, Japan and the Asian Tigers began to lose market shares, while North America and, momentarily, Europe, began to win back some of their lost import shares. The reaction of United States corporations was also registered through their offshore sourcing from new EPZ activities in Latin America, especially the Caribbean Basin.

Tables 5, 6 and 7 provide information for comparing the tendencies of the Western European, North American and Japanese markets with respect to the imports of manufactures during 1980-1994. Manufactures are clearly the most dynamic and most important element of total imports in these markets (from 58% to 75% in Western Europe, from 57% to 80% in North America, and from 22% to 51% in Japan). In each market, market shares of the OECD countries themselves have declined (from 90% to 84% in Western Europe, from 78% to 65% in North America, and from 64% to 55% in Japan), while market shares of developing Asia have soared (from 4% to 9% in Western Europe, from 15% to 24% in North America, and from 24% to 40% in Japan), although

the advance of Japan and the Asian Tigers has been slowed or stopped. Market shares of both Africa and Eastern Europe have collapsed. This suggests that a common phenomenon was present in each of these separate components of the OECD market.

Table 5
WESTERN EUROPEAN IMPORTS OF MANUFACTURES, BY SOURCE REGIONS, 1980-1994
(Percentages)

| | 1980 | 1985 | 1990 | 1994 | Change 1980-1994 |
|--|-------|-------|-------|-------|---------------------|
| OECD | 89.54 | 89.94 | 88.29 | 84.42 | -6 |
| North America | 9.55 | 8.99 | 8.63 | 9.34 | -2 |
| Western Europe ^a | 76.82 | 75.82 | 74.35 | 69.77 | -9 |
| Japan | 4.50 | 5.98 | 5.96 | 6.00 | 34 |
| Turkey | 0.11 | 0.28 | 0.48 | 0.57 | 410 |
| Developing Asia | 4.17 | 4.53 | 6.33 | 8.73 | 109 |
| China | 0.31 | 0.41 | 1.04 | 2.03 | 547 |
| Tigers ^b | 2.62 | 2.85 | 3.53 | 4.00 | 53 |
| Rest of Developing Asia ^c | 1.24 | 1.27 | 1.76 | 2.70 | 118 |
| Latin America and the Caribbean | 0.99 | 0.90 | 0.96 | 0.80 | -19 |
| Caribbean Basin | 0.10 | 0.08 | 0.10 | 0.06 | -43 |
| Mexico | 0.10 | 0.07 | 0.12 | 0.13 | 32 |
| Rest of Latin America | 0.79 | 0.75 | 0.74 | 0.61 | -26 |
| Africa | 1.09 | 0.98 | 0.95 | 0.96 | -12 |
| North Africa | 0.29 | 0.37 | 0.44 | 0.58 | 98 |
| Rest of Africa | 0.79 | 0.60 | 0.51 | 0.38 | -52 |
| Eastern Europe | 1.64 | 1.39 | 1.28 | 1.40 | -15 |
| Manufactures as % of total Western European imports | 58.0 | 63.7 | 74.7 | 75.1 | 30 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Includes some non-OECD countries.

^b Hong Kong, the Republic of Korea, Singapore and Chinese Province of Taiwan.

^c India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines and Thailand.

One very significant difference can be perceived. While Latin America has lost import market shares for manufactures in both Western Europe (from 1% to 0.8%) and Japan (from 4% to 2%), its import market share in the North American market almost doubled (from 5% to 9%). Moreover, those gains were concentrated in Mexico (from 2.4% to 5.9%) and the Caribbean Basin (0.5% to 1%). Thus, the rather limited gains of Latin American countries in OECD imports of manufactures are wholly concentrated in the North American component of that market and are centered on Mexico and the Caribbean Basin.

Table 6
NORTH AMERICAN IMPORTS OF MANUFACTURES, BY SOURCE REGIONS, 1980-1994
(Percentages)

| | 1980 | 1985 | 1990 | 1994 | Change 1980-1994 |
|--|-------|-------|-------|-------|---------------------|
| OECD | 77.80 | 74.96 | 69.54 | 64.86 | -17 |
| North America | 33.69 | 28.41 | 26.91 | 26.65 | -21 |
| Western Europe ^a | 24.37 | 23.16 | 21.19 | 18.68 | -23 |
| Japan | 19.99 | 23.44 | 21.23 | 19.35 | 3 |
| Turkey | 0.01 | 0.08 | 0.14 | 0.16 | 1163 |
| Developing Asia | 14.52 | 17.62 | 21.60 | 24.28 | 67 |
| China | 0.53 | 1.03 | 3.34 | 6.09 | 1048 |
| Tigers ^b | 11.00 | 13.64 | 13.84 | 11.61 | 6 |
| Rest of Developing Asia ^c | 2.99 | 2.95 | 4.42 | 6.58 | 120 |
| Latin America and the Caribbean | 4.74 | 5.52 | 7.11 | 8.57 | 81 |
| Caribbean Basin | 0.49 | 0.53 | 0.74 | 1.03 | 110 |
| Mexico | 2.38 | 2.87 | 4.49 | 5.89 | 147 |
| Rest of Latin America | 1.87 | 2.12 | 1.88 | 1.65 | -12 |
| Africa | 1.66 | 0.76 | 0.45 | 0.40 | -76 |
| North Africa | 0.03 | 0.02 | 0.05 | 0.07 | 144 |
| Rest of Africa | 1.63 | 0.74 | 0.41 | 0.33 | -80 |
| Eastern Europe | 0.54 | 0.34 | 0.23 | 0.20 | -62 |
| Manufactures as % of total North American imports | 57.3 | 73.5 | 76.9 | 80.2 | 40 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Includes some non-OECD countries.

^b Hong Kong, the Republic of Korea, Singapore and Chinese Province of Taiwan.

^c India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines and Thailand.

Table 8 outlines the structural transformation of the Caribbean Basin the integration in the North American economy during 1980-1994. The proportion of total exports classified as natural resources going to that import market dropped from 84% to 37%; this tendency was common to all agricultural products, energy and other natural resources. Manufactures rocketed from 13% to 59% of all exports to the North American market, with the advance recorded both by manufactures based on natural resources and by those not based on natural resources. Sluggish exports of natural resources were rapidly displaced by exports of manufactures. With regard to market shares, the Caribbean Basin lost ground in the North American market (falling from 2.2% to 1.4%) because the growth in manufactures (from 0.5% to 1%) was not sufficient to counteract the sharp decline of natural resources (from 5% to 3%).

Table 7
JAPANESE IMPORTS OF MANUFACTURES, BY SOURCE REGIONS, 1980-1994
(Percentages)

| | 1980 | 1985 | 1990 | 1994 | Change 1980-1994 |
|--|-------|-------|-------|-------|---------------------|
| OECD | 64.27 | 64.89 | 60.88 | 54.76 | -15 |
| North America | 35.86 | 37.21 | 29.46 | 28.65 | -20 |
| Western Europe ^a | 28.03 | 26.76 | 30.15 | 25.09 | -11 |
| Japan | n.a. | n.a. | n.a. | n.a. | n.a. |
| Turkey | - | 0.04 | 0.15 | 0.07 | 1478 |
| Developing Asia | 23.88 | 24.87 | 31.41 | 39.51 | 65 |
| China | 3.43 | 4.12 | 6.04 | 12.64 | 268 |
| Tigers ^b | 15.16 | 15.39 | 17.78 | 16.15 | 7 |
| Rest of Developing Asia ^c | 5.29 | 5.36 | 7.59 | 10.72 | 103 |
| Latin America and the Caribbean | 4.43 | 3.94 | 3.08 | 1.95 | -56 |
| Caribbean Basin | 0.22 | 0.20 | 0.07 | 0.06 | -75 |
| Mexico | 0.77 | 0.47 | 0.35 | 0.26 | -66 |
| Rest of Latin America | 3.44 | 3.26 | 2.66 | 1.63 | -53 |
| Africa | 3.29 | 2.46 | 1.24 | 0.94 | -71 |
| North Africa | 0.07 | 0.03 | 0.03 | 0.03 | -54 |
| Rest of Africa | 3.21 | 2.44 | 1.22 | 0.91 | -72 |
| Eastern Europe | 0.62 | 0.66 | 0.46 | 0.16 | -74 |
| Manufactures as % of total Japanese imports | 21.8 | 29.4 | 47.0 | 50.8 | 133 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Includes some non-OECD countries.

^b Hong Kong, the Republic of Korea, Singapore and Chinese Province of Taiwan.

^c India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines and Thailand.

During 1980-1994, almost two-thirds of the Caribbean Basin's exports to the North American market were made up of the ten product groups listed in table 8 (at three digits of the Standard International Trade Classification or SITC). Five were natural resources and five were manufactures. In 1980, natural resources (crude petroleum, coffee, sugar, metallic ores and bananas) were the most important export products, while by 1994 manufactures (without exception, garments) made up almost 40% of the total. By 1994, the only sectors in which the Caribbean Basin countries were gaining export shares and which represented dynamic elements of the North American import market were garments.

Table 8
**THE CARIBBEAN BASIN 'S INTERNATIONAL COMPETITIVENESS, IN THE NORTH AMERICAN MARKET,
 1980, 1985, 1990 AND 1994**
 (Percentages)

| | | 1980 | 1985 | 1990 | 1994 |
|---|---------------------------|-------|-------|-------|-------|
| I. Contribution (structure of its exports to North America) | | 100.0 | 100.0 | 100.0 | 100.0 |
| Natural resources <u>1/</u> + <u>2/</u> + <u>3/</u> | | 83.8 | 68.6 | 50.5 | 37.2 |
| Agriculture <u>1/</u> | | 42.2 | 44.3 | 33.3 | 26.6 |
| Energy <u>2/</u> | | 31.3 | 17.7 | 10.0 | 5.7 |
| Other natural resources (textile fibers, minerals, etc.) <u>3/</u> | | 10.3 | 6.7 | 7.1 | 4.9 |
| Manufactures <u>4/</u> + <u>5/</u> | | 13.0 | 27.4 | 45.9 | 59.0 |
| Based on natural resources <u>4/</u> | | 2.1 | 3.0 | 3.7 | 3.3 |
| Not based on natural resources <u>5/</u> | | 10.9 | 24.4 | 42.2 | 55.7 |
| Other <u>6/</u> | | 3.1 | 4.0 | 3.6 | 3.9 |
| II. Market share of North American imports | | 2.16 | 1.42 | 1.24 | 1.40 |
| Natural resources <u>1/</u> + <u>2/</u> + <u>3/</u> | | 4.52 | 5.42 | 3.16 | 3.18 |
| Agriculture <u>1/</u> | | 8.74 | 7.15 | 4.20 | 5.23 |
| Energy <u>2/</u> | | 2.48 | 1.93 | 1.14 | 0.96 |
| Other natural resources (textile fibers, minerals, etc.) <u>3/</u> | | 9.61 | 6.9 | 6.6 | 6.87 |
| Manufactures <u>4/</u> + <u>5/</u> | | 0.49 | 0.53 | 0.74 | 1.03 |
| Based on natural resources <u>4/</u> | | 0.95 | 1.01 | 1.12 | 1.24 |
| Not based on natural resources <u>5/</u> | | 0.45 | 0.50 | 0.72 | 1.02 |
| Others <u>6/</u> | | 2.55 | 1.75 | 1.37 | 1.60 |
| III. Principal exports to North America (% of all exports to North America) | ^a ^b | 64.4 | 61.5 | 61.9 | 63.0 |
| 846 Undergarments, knitted or crocheted | * + | 1.8 | 2.8 | 6.7 | 10.8 |
| 843 Outer garments, women's and girls' of textile fabrics | * + | 1.0 | 2.9 | 7.1 | 9.1 |
| 842 Outer garments, men's and boys, of textile fabrics | * + | 0.4 | 2.0 | 6.6 | 9.0 |
| 057 Fruit and nuts, fresh or dried | - | 7.3 | 10.5 | 9.7 | 8.5 |
| 845 Outer garments, other articles, knitted | * + | 0.2 | 0.6 | 4.0 | 5.5 |
| 287 Ores and concentrates of base metals | - | 9.8 | 6.3 | 6.6 | 4.6 |
| 844 Undergarments, textile (not knitted/crocheted) | * + | 0.5 | 1.1 | 2.2 | 4.3 |
| 071 Coffee and coffee substitutes | + | 11.7 | 13.6 | 6.3 | 4.2 |
| 333 Petroleum oils, crude | - | 20.5 | 14.5 | 7.5 | 3.7 |
| 061 Sugar and honey | - | 11.2 | 7.2 | 5.1 | 3.4 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

Note: The Caribbean Basin consists of Barbados, Costa Rica, Cuba, Dominican Republic, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Nicaragua, Panama, Surinam and Trinidad and Tobago.

^a Groups which correspond to the 50 most dynamic in the North American market during 1980-1994.

^b - Groups in which the market share of the Caribbean Basin declined during 1980-1994.

+ Groups in which the market share of the Caribbean Basin increased during 1980-1994.

1/ Sections 0, 1 and 4, divisions 21, 22, 23, 24, 25 and 29 of the Standard International Trade Classification (SITC) Revision 2.

2/ Section 3 of SITC.

3/ Divisions 26, 27 and 28 of SITC.

4/ Divisions 61, 63 and 68; groups 661, 662, 663, 667 and 671 of SITC.

5/ Sections 5, 6 (minus the divisions and groups mentioned in 4), 7 and 8 of SITC.

6/ Section 9 of SITC.

For centuries the main link between the Caribbean Basin and the international economy was the extraction and export of natural resources such as sugar, bananas and coffee, which was later complemented by minerals such as bauxite and nickel. This resulted in a slow-growth trajectory for the countries because these are not dynamic goods in world trade. Moreover, a dissonance or duality was created by the mainly enclave-type activities, with severe instability from the boom and bust cycles associated with the international prices of most natural resource commodities. The fact that the region finally began to generate other forms of integration into the international economy thus represented a significant structural innovation. Export of manufactures, specifically garments, and the tourism industry proved to be the most dynamic new sectors. These advances resulted less from national policy initiatives of the Caribbean Basin countries themselves than from international market factors, new strategies on the part of mainly United States corporations and United States national policy to assist those corporations. Moreover, several Asian companies also established apparel assembly operations to gain access to the United States market using export quotas of Caribbean countries since quotas of the country in their region were used up.

The process of change began when United States corporations responded to the Asian challenge in their own national market, searching for the means to remain competitive. Many United States corporations altered their strategies to take advantage of existing United States legislation which permitted companies based in the United States to export locally made components to be assembled into finished products outside the country; duties or taxes on the re-imported goods were assessed only on the value added outside of the country. This was originally known as TSUS 807 regime and is now known as HTS 9802.⁷ Many Caribbean Basin countries faced a severe international debt crisis during the 1980s, and part of their reaction to that macroeconomic problem involved steep devaluations of the national currency, thereby drastically cheapening national labour costs measured in dollars. They also offered very significant incentives to foreign investors in terms of EPZ conveniences and tax relief. The result was a virtual explosion of the export of assembled goods to the United States market.

Excluding offshore financial centers, FDI flows to the Caribbean Basin in the 1990s have been concentrated in just three countries: Costa Rica, the Dominican Republic and Jamaica.⁸ Most of this investment came from the United States, while FDI from Japan and Western Europe has been rather small (IRELA and IDB, 1996). Solid statistical information on the sectoral distribution of this FDI is not available; however, most of it has apparently been channeled to three basic activities: capital-intensive natural resource projects, tourism projects, and a very large number of assembly activities usually located in export processing zones.

⁷ All 807 imports into the United States which originate from Caribbean Basin countries are subject to the quotas applied under the Multifiber Arrangement and other quantitative restrictions affecting imports of shoes and leather goods. A special regime enacted in 1986 (known as Super 807 or 807A) freed qualifying-nation exports from all quota agreements if the fabric was produced and cut in the United States or in other qualifying nations. Since 1987, the Caribbean Basin Initiative II Bill allows the use of materials sourced outside the United States if the material is not produced in the United States or is in short supply, and it permits the cutting and layout of materials in qualifying Caribbean Basin Initiative (CBI) countries. However, it excludes the most important contributors to value-added: cloth, design, grading and marketing (Kaplinski, 1993; USITC, 1995a).

⁸ According to balance-of-payments figures from the International Monetary Fund (IMF) quoted in ECLAC (1995), table 12, page 82.

The latter phenomenon is registered in table 9, which indicates United States imports from developing countries via the Harmonized Tariff Schedule (HTS) 9802.00.80 mechanism during 1989-1993. Trade values increased by over 45% during that short period, from US\$ 21.5 billion to US\$ 31.2 billion. The big gainers were Mexico (from 55% to 60%) and the small countries of the Caribbean Basin (from 5% to 10%), while the Asian suppliers' share of this trade dropped substantially (from 32% to 26%). Thus, the dynamism of the Caribbean Basin exports of manufactures to the United States market stems primarily from the effects of new strategies by United States corporations facing intense competition from Asian imports in their own national market.

Table 9
UNITED STATES IMPORTS FOR CONSUMPTION FROM DEVELOPING COUNTRIES
UNDER HTS PROVISION 9802.00.80, 1989 AND 1993
(Percentages and millions of United States dollars)

| Country | 1989 | 1993 |
|------------------------------|---------------|---------------|
| Mexico | 54.7 | 60.0 |
| Malaysia | 6.1 | 5.3 |
| Republic of Korea | 9.2 | 5.3 |
| Dominican Republic | 3.1 | 4.9 |
| Singapore | 6.4 | 4.7 |
| Philippines | 2.7 | 3.4 |
| Chinese Province of Taiwan | 4.9 | 3.1 |
| Costa Rica | 1.3 | 1.8 |
| Guatemala | n.a. | 1.3 |
| China | n.a. | 1.3 |
| Thailand | 1.3 | 1.3 |
| Honduras | n.a. | 1.1 |
| Hong Kong | 1.4 | 1.1 |
| Jamaica | 0.8 | 1.0 |
| All other | 8.1 | 4.4 |
| Total | 100.0 | 100.0 |
| Total (US\$ millions) | 21,529 | 31,241 |

Source: Based on the United States International Trade Commission (USITC), *Production sharing: Use of United States components and materials in foreign assembly operations, 1990-1993*, USITC Publication 2886, Washington DC, May 1995.

3. THE SECTORAL AND COMPANY LEVELS

The garment industry is one of the most internationalized manufacturing industries and one in which developing countries have made the greatest gains in OECD import market shares. Three distinct new sourcing tendencies became evident during 1980-1984: (i) developing Asian competitors held significant and growing market shares in garment imports of the OECD countries (46% in 1994); (ii) of these developing Asian competitors, the Tigers are experiencing a dramatic collapse in their import market shares (from 30% to 16%) while China and other developing Asian competitors are making impressive gains (together from 8% to 30%); and (iii) each component of the OECD market has a common sourcing element (developing Asia) and a new regional focus, that is, the Caribbean Basin and Mexico in the case of North America (from 7% to 15% of that market), North Africa, Turkey and Eastern Europe in the case of Western Europe (from 7% to 18% of that market), and solely developing Asia in the case of Japan (from 74% to 79% of that market). As can be appreciated in the previous section, the garment industry is at the forefront of the Caribbean Basin's new integration into the North American economy. This section of the paper focuses on that sector.

Table 10 demonstrates the principal source regions of garment (SITC 84) imports in North America (i.e., the United States and Canada). This market was very dynamic, with garment imports doubling in importance during 1980-1994 (from 2.6% to 5.1% of all North American imports). While developing Asian competitors continued to dominate that market (together possessing 63% of North American garment imports in 1994), their share declined (down from 75% in 1980). Moreover, the Asian Tigers share collapsed (from 62% to 27%), while that of China (from 4% to 18%) and others (from 8% to 19%) grew strongly. The Caribbean Basin and Mexico became the most competitive of the non-Asian source countries in this industry, reaching a joint 15% share in the North American market by 1994.

Referring strictly to the United States market, garment imports through the HTS 9802 mechanism rose from 6% of total garment imports in 1987 to 15% in 1994. Almost three-quarters of these imports in 1994 came from only two principal sources: the Caribbean Basin (62%) and Mexico (11%). These countries were clearly playing a central role in the attempts by United States garment corporations to meet the Asian challenge in their own national market by taking advantage of United States policy measures, as well as the incentives and other benefits offered by the Latin American countries.

Table 10
**STRUCTURE OF NORTH AMERICAN IMPORTS OF GARMENTS (SITC 84),
 BY SOURCE REGIONS, 1980-1994**
(Percentages)

| | 1980 | 1985 | 1990 | 1994 | Change 1980-1994 |
|---|-------|-------|-------|-------|---------------------|
| OECD | 12.71 | 15.45 | 11.16 | 9.25 | -27 |
| North America | 2.10 | 1.61 | 1.66 | 2.63 | 25 |
| Western Europe ^a | 8.99 | 11.18 | 8.02 | 5.37 | -40 |
| Japan | 3.10 | 3.01 | 0.71 | 0.33 | -89 |
| Turkey | 0.03 | 0.59 | 1.17 | 1.28 | 4066 |
| Developing Asia | 74.86 | 72.34 | 69.52 | 63.05 | -16 |
| China | 4.43 | 7.99 | 13.41 | 17.84 | 302 |
| Tigers ^b | 62.04 | 54.24 | 41.75 | 26.68 | -57 |
| Rest of Developing Asia ^c | 8.39 | 10.11 | 14.86 | 18.53 | 121 |
| Latin America and the Caribbean | 8.11 | 6.60 | 11.96 | 17.15 | 111 |
| Caribbean Basin | 3.57 | 3.47 | 7.29 | 11.00 | 208 |
| Mexico | 3.07 | 1.63 | 2.57 | 4.23 | 38 |
| Rest of Latin America | 1.48 | 1.49 | 2.10 | 1.92 | 30 |
| Africa | 0.14 | 0.27 | 0.49 | 0.99 | 605 |
| North Africa | 0.06 | 0.07 | 0.33 | 0.60 | 955 |
| Rest of Africa | 0.08 | 0.21 | 0.16 | 0.39 | 367 |
| Eastern Europe | 1.59 | 0.99 | 0.54 | 0.51 | -68 |
| Garments as % of North American imports | 2.6 | 4.1 | 4.7 | 5.1 | 98 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Includes some non-OECD countries.

^b Hong Kong, the Republic of Korea, Singapore and Taiwan (Province of China).

^c India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines and Thailand.

Tables 11, 12 and 13 highlight the main aspects of the international competitiveness of the Dominican Republic, Costa Rica and Jamaica. All three cases underwent a structural transformation of their exports to the North American market. The share of manufactures in the total exports of these countries rocketed in the period 1980-1994 (from 27% to 84% in the Dominican Republic, from 14% to 56% in Costa Rica, and from 4% to 53% in Jamaica). Natural resources became an increasingly minor component of the countries' integration into the North American market. Manufactures—not natural resources—registered increases in import market shares, and manufactures which are not based on natural resources were by far the most dynamic elements.

Table 11
**DOMINICAN REPUBLIC: ASPECTS OF ITS INTERNATIONAL COMPETITIVENESS
 IN THE NORTH AMERICAN MARKET 1980, 1985, 1990 AND 1994**
 (Percentages)

| | | 1980 | 1985 | 1990 | 1994 |
|--|-----|--------------|--------------|--------------|--------------|
| I. Market share in North American imports | | 0.28 | 0.25 | 0.31 | 0.38 |
| Natural resources <u>1/</u> + <u>2/</u> + <u>3/</u> | | 0.45 | 0.50 | 0.32 | 0.28 |
| Agriculture <u>1/</u> | | 1.66 | 1.38 | 0.88 | 0.65 |
| Energy <u>2/</u> | | 0.00 | 0.00 | 0.00 | 0.00 |
| Other natural resources (textile fibers, minerals, etc.) <u>3/</u> | | 0.35 | 0.04 | 0.09 | 0.04 |
| Manufactures <u>4/</u> + <u>5/</u> | | 0.13 | 0.14 | 0.29 | 0.40 |
| Based on natural resources <u>4/</u> | | 0.55 | 0.49 | 0.86 | 1.01 |
| Not based on natural resources <u>5/</u> | | 0.09 | 0.12 | 0.26 | 0.37 |
| Others <u>6/</u> | | 0.82 | 0.99 | 0.59 | 0.39 |
| II. Contribution (structure of its exports to North America) | | 100.0 | 100.0 | 100.0 | 100.0 |
| Natural resources <u>1/</u> + <u>2/</u> + <u>3/</u> | | 65.5 | 46.0 | 20.8 | 12.2 |
| Agriculture <u>1/</u> | | 62.5 | 45.8 | 20.4 | 12.1 |
| Energy <u>2/</u> | | 0.0 | 0.0 | 0.0 | 0.0 |
| Other natural resources (textile fibers, minerals, etc.) <u>3/</u> | | 3.0 | 0.2 | 0.4 | 0.1 |
| Manufactures <u>4/</u> + <u>5/</u> | | 26.5 | 41.2 | 72.9 | 84.3 |
| Based on natural resources <u>4/</u> | | 9.6 | 8.1 | 11.4 | 9.8 |
| Not based on natural resources <u>5/</u> | | 16.9 | 33.0 | 61.5 | 74.5 |
| Others <u>6/</u> | | 7.9 | 12.8 | 6.3 | 3.5 |
| III. Principal exports to North America by contribution | a b | 44.7 | 45.7 | 66.0 | 74.8 |
| 842 Outer garments, men's and boys' of textile fabrics | * + | 1.1 | 5.4 | 13.5 | 16.6 |
| 843 Outer garments, women's and girls', of textile fabrics | * + | 2.2 | 5.8 | 10.2 | 12.9 |
| 846 Undergarments, knitted or crocheted | * + | 4.6 | 5.6 | 8.2 | 11.9 |
| 612 Leather manufactures, artificial or regenerated | + | 1.2 | 3.4 | 6.3 | 7.7 |
| 845 Outer garments, knitted or crocheted | * + | 0.7 | 0.9 | 4.7 | 5.3 |
| 872 Medical instruments and appliances, n.e.s. | * + | 0.2 | 0.0 | 4.3 | 4.9 |
| 772 Electrical apparatus for making/breaking electrical circuits, etc. | * + | 0.7 | 1.3 | 3.9 | 4.4 |
| 061 Sugar and honey | - | 32.3 | 17.8 | 7.2 | 4.4 |
| 897 Jewelry, goldsmiths' and silversmiths' ware | * + | 0.1 | 3.7 | 4.8 | 4.2 |
| 931 Operations and merchandise, n.e.s. | * + | 1.7 | 1.8 | 2.9 | 2.7 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Groups which correspond to the 50 most dynamic in the North American market during 1980-1994.

^b - Groups in which the market share of the Dominican Republic declined during 1980-1994.

+ Groups in which the market share of the Dominican Republic increased during 1980-1994.

1/ Sections 0, 1 and 4, divisions 21, 22, 23, 24, 25 and 29 of the Standard International Trade Classification (SITC) Revision 2.

2/ Section 3 of SITC.

3/ Divisions 26, 27 and 28 of SITC.

4/ Divisions 61, 63 and 68; groups 661, 662, 663, 667 and 671 of SITC.

5/ Sections 5, 6 (minus the divisions and groups mentioned in 4), 7 and 8 of SITC.

6/ Section 9 of SITC.

Table 12
**COSTA RICA: ASPECTS OF ITS INTERNATIONAL COMPETITIVENESS IN
 THE NORTH AMERICAN MARKET 1980, 1985, 1990 AND 1994**
 (Percentages)

| | | | 1980 | 1985 | 1990 | 1994 |
|--|--|--|--------------|--------------|--------------|--------------|
| I. Market share in North American imports | | | 0.15 | 0.15 | 0.19 | 0.23 |
| Natural resources <u>1/</u> + <u>2/</u> + <u>3/</u> | | | 0.31 | 0.45 | 0.48 | 0.60 |
| Agriculture <u>1/</u> | | | 1.20 | 1.17 | 1.25 | 1.38 |
| Energy <u>2/</u> | | | 0.00 | 0.01 | 0.00 | 0.00 |
| Other natural resources (textile fibers, minerals, etc.) <u>3/</u> | | | 0.03 | 0.05 | 0.02 | 0.04 |
| Manufactures <u>4/</u> + <u>5/</u> | | | 0.03 | 0.06 | 0.12 | 0.16 |
| Based on natural resources <u>4/</u> | | | 0.03 | 0.04 | 0.07 | 0.07 |
| Not based on natural resources <u>5/</u> | | | 0.03 | 0.06 | 0.13 | 0.17 |
| Others <u>6/</u> | | | 0.07 | 0.04 | 0.08 | 0.12 |
| II. Contribution (structure of its exports to North America) | | | 100.0 | 100.0 | 100.0 | 100.0 |
| Natural resources <u>1/</u> + <u>2/</u> + <u>3/</u> | | | 85.2 | 71.0 | 49.6 | 42.5 |
| Agriculture <u>1/</u> | | | 84.8 | 70.1 | 49.5 | 42.4 |
| Energy <u>2/</u> | | | 0.0 | 0.5 | 0.0 | 0.0 |
| Other natural resources (textile fibers, minerals, etc.) <u>3/</u> | | | 0.4 | 0.5 | 0.2 | 0.2 |
| Manufactures <u>4/</u> + <u>5/</u> | | | 13.5 | 28.1 | 49.1 | 55.8 |
| Based on natural resources <u>4/</u> | | | 1.0 | 1.2 | 1.4 | 1.1 |
| Not based on natural resources <u>5/</u> | | | 12.5 | 27.0 | 47.7 | 54.7 |
| Others <u>6/</u> | | | 1.3 | 0.8 | 1.3 | 1.7 |
| III. Principal exports to North America by contribution | | | a | b | 78.4 | 73.7 |
| 057 Fruit and nuts, fresh or dried | | | | + | 34.4 | 34.1 |
| 842 Outer garments, men's and boys', of textile fabrics | | | * | + | 0.5 | 3.7 |
| 846 Undergarments, knitted or crocheted | | | * | + | 5.2 | 5.0 |
| 843 Outer garments, women's, girls' and infants', of textile fabrics | | | * | + | 2.6 | 5.4 |
| 844 Undergarments, of textile fabrics (not knitted) | | | * | + | 0.1 | 2.0 |
| 845 Outer garments, knitted or crocheted | | | * | + | 0.3 | 0.6 |
| 011 Beef, fresh, refrigerated or frozen | | | | - | 17.0 | 9.3 |
| 071 Coffee and coffee substitutes | | | | + | 17.6 | 12.5 |
| 054 Vegetables, fresh, refrigerated, frozen or preserved | | | * | + | 0.8 | 1.0 |
| 775 Home appliances, electrical and non-electrical | | | * | + | 0.0 | 0.0 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Groups which correspond to the 50 most dynamic in the North American market during 1980-1994.

^b - Groups in which the market share of Costa Rica declined during 1980-1994.

+ Groups in which the market share of Costa Rica increased during 1980-1994.

1/ Sections 0, 1 and 4, divisions 21, 22, 23, 24, 25 and 29 of the Standard International Trade Classification (SITC) Revision 2.

2/ Section 3 of SITC.

3/ Divisions 26, 27 and 28 of SITC.

4/ Divisions 61, 63 and 68; groups 661, 662, 663, 667 and 671 of SITC.

5/ Sections 5, 6 (minus the divisions and groups mentioned in 4), 7 and 8 of SITC.

6/ Section 9 of SITC.

Table 13
**JAMAICA: ASPECTS OF ITS INTERNATIONAL COMPETITIVENESS IN THE NORTH
 AMERICAN MARKET 1980, 1985, 1990 AND 1994**
 (Percentages)

| | | 1980 | 1985 | 1990 | 1994 |
|--|-----|--------------|--------------|--------------|--------------|
| I. Market share in North American imports | | 0.15 | 0.11 | 0.12 | 0.12 |
| Natural resources <u>1/</u> + <u>2/</u> + <u>3/</u> | | 0.35 | 0.35 | 0.35 | 0.32 |
| Agriculture <u>1/</u> | | 0.17 | 0.18 | 0.15 | 0.17 |
| Energy <u>2/</u> | | 0.00 | 0.02 | 0.00 | 0.00 |
| Other natural resources (textile fibers, minerals, etc.) <u>3/</u> | | 5.35 | 4.53 | 4.33 | 4.00 |
| Manufactures <u>4/</u> + <u>5/</u> | | 0.01 | 0.03 | 0.06 | 0.08 |
| Based on natural resources <u>4/</u> | | 0.00 | 0.00 | 0.00 | 0.01 |
| Not based on natural resources <u>5/</u> | | 0.01 | 0.03 | 0.07 | 0.08 |
| Others <u>6/</u> | | 0.09 | 0.06 | 0.07 | 0.09 |
| II. Contribution (structure of its exports to North America) | | 100.0 | 100.0 | 100.0 | 100.0 |
| Natural resources <u>1/</u> + <u>2/</u> + <u>3/</u> | | 94.3 | 77.0 | 58.0 | 44.1 |
| Agriculture <u>1/</u> | | 11.6 | 15.2 | 9.4 | 10.2 |
| Energy <u>2/</u> | | 0.0 | 2.0 | 0.3 | 0.0 |
| Other natural resources (textile fibers, minerals, etc.) <u>3/</u> | | 82.8 | 59.9 | 48.4 | 33.9 |
| Manufactures <u>4/</u> + <u>5/</u> | | 4.1 | 21.2 | 39.9 | 53.2 |
| Based on natural resources <u>4/</u> | | 0.0 | 0.1 | 0.1 | 0.2 |
| Not based on natural resources <u>5/</u> | | 4.1 | 21.1 | 39.9 | 53.0 |
| Others <u>6/</u> | | 1.6 | 1.8 | 2.0 | 2.6 |
| III. Principal exports to North America by contribution | a b | 94.9 | 84.0 | 90.2 | 89.8 |
| 287 Ores and concentrates of base metals | - | 82.5 | 59.4 | 47.9 | 33.5 |
| 846 Undergarments, knitted or crocheted | * + | 1.1 | 4.1 | 13.5 | 30.7 |
| 845 Outer garments, knitted or crocheted | * + | 0.1 | 1.6 | 8.7 | 4.8 |
| 844 Undergarments, of textile fabrics (not knitted) | * + | 0.9 | 1.3 | 1.2 | 4.8 |
| 843 Outer garments, women's, girls' and infants', of textile fabrics | * + | 0.3 | 3.4 | 5.4 | 3.4 |
| 842 Outer garments, men's and boys', of textile fabrics | * + | 0.6 | 2.9 | 4.2 | 2.9 |
| 512 Alcohols, phenols and their derivatives | - | 0.0 | 3.4 | 3.0 | 2.8 |
| 112 Alcoholic beverages | - | 4.4 | 4.7 | 2.9 | 2.7 |
| 931 Operations and merchandise, n.e.s. | * - | 1.5 | 1.2 | 2.0 | 2.6 |
| 061 Sugar and honey | + | 3.4 | 2.1 | 1.3 | 1.5 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Groups which correspond to the 50 most dynamic in the North American market during 1980-1994.

^b - Groups in which the market share of Jamaica declined during 1980-1994.

+ Groups in which the market share of Jamaica increased during 1980-1994.

1/ Sections 0, 1 and 4, divisions 21, 22, 23, 24, 25 and 29 of the Standard International Trade Classification (SITC) Revision 2.

2/ Section 3 of SITC.

3/ Divisions 26, 27 and 28 of SITC.

4/ Divisions 61, 63 and 68; groups 661, 662, 663, 667 and 671 of SITC.

5/ Sections 5, 6 (minus the divisions and groups mentioned in 4), 7 and 8 of SITC.

6/ Section 9 of SITC.

In each country garments represented a very substantial share of the total exports to the North American market in 1994, a sharp difference with the situation in 1980. In the Dominican Republic, garments corresponded to 47% of total exports to

North America, up from just 8.6% in 1980. For Costa Rica, garment exports to North America jumped from 8.7% to 36.9% over the same period. In the case of Jamaica, garment exports accounted for only 3% of total exports to North America in 1980 and rose to 46.6% by 1994. In all cases, garment exports gained dramatic increases in market shares in dynamic sectors of North American imports. Finally, garments accounted for four or five of the ten principal, most dynamic exports (at three digits of the SITC) of each of these countries.

Two segments of the garment industry were among the largest and most dynamic Caribbean Basin exports to the North American market: outer garments of textile fabrics for men and boys (SITC 842) and knitted or crocheted undergarments (SITC 846). As tables 14 and 15 demonstrate, imports of men's and boys' outer clothing of textile fabrics (SITC 842) rose from 0.4% to 0.8% of all North American imports between 1980 and 1994. The change in the structure of these imports by source region is similar to the general situation of the garment industry (SITC 84); however, the dimension is distinct. In this case Caribbean Basin market share reached 16% in 1994 and was superior to that of both China and the rest of developing Asia, excluding the Tigers. Mexico's gains were also notable in this respect.

Imports of knitted or crocheted undergarments (SITC 846) showed less dynamic growth. These imports rose during 1980-1985, declined until 1990 and rose sharply again thereafter. The Caribbean Basin was already providing a significant level of North American imports in 1980. Nevertheless, it made huge market share gains by 1994 (accounting for 29.7% of total imports of these goods), becoming the single most important North American sourcing center for these goods.⁹

The SITC 842 and 846 components of the garment industry offer particularly important insights into the company-level changes taking place in the Caribbean Basin and the degree of heterogeneity of corporate strategies, both of which help clarify the impact of host-country policies on trade, FDI and tax incentives. Detailed questionnaires were administered to about 80 garment firms in the Dominican Republic, Costa Rica and Jamaica in 1994-1996 to examine the nature of their contribution to the successes of and challenges to that industry and to better comprehend the factors influencing their behavior. Data from these questionnaires was used to define the principal elements of three distinct competitive situations: the homogeneous group of large United States assemblers of SITC 846 undergarments (Group I),¹⁰ the group of national firms producing primarily SITC 842

⁹ Another ECLAC computer programme —MUSIC— is based exclusively on United States import data in the Harmonized Tariff Schedule (HTS) format. This programme facilitates an examination of some of the most dynamic products at six digits of the HTS classification, such as men's and boys' cotton trousers or women's and girls' cotton panties and brassieres. For these products, the United States import market shares won from Asian producers have been concentrated in only a few Latin American and Caribbean countries: Mexico, the Dominican Republic, Costa Rica and Jamaica, although, more recently, other Caribbean Basin countries have been winning United States import market shares from them.⁹ This suggests that the more recent incentive policies of other Caribbean Basin countries may be influencing the siting of new or footloose garment assembly plants outside the existing principal Caribbean Basin locations.

¹⁰ A few firms belonging to large domestic conglomerates (or holding companies) may also be included in this group. Their behavior and performance are quite similar to those of the largest United States producers and they tend to be linked to large United States retailers through subcontracting. They are too few to justify a specific category in this analysis.

men's and boys' outerwear (Group II) and the other foreign assemblers of similar outerwear and other clothing products (Group III).

Firms in Group I operate in a very well defined competitive situation. More than a decade ago the parent companies of these subsidiaries faced a severe challenge in the United States. Manufacturers responded by establishing off-shore assembly operations in nearby Latin America, making use of the cheap labour and specific incentives offered by those countries coupled with privileged access to the United States market. Interestingly, these companies have established wide-spread assembly networks in the Caribbean Basin: they tend to have several assembly operations located in a number of countries, which enables them to respond to changes in the competitive situation of each cost center. They have been very successful in winning back United States import market shares for knitted or crocheted undergarments.

Table 14
**STRUCTURE OF NORTH AMERICAN IMPORTS OF MEN'S AND BOYS' OUTER
 GARMENTS OF TEXTILE FABRICS, BY SOURCE REGIONS, 1980-1994**
(Percentages)

| | 1980 | 1985 | 1990 | 1994 | Change 1980-1994 |
|---|-------|-------|-------|-------|---------------------|
| OECD | 14.78 | 16.93 | 12.09 | 10.31 | -30 |
| North America | 2.43 | 1.67 | 2.02 | 3.84 | 58 |
| Western Europe ^a | 15.56 | 15.46 | 10.07 | 6.96 | -553 |
| Japan | 0.87 | 2.00 | 0.51 | 0.18 | -79 |
| Turkey | - | 0.54 | 0.42 | 0.22 | 4 355 |
| Developing Asia | 68.14 | 63.42 | 59.37 | 50.53 | -26 |
| China | 5.65 | 9.96 | 13.37 | 14.11 | 150 |
| Tigers ^b | 57.93 | 46.35 | 34.35 | 22.85 | -61 |
| Rest of Developing Asia ^c | 4.56 | 7.11 | 11.65 | 13.57 | 198 |
| Latin America and the Caribbean | 8.39 | 11.04 | 18.83 | 25.64 | 206 |
| Caribbean Basin | 2.60 | 5.22 | 11.91 | 16.41 | 531 |
| Mexico | 4.30 | 4.22 | 5.14 | 7.34 | 71 |
| Rest of Latin America | 1.50 | 1.61 | 1.78 | 1.88 | 26 |
| Africa | 0.25 | 0.34 | 0.59 | 1.29 | 416 |
| North Africa | 0.06 | 0.07 | 0.30 | 0.60 | 877 |
| Rest of Africa | 0.19 | 0.27 | 0.29 | 0.69 | 267 |
| Eastern Europe | 4.09 | 2.83 | 1.31 | 0.95 | -77 |
| 842 as % of the North American imports | 0.36 | 0.54 | 0.69 | 0.77 | 114 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Includes some non-OECD countries.

^b Hong Kong, the Republic of Korea, Singapore and Taiwan (Province of China).

^c India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines and Thailand.

Table 15
**STRUCTURE OF NORTH AMERICAN IMPORTS OF KNITTED OR CROCHETED
 UNDERGARMENTS, BY SOURCE REGIONS, 1980-1994**
(Percentages)

| | 1980 | 1985 | 1990 | 1994 | Change 1980-1994 |
|--------------------------------------|-------|-------|-------|-------|---------------------|
| OECD | 8.29 | 8.16 | 10.34 | 8.74 | 5 |
| North America | 1.27 | 0.57 | 2.38 | 3.09 | 144 |
| Western Europe ^a | 4.22 | 4.85 | 5.56 | 2.63 | -38 |
| Japan | 3.76 | 2.69 | 0.31 | 0.08 | -98 |
| Turkey | 0.01 | 0.66 | 2.51 | 3.28 | > 10000 |
| Developing Asia | 72.88 | 75.75 | 53.78 | 42.09 | -42 |
| China | 1.80 | 5.94 | 5.60 | 5.11 | 184 |
| Tigers ^b | 62.60 | 57.71 | 30.61 | 16.80 | -73 |
| Rest of Developing Asia ^c | 8.48 | 12.10 | 17.57 | 20.18 | 138 |
| Latin America and the Caribbean | 14.65 | 10.37 | 28.25 | 40.74 | 178 |
| Caribbean Basin | 9.12 | 7.18 | 21.02 | 29.70 | 226 |
| Mexico | 4.90 | 2.03 | 4.04 | 7.71 | 57 |
| Rest of Latin America | 0.63 | 1.17 | 3.19 | 3.33 | 430 |
| Africa | 0.03 | 0.15 | 0.83 | 0.86 | 2755 |
| North Africa | 0.01 | 0.05 | 0.71 | 0.61 | 5281 |
| Rest of Africa | 0.02 | 0.10 | 0.13 | 0.25 | 1235 |
| Eastern Europe | 0.96 | 0.62 | 0.45 | 0.37 | -61 |
| 846 as % of North American imports | 0.42 | 0.55 | 0.40 | 0.51 | 22 |

Source: Based on the Competitive Analysis of Nations (CANPLUS) computer software.

^a Includes some non-OECD countries.

^b Hong Kong, the Republic of Korea, Singapore and Taiwan (Province of China).

^c India, Indonesia, Malaysia, Myanmar, Pakistan, the Philippines and Thailand.

These Group I enterprises tend to be much more specialized in their production and more sophisticated in terms of quality than the rest of the sample. Their corporate strategy is more aggressive and their outlook more "corporate". They carry out a very specific role in the integrated international production system of their parent corporations. Quality is especially important because they export mainly to their parent firms, which market the products.

These enterprises have increased their ability to compete by improving labour productivity, quality and service. The gains in labour productivity have presumably helped offset the increased costs of labour (i.e., wages and social security), especially given the appreciating national currencies in many of the countries in which they operated. The labour force has been trained to meet corporate standards of performance. Virtually no local physical inputs (via local sourcing or component subcontracting) enter into the production process. Each assembly plant is a self-contained element of the corporate network, producing a small range of identical items in a very competitive manner.

At the other extreme, the national companies in Group II were created for the most part during the import-substitution phase of industrialization. Since the reorientation of macroeconomic policy in the 1980s, they have experienced collapsing national market shares due to import penetration and have adapted by seeking out contracts with foreign buyers, mainly large department stores or trade-marked apparel companies. They compete with the rest of the world for relatively short-term contracts for standardized garments in which price is the principal determinant. In contrast to the foreign firms, they consider their own corporate strategies as more central to their competitiveness than international market factors. They tend to adopt defensive stances, and they have experienced mixed results in defending or winning United States import market shares for men's and boys' outerwear of textile fabrics.

These national companies have several disadvantages compared to the foreign competitors operating within transnational corporation (TNC) networks. First, the TNC network permits better programming of individual plant capacities to accommodate sporadic and changing demand for their relatively more specialized products, which makes the company much more flexible. Second, the parent company in the TNC network takes care of many aspects of the operations, such as selecting and purchasing technology, marketing, acquiring new organizational practices and setting quality standards. Third, the TNC network is highly mobile because it can easily add new lines of production in more competitive sites or, if necessary, migrate to them. Fourth, the TNC network has the financial capacity to invest in or guarantee local plant expansion or adaptation. Consequently, small national enterprises face a very difficult competitive situation, considering that that foreign firms with assembly operations in the Caribbean Basin are their principal competitors.

In the questionnaires, these companies expressed the belief that national policy is considerably less important to their competitiveness than it is for foreign firms, even though it could conceivably be a means of leveling some of the disadvantages they face *vis-à-vis* their foreign competitors, who are mainly installed in EPZs in the Caribbean Basin. They view their single, most important impediment to further exports to be the lack or high cost of local financing, which they consider the principal failure of national policy. They feel that national policy has in no way compensated for the advantages of the foreign companies.

Generally, these national companies are less specialized, less sophisticated in terms of quality and, at the same time, less willing to invest in what is clearly their principal comparative advantage: cheap labour. Rather, they see their international competitiveness as more dependent on the acquisition of foreign technology and organizational practices, which help make their production lines more flexible, improve quality and lower labour costs. Some of these enterprises possess important levels of local procurement, but this is not considered basic to their international competitiveness. They appear to be trying to acquire the means to make significant improvements in quality to compensate for increasing shortfalls in competitive pricing. These firms can be characterized as relatively low-cost producers of mostly short runs of simple, standardized clothing items for international contractors.

The more numerous Group III enterprises represent the middle ground. They are bigger but less specialized components of smaller, less extensive corporate networks. Most of their competitors are other assembly operations in the Caribbean Basin. They face cutthroat price competition to win contracts or to defend the flagging United States market shares of their parent corporations. These enterprises moved offshore more recently than the Group I firms. They have a more stark, cost-centered mentality. The essence of their corporate strategy in the Caribbean Basin is similar to that of the

national firms, solidly based on cheap labour with an emerging preoccupation for quality. Also like national companies, they are facing a kind of harsh renewal in which the modernization and rationalization of production are central aspects of their corporate strategies.

These firms have sought to improve efficiency in the same fashion as national firms, through monetary incentives for labour and the acquisition and implementation of foreign technologies and organizational practices. Although their problem with human resource is somewhat different than national firms—the high cost of social security rather than simply wage rates—they have sought the same improvements in work organization, namely a more flexible production line. These companies received their technology from the parent corporation, though like the national companies, they had to adapt it to the local setting. They consider rapid delivery as one of their competitive advantages, again similar to national firms, but they feel that productivity is an advantage that derives primarily from inputs from their corporate network.

Thus, an important degree of heterogeneity exists in the competitive situations of garment firms operating in the Caribbean Basin. Corporate strategies define the different reactions of distinct groups of companies to the various challenges faced by the industry. The large subsidiaries of well-known TNCs which make up Group I already possess an integrated international production system that allows them to adapt to changing competitive situations by expanding a production line in one country, while reducing another in a second country. They do not have to physically shift production from one location to another. The Group III subsidiaries of smaller, less well known TNCs do not have those advantages. Often, they do not produce for direct sale to their parent corporations, but rather for international buyers, usually the big department stores or specialist clothing companies. They face a more directly competitive situation, and a growing cost differential among distinct production sites can result in the physical transfer of plant and equipment to another location. Finally, the Group II national firms possess neither the integrated international production system of the former nor the footloose capabilities of the latter. Born for the most part during the era of import substitution, they have seen their national market shares collapse in the face of new imports. They have been forced to compete for assembly-based export contracts, within a framework in which national policy does not compensate for the advantages of the foreign companies operating in those countries.

4. POLICY COMPETITION: HOW COUNTRIES COMPETE

National policy makers in the Caribbean now face a quandary. In view of the corporate strategies presented in the previous section, it seems clear that fiscal or financial incentives will not much influence new FDI flows to this region. The large transnational producers of undergarments (Group I) are already present in the most relevant offshore assembly sites. Incentives might have a marginal influence on the expansion or reduction of existing production lines, but they would probably not result in a physical transfer from one existing site to another or in the creation of a new large-scale operation. Incentives could very well influence the transfer or siting of the smaller, Group III transnational producers of men's and boys' outerwear, but the result might not be beneficial to the host country. These operations are footloose by their very nature. Relatively minor declines in the competitive situation of a host country can result in a hurried exit to another site, because these firms operate with very small margins. National policy makers can be assured that an incentive war to temporarily attract this kind of operation would not produce the desired results. Finally, the small, national garment firms might be enticed to set up new operations in neighboring countries to the extent that incentives are available. However, given that they generally have rather tenuous operations somewhat like the Group III foreign firms, the results would probably not be what the host country is expecting.

This section analyzes policy competition for foreign investment examining four stages of the process: the legal frameworks that countries in the region offer to foreign investors, the ways in which those countries sell an image to attract investors, their strategies for competing for FDI in export platforms and the role of competitiveness policies in this process.

4.1 THE LEGAL FRAMEWORK FOR FOREIGN DIRECT INVESTMENT

FDI regimes in the Latin American and the Caribbean countries share many similarities (Mayorga, 1996). Not only are regulations similar, but all countries share a common interest in the promotion and protection of foreign investment. Furthermore, government proposals for changes to legislation are usually oriented towards a freer, less regulated framework with greater security and benefits for foreign investors. However, countries also display a variety of differences, some of which derive from the existence of two different legal systems in the region: civil law in the Latin countries and common law in the English-speaking Caribbean countries. The following list of stylized facts highlights the current differences and similarities:

- (i) Not all countries have a special legal statute for foreign investment, and definitions of what is to be considered a foreign investment varies widely (e.g., contributions from abroad, investment by foreigners or contributions from abroad by foreigners).

- (ii) Only in a few, special cases does the law permit nationals to benefit from incentives to foreign investors.
- (iii) Different rules apply to the employment of foreign managers and workers.
- (iv) Countries exclude foreign investors from different economic sectors, although the number of those sectors has been significantly reduced in the last decade.
- (v) Grounds for expropriation and the determination of compensations differ.
- (vi) There are minor differences related to remittance of profits abroad.
- (vii) Dispute settlements are increasingly uniform, because agreements follow a similar model. Settlement mechanisms usually take precedence over national law.
- (viii) Agencies for the monitoring and promotion of foreign investment differ regarding their membership (public or public and private) and legal status. Only a few countries lack agencies in charge of these matters.
- (ix) Taxation is the area that shows the greatest differences among countries, including the types of taxes in force, tax rates and incentives.

Costa Rica, Jamaica and the Dominican Republic are not exceptions to this trend towards a convergence of foreign investment regimes in the region, although they present certain differences (see table 16), which seem to show that Costa Rica has the most liberal regime. In spite of those differences, all three countries share a basic perspective in favour of FDI. Differences on these matters are not significant and cannot explain differences in the attractiveness of each country for foreign investment. This is particularly true after the Dominican Republic abrogated its previous interventionist law on foreign investment in November 1995.

Table 16
FOREIGN INVESTMENT REGIMES IN LATIN AMERICA AND THE CARIBBEAN

| COMPONENTS OF THE LEGAL REGIME | LATIN AMERICAN AND CARIBBEAN TRENDS | COSTA RICA, JAMAICA AND THE DOMINICAN REPUBLIC |
|--|--|---|
| Registration and authorization | Investments should conform to local legislation. The most common method is registration. | CR has no registration requirements and no special law or statute on foreign investment. |
| Sector specific restrictions on foreign investment | All countries still have restrictions, in spite of a widened scope for the private sector. | CR has some restrictions on private investments in general; J and DR have some restrictions on FDI. |
| Formalities and restrictions on FDI contributions (foreign currency, capital goods, technology, associated credits, profit capitalization, intangible goods) | A few countries have restrictions on foreign credits and capital goods. | In CR, FDI contributions are unrestricted. |
| Restrictions on remittances | Most countries have no restrictions on remittances. | CR and J have no restrictions; DR has minor restrictions. |
| Foreign exchange markets | Freely accessible. In most countries there is only one foreign exchange market. | |
| Tax regimes | The rule is equal treatment for foreign and local companies. | DR does not tax remittances; it also has one of the lowest income tax rates (25%). |
| Agreements to avoid double taxation | Most countries are parties to conventions to avoid double taxation with other countries in the Americas. | J has agreements with the United States, Canada, 5 European countries, Israel and CARICOM; DR has an agreement with Canada. |

| | | |
|---|--|---|
| Incentives to attract foreign investment | Most countries have incentive schemes that benefit domestic as well as foreign investors. | J has some incentives that benefit only foreign investors; DR has no incentives. |
| National treatment and most-favored-nation clause | National treatment is the rule in most countries in spite of minor exceptions in favour of local investors. | |
| Principle of reciprocity | Most countries formally accept this principle. | DR is an exception; in CR, it applies for specific economic sectors. |
| Performance requirements | They have either been eliminated or are the exception rather than the rule. | DR has no requirements; they are exceptional in J (i.e., only when incentives are granted). |
| Property protection and expropriation rules | The wide variety of vague reasons for expropriation includes: public purposes, social interest, national security, public necessity, collective benefits, etc. | CR cites "collective use and social benefit"; DR uses "promotion of agrarian reform". |
| Compensation rules | The two mechanisms are judicial process and administrative decisions | J and DR employ judicial process. CR employ administrative process and allows payments in installments. |
| Material possession of expropriated property | In general, the government cannot take possession of property prior to payment. | CR and DR have some exceptions to this rule (war, public disaster and domestic unrest); J may take possession prior to compensation. |
| Privatization process | Foreign investors may participate in the process in most countries. | In DR, the authorities can impose special regulations; CR has restrictions that apply to domestic and foreign investors. |
| Domestic settlement of disputes | Foreign investors have the same rights as local firms; countries that are parties to bilateral investment treaties contemplate international arbitration for the foreign investor. | |
| International settlement of disputes | Many countries are members of ICSID ^a or other conventions (MIGA ^b , OPIC ^c). | J and CR are members of ICSID ^a ; CR is a member of the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards. |
| Bilateral investment treaties (BITs) | BITs are in force or have been approved in several countries. | CR has BITs with Mexico and Germany; J has BITs with Argentina, the United States and 5 European countries; DR has not signed any convention. |
| Legal status of international treaties | Treaties take precedence over national law, except the constitution. | |
| Agencies in charge of foreign investment | Countries may have no agency, one agency or more than one agency; agencies are public, private or mixed. | J has is a central agency at the cabinet level; DR has an agency at the ministerial level with private-sector members; CR has a public agency (the private sector has the majority in its board). |

Source: Authors' adaptation of Mayorga, R., *Foreign investment regimes in countries within the hemisphere: Legal challenges*, presented at the Seminar "Investment Policies and Multilateral Rules of Investment in Latin America", Organization for Economic Cooperation and Development, Inter-American Development Bank, Ministry of Foreign Affairs (Brazil) and Ministry of Trade (Spain), Rio de Janeiro, Brazil, 16-18 July 1996. Mayorga utilizes data for 27 countries, taken from IDB, *Foreign investment regimes in the countries of the Americas. A comparative study*, Washington, D. C., March 1996.

^a International Center for Settlement of Investment Disputes (ICSID).

^b Multilateral Investment Guarantee Agency (MIGA) of the World Bank.

^c Overseas Private Investment Corporation (OPIC) of the United States.

4.2 SELLING A COUNTRY'S IMAGE

How countries sell an image to attract investment provides a clue to which competitive advantages they consider to be the most effective for catching investors' attention. The following review of the promotional efforts undertaken by Costa Rica, Jamaica and the Dominican Republic shows that countries try to highlight a broad package of natural, social and policy advantages, which are extremely similar —perhaps too similar for countries as different as Jamaica and Costa Rica. Countries perceive that investors expect some benefits and advantages, and they are forced to show that they compete to provide those incentives. This homogeneity may point to harsh policy competition among Caribbean Basin countries. Within these homogeneous messages however, countries feel the need to highlight how they are tackling their most important disadvantages, as is shown by the Dominican Republic's efforts to emphasize the benefits investors may expect from the abrogation of the restrictive 1978 legislation on FDI.

(a) Costa Rica as a profit center in the Americas

"Low risk. High productivity. Big opportunity. And a long-standing tradition of quality. No wonder Costa Rica is the place for business to locate in America. A modern, enduring democracy and political tranquillity makes for the most stable business environment in Latin America. Its strategic location at the heart of the Western Hemisphere makes it the ideal site for relocating international business operations. Government attitude towards business, country infrastructure, market access, and the quality and cost of labour rank it as a top choice for locating business operations." This is the image that the Ministry of Foreign Trade tries to convey to investors (Ministerio de Comercio Exterior, 1996). The message highlights the country's many advantages to investors, including those listed below:

- (i) Costa Rica has one of the highest literacy rates in the world (93%). Education has long been a national priority, and it is free and mandatory up to secondary level. Academic, technical, agricultural and scientific high schools are located throughout the country, together with twelve universities (four public and eight private). The National Institute for Apprenticeship, a governmental training institution, keeps track of the needs of industry in order to maintain an updated workforce. A large pool of highly qualified, bilingual professionals is available, as well as middle-level technicians and supervisors.
- (ii) High-productivity workmanship is found at all levels. Investors find that the quality and productivity of the workforce is one of the best assets of the country.
- (iii) Modern ports on the Caribbean and Pacific coasts offer facilities for containers and roll-on roll-off cargo. Air connections to and from major international markets are excellent.
- (iv) Low-cost, reliable hydroelectric power is available, with a wide distribution network.
- (v) A modern telecommunications network (e.g., cellular phones, data transmission, facsimile facilities, telex and telephone) enables direct and immediate access worldwide using both satellite and microwave links.

- (vi) Well-maintained highways and roads connect the country from coast to coast. An intercoastal railroad also exists.
- (vii) High living standards create an outstanding environment in which to do business and to live. Excellent medical services are readily available. Life expectancy at birth is 75 years, while infant mortality at birth stands at 1.4%.
- (viii) Other positive characteristics include the following: (a) Costa Rica has had a stable democracy, with no army since 1948, which allows for long-term, risk-free planning and fast-paced, continuous progress; (b) the country has remarkable ecosystems and biological diversity; and (c) the European cultural base allows the country to be a cultural center with a symphony orchestra, theaters, etc., as well as ten local TV channels and 28 international cable TV channels from the United States, Europe and Latin America.

(b) The new investment climate in the Dominican Republic

According to the Central Bank of the Dominican Republic, the country should promote the following aspects of its image: (i) a nation with a tradition of democracy and free enterprise; (ii) a Latin American country by language and tradition; (iii) the second-largest Caribbean nation; (iv) an economy traditionally linked to the United States; (v) a beneficiary of special access to the European Union; (vi) a natural haven for tourism; (vii) a success in free-zone development; (viii) a fertile land for agriculture; (ix) a source of mineral wealth; (x) a nation inhabited by willing workers; and (xi) a low-cost country for economic operations (Russin, Vecchi and Heredia Bonetti, 1996).

In addition to marketing this generally favourable context for investment, the main message the Dominican Republic Government sends to investors is that the country adopted a new law in November 1995 to govern foreign investment, thus responding to new internal pressures and to the imperative of new international commercial norms and relationships. The government considers that Law 16-1995 presents real advantages for the investor, which are even more impressive when compared with the restrictive legislation of Law 861 of 1978, now abrogated.

The fundamental purpose of the new law is to grant equal treatment, under the principle of free enterprise, to foreign and national investors, from the point of view of rights as well as obligations. This equal treatment is reflected in the procedure adopted to implement the law.¹¹ Individuals and corporations investing in the country shall enjoy liberalized, restriction-free use of their capital or dividends, which can be repatriated in freely convertible currency as follows: (i) for the full amount of capital and capital gains; (ii) for the dividends declared during each fiscal period up to the total amount of net profits (upon payment of taxes); and (iii) for fees for technology transfer and royalties for contracts previously approved by the Central Bank.

¹¹ The law indicates that the exceptions to the principle of equal treatment are those specified in the same law and those foreseen in special laws. The former has to do with environmental protection, health and national security; thus investments are forbidden in the following areas: (i) disposal and discarding of toxic, dangerous or radioactive materials, (ii) activities affecting public health and the environment and (iii) production of materials and equipment linked to national security and defense, unless a special authorization is obtained from the President of the Republic.

According to the Central Bank, the liberalization of the legal framework for foreign investments may provide a growing inflow of capital and technology. This assumption is supported by the formidable development of the free-zone sector governed by Law 8-90, which was always excluded from the restrictions and requirements of Law 861. Moreover, the country may now take advantage of opportunities such as the guarantees for foreign investment offered by the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group. MIGA acts similarly to the Overseas Private Investment Corporation (OPIC) of the United States, but it is open to investment from member countries.

Russin, Vecchi and Heredia Bonetti (1996), however, consider that a new liberal legislation is not all the country needs to attract more investment. The Dominican Republic cannot lose more time and must move forward with some indispensable reforms to mobilize economic and political modernization. These reforms include the improvement of the electoral system, the independence of the Judiciary, the modernization of the Civil Service, and the general strengthening of democratic institutions.

The reform agenda also includes the approval of a new Monetary and Financial Bill, additional customs reform, legislation on intellectual property, the General Telecommunications Law, the General Law on Privatization, new legislation on private insurance, the General Law on Education and new environmental legislation. Finally, a law should be approved to privatize electrical power so as to make it more efficient. The single, most negative element in the country's investment climate is the short supply of energy, which causes inefficiency in the production sector and increases its costs.

The repeal of Law 861 began the process of updating the country legislation. New legislation must complete that task in order to meet the exigencies of a new world economic context and to establish a better position for entering into international competition.

(c) Jamaica as a premier investment location

"The Smart Business Choice" is the image that Jamaica Promotions Limited (JAMPRO) tries to sell to investors (JAMPRO, 1996). Different advantages corroborate this assertion.

Geography. Jamaica is located in the hub of the Caribbean Sea, featuring a mountainous central spine and broad coastal plains, fringed with beautiful beaches. The island is the largest of the English-speaking countries in the Caribbean. The country lies at the crossroads of major shipping and air routes linking the markets of Europe and North America, and the Panama Canal links it to the Pacific. The world's major capitals are within easy reach from the island's strategic location.

Political stability. A former British colony, Jamaica has maintained a tradition of democratically elected governments that respect and protect individual rights, freedom and property.

Vibrant business climate. Both Government and Opposition agreed on a philosophy of economic development led by the private sector. The country has embarked on a path of liberalization of all the economic forces. The privatization of government-owned entities has proceeded apace, and Jamaica is first among 26 developing countries in terms of divested properties.

Education. Jamaica's education and training system has its roots in the British system. The formal education system has four levels, from pre-primary to tertiary, and a

non-formal system provides specialized skills and vocational training, including on-the-job training. Tertiary education is available beyond the high-school level at the University of the West Indies, the College of Arts, Science and Technology and various other specialized institutions. Local degrees and diplomas are internationally accepted, and the University has post-graduate links with several universities in North America and the United Kingdom. The Jamaican population is 85% literate.

Safe foreign investment. Foreign investment is welcome and enjoys an attractive package of fiscal incentives. Jamaica has signed bilateral investment agreements with the United Kingdom, the United States, Germany, France, Switzerland and the Netherlands. Although joint ventures between local and foreign entrepreneurs are encouraged, foreign investors may own 100% of a company that is locally incorporated or registered, and no approvals are required.

Income tax regime. The corporate income tax rate and the withholding tax on remittances are 33.3%. There is no capital gains tax. The personal income tax rate is 25% on earnings over United States \$ 18 408. Double taxation agreements exist with the following countries: Canada, Denmark, Germany, Israel, Norway, Sweden, the United Kingdom and the United States. There is also an agreement with the Caribbean Community (CARICOM) countries.

4.3 INVESTMENT IN EXPORT PLATFORMS

Besides selling a favourable country image, governments have to provide competitive conditions for investors interested in establishing production and trade facilities oriented towards the international market. Those facilities are the most sought after, because the prevailing export-led growth strategies rely on them. At least in the short term, a large share of those plants will be installed in EPZs. Special attention should therefore be paid to the current free-zone regimes in the three countries under consideration.

(a) Costa Rica

Costa Rica has two export promotion mechanisms in place: the regime of active perfection (temporary admission) and free zones. A third regime (export contracts) was eliminated in 1996, with minor exceptions which will extend some contracts until 1999 (CENPRO, PROCOMER and Zona Franca, 1996; PROCOMER, 1997).¹²

The regime of active perfection (temporary admission) is based on customs regulations which suspend all taxes on the entry into national territory of certain merchandise destined to be re-exported to non Central American markets after being transformed, repaired, reconstructed, mounted or assembled. The normal time limits for imported goods to remain in the country is three months for samples and models, six months for raw materials and other components used in the production process and five months for machinery and equipment. All these terms can be renewed. The benefits of temporary admission are granted for a period of five years, which is automatically renewed with the approval of the Ministry of Foreign Trade.

¹² Eduardo Alonso, General Manager of the Foreign Trade Corporation (PROCOMER), provided information on the Costa Rican trade regime. His comments and criticism on several points of the paper dealing with that country have been very useful.

The mainstay of the country's export and investment strategy, however, are the export free zones. The free zones are considered as extra-territorial areas for customs and fiscal regulations. Ease of operation, fiscal incentives and a preferential foreign trade regime are some of the advantages that installing a facility in a free zone provides.

Six types of companies can be established in a free zone: (i) export processing industries which produce and process for export; (ii) trading companies which distribute non-traditional products; (iii) service companies which provide services to export-producing or export-marketing companies; (iv) management firms which have been granted concessions for the administration of the free zones; (v) individuals or corporations dedicated to scientific research, contributing to the improvement of the technological level of the country; and (vi) vessel construction, repair and maintenance industries which intend to provide and operate dry-docking facilities, shipwright services and similar work.

Several incentives are granted to firms that choose to locate in a free zone or to operate under the temporary admission regime. Although export incentives are basically similar for both regimes, free zones enjoy a much more favourable profit-tax regime. However, the free zone regime will expire in 2003 to make the country's trade system fully World Trade Organization (WTO) compatible. Table 17 provides a summary of the current incentives.

Table 17
EXPORT INCENTIVES IN COSTA RICA, 1997

| INCENTIVES | FREE ZONES | TEMPORARY ADMISSION |
|---|--|--|
| Import taxes and duties on raw materials, components, machinery and equipment | 100% exemption | 100% exemption |
| Export taxes | 100% exemption | 100% exemption |
| Management of foreign currency | Independent | Independent |
| Customs service | Expedited on site | Normal procedure |
| Sales on the domestic market | Up to 40% of production | Not allowed |
| Time limits | Indefinite | Five year permits, automatically renewed |
| Import duties on vehicles | 100% exemption | Not applicable |
| Taxes on profits | Exemptions: 100% for 8 years, plus 50% for 4 years; 100% for 12 years plus 50% for 6 years to companies established in less-developed areas. | Not applicable |
| Payroll bonus | Five-year regional incentives for companies established in less-developed areas; bonus equivalent to 15% of wages paid the previous year. | Not applicable |
| Training subsidy | New workers in less-developed areas may be trained and paid by the Government for 3 months | Not applicable |
| Taxes on net capital, assets, land and real estate transfers; local taxes and patents | 100% exemption for 10 years | Not applicable |
| Capital and profit repatriation | Tax exempted | No exemption (15% tax) |
| Local sales and excise taxes | 100% exemption for 10 years | 100% exemption (a tax return must be filled) |

Source: CENPRO, PROCOMER and Zona Franca, *Exporters 96: Costa Rican Export Directory*, San Jose, Costa Rica, 1996, and PROCOMER, *Exporters 97: Costa Rican Export and Import Directory*, San Jose, Costa Rica, 1997.

In addition to export incentives, Costa Rica offers investors preferential market access to the United States, the European Union and other Latin American countries based on a number of trade agreements.

- (i) *Caribbean Basic Initiative (CBI) II*. CBI a unilateral United States programme which provides the country with trade and tax measures to promote economic revitalization and to expand private-sector business opportunities. Virtually all products from Costa Rica are eligible except for textiles and apparel, canned tuna, petroleum and petroleum products and certain watches (USITC, 1995a).¹³
- (ii) *Generalized System of Preferences (GSP)*. Most developed countries have implemented this instrument to promote imports from developing countries under reduced or zero import duties. Costa Rica is a beneficiary of the GSP of a large number of countries, including the United States, Japan and the European Union.
- (iii) *Central American Common Market (CACM)*. Exports from Costa Rica to other Central American countries enjoy duty-free entry under the CACM. Goods produced within a free zone, however, may not be considered of Costa Rican origin by other member countries.
- (iv) *Free Trade Agreement with Mexico*. Costa Rica was the only Central American country able to respond positively to Mexico's 1991 invitation to negotiate free trade agreements. The Costa Rica-Mexico Agreement was signed in 1994 and began its implementation the following year.

(b) Dominican Republic

The Dominican Republic has, at least formally, a dual system to promote exports: Law 69, which is the cornerstone of the policy to support exports from the customs economy, and export processing or free zones.

Law 69 was enacted in 1979. It originally included three basic types of incentives: (i) a foreign exchange incentive allowing export companies to retain a percentage of their hard-currency earnings, (ii) a fiscal subsidy ranging from 5% to 25% and (iii) duty free and tax exemptions on imports of raw material and parts (not including machinery).¹⁴ Law 69 has been plagued by administrative and procedural delays, implementation inconsistencies and other obstacles that have rendered it almost useless. Law 69 rebates have long been considered a failure, and it is now widely accepted that the country does not have efficient export-promotion policies except for the free-zone regime (Vicens and Martínez, 1996).

The successful performance of free zones in the Dominican Republic stems from the convergence of local and international determinants. In 1983, the Caribbean Basin Initiative (Caribbean Basin Economic Recovery Act) was enacted in the United States, and in 1990 the Dominican Republic joined the Lomé IV Convention. The country thus enjoys privileged access to the two premier world markets: the United States and the European Union. On the domestic side, the Dominican Republic offers important benefits

¹³ Bilateral textile agreements with the United States are available under the Super 807 regime. Costa Rica, however, has not used this benefit because of its reluctance to accept any kind of export quotas.

¹⁴ In general, exports are free of taxes and duties. That was not the case a decade ago, however, when export duties of 36% on traditional goods and 5% on non-traditional goods were levied on exports from non-free zones.

for investors wishing to establish enterprises in the free zones, as well as plentiful trained labour. Although free zones in the country date back to 1969, the current regime was enacted quite recently, in January 1990.¹⁵ Law 8-90 provides the legal framework for the handling, organization, incentives, rights and obligations of the industrial free-zone companies and park operations (Pellerano and Herrera, 1996).

Free zones are defined as geographical areas of the country which are subject to special customs and tax controls established by law and where it is legal to install companies dedicating their production or services to foreign markets, via the granting of necessary incentives for their development. Law 8-90 foresees several kinds of free zones according to location.

- (i) Industrial or services free zones can be installed anywhere in the national territory to engage in the manufacture of goods or the providing of services.
- (ii) Border free zones are granted special incentives, such as those foreseen in Law 8-90 and those granted by the Executive Power. These free zones must be located at a distance of three to 25 kilometers from the border with Haiti.
- (iii) Special free zones are allowed to be established near the source of non-movable resources, whether because of the nature of the production process or the geographic, economic and infrastructural conditions of the country.

As of mid-1996, there were 33 free zones in the country and another 10 under construction. In those zones, 476 firms provided about 182,000 direct jobs, which is more jobs than those provided by all the manufacturing sector, except sugar (Valdez, 1996; Kaplinski, 1993). Most companies originated in the United States, Canada, Europe, Taiwan (Province of China), the Republic of Korea and Japan. Following is a list of the main incentives available to investors in the export free zones.

- (i) Total exemption from import duties is given for all goods used for producing export goods by free-zone companies and operators (i.e., individuals or companies whose main activities are purchasing or leasing land, developing free-zone infrastructure, selling or leasing buildings and facilities, and carrying out promotion and marketing activities to attract national and foreign companies).¹⁶

¹⁵ The first free-zone law in the country was enacted in 1955. No industrial free zones were created, however, until the enactment of Law 299 in 1968, which provided tax and duty exemptions on imports of machinery and raw materials and other fiscal incentives. Paradoxically, Law 299 was the main legal instrument aimed at fostering industrialization through import substitution in the Dominican Republic (Vicens and Martínez, 1996).

¹⁶ Article 24 of Law 8-90 stipulates the following exemptions for the free-zone companies and operators: (a) income tax; (b) tax for constructions, loan contracts and the registration and transfer of real property as of the constitution of the corresponding free-zone operators; (c) tax on the formation of commercial companies or the capital increase of same; (d) import taxes, duties, customs tariffs and other related charges affecting raw materials, equipment, construction material, building parts, office equipment, etc., all of which are oriented to constructing, preparing or operating in the free zones; (e) all existing export and re-export taxes with a few exceptions; (f) taxes for licenses and corporate assets, as well as the value-added tax; (g) consular duties for all imports to be used by the free zone operators and companies; (h) import taxes related to the equipment and utensils necessary for the installation and operation of the dining areas, health areas, medical assistance, childcare facilities, entertainment or amenities, or any other kind of equipment for the welfare of the workforce; (i) import taxes on transportation equipment including cargo vehicles, garbage collectors, minibuses and vans for the transportation of employees or workers to and from work centers, in every case upon approval by the National Council for Export Free Zones.

- (ii) Free-zone operators and companies enjoy the benefits granted by the law for periods of 20 years for border free zones and 15 years for those located in the rest of the country.
- (iii) Investors are free to repatriate profits obtained in the free zones.
- (iv) Up to 20% of total production may be sold on the domestic market (applicable only for goods or services produced by a company in the customs territory).
- (v) Plentiful labour is available at competitive prices, which is subject to national labour and social security regulations, but exempt from paying workers a bonus equivalent to 10% of profits, as is legally mandatory elsewhere in the country.
- (vi) Sea and air cargo services are generally of good quality.

Like other Caribbean countries, the Dominican Republic is able to provide investors with preferential access to foreign markets. The country enjoys preferential access (non-reciprocal) to the United States market not only under the Caribbean Basin Initiative II, but also under Super 807 textile and garment agreements and the Generalized System of Preferences. It also enjoys access the European market under the Lomé IV Convention, as mentioned above.

Another regime which was particularly important for the Dominican Republic was the United States Internal Revenue Code (USIRC) Section 936. This statute provided a special credit for certain types of income in qualifying corporations operating in Puerto Rico and United States possessions other than the Virgin Islands. The Puerto Rican government complemented this statute by granting tax exemptions of up to 90% of income to certain approved companies for a specific period of time, generally 10 to 15 years. The combination of Section 936 credit, the incentives offered by Puerto Rico and the Dominican Republic free-zone regime practically exempted companies operating under this law from taxes on their income from Puerto Rican and Dominican Republic sources. "Twin plants" were formed when firms operating in Puerto Rico under the 936 tax provision installed complementary plants in the Dominican Republic to maintain the 936 tax exemption, while utilizing relatively inexpensive Dominican labour (Pellerano and Herrera, 1995).

(c) Jamaica

Although the encouragement of exports has been an objective of Jamaican development policy for a long time, the orientation towards an export-push strategy was only attempted in earnest in the 1980s. Like Costa Rica and the Dominican Republic, Jamaica has a dual regime to promote exports: free-trade zones and export incentives for exporters located in the customs territory. Although free zones provide about 30,000 jobs (that is, nearly one-fourth of total manufacturing employment), they rate much lower than in the other two countries regarding government policy and interests (van Riel, 1996).

Exporters located in the customs territory benefit from fiscal incentives under the Export Industry Encouragement Acts (EIEA) of 1956, 1969 and 1974. They also have access to a customs-duty drawback scheme that provides a rebate for duties paid on imported raw materials used in export production.

Export financing and credit insurance are provided through the Export -Import Bank. Development financial institutions, such as the National Development Bank, grant

long-term financing at preferential rates. Credit schemes offering foreign exchange financing for raw material and equipment are also available.

Particular encouragement is given to industries producing for exports to countries outside CARICOM. These industries include manufacturing activities, such as garments, furniture and footwear; agriculture, such as a variety of tree crops, exotic fruits and flowers; tourism; bauxite; and motion pictures. Investors are eligible for income tax relief and import duty exemptions for a maximum period of fifteen years. In particular, exporters of manufactured products and processed foods are eligible for duty and income tax exemptions for a period of up to ten years. It is a simple matter, however, for a company to change its name and obtain, in effect, the incentives in perpetuity (Willmore, 1993a).

With regard to the free-zone regime, the Jamaican government operates three zones with approximately 165,000 square meters of building space, for companies producing exclusively for export.¹⁷ Although investors in the free zones are required to incorporate and register a Jamaican company, they have access to credit in the local financial markets under the same conditions as domestic companies. Such investors receive exemptions on duties and taxes on raw materials, machinery and equipment, and on corporate taxes and remittance taxes in perpetuity.

The EIEA regime offers exporters in the customs territory practically all the benefits associated with free-zone status. The main difference is that EIEA exporters are not free from foreign exchange controls or from quantitative restrictions on imports. Trade and foreign exchange liberalization¹⁸ has tended to blur the differences between the two regimes (Willmore, 1993a).

Preferential market access to the European Union is guaranteed under the Lomé IV Convention for products which meet rules-of-origin criteria, and to the United States under the Caribbean Basin Initiative II and the bilateral Super 807 textile and apparel agreement. Jamaica also benefits from general duty free entry for products traded within the Caribbean Community (CARICOM) and duty free entry for selected products exported to Canada (under CARIBCAN) and to Venezuela (under the CARICOM-Venezuela Agreement).

4.4 COMPETITIVENESS POLICIES

Since the mid-1980s, policy efforts in Latin America and the Caribbean have concentrated on macroeconomic stabilization and export promotion. Most countries, designed and implemented those policies on the assumption that free markets and private-sector initiative were the best strategies for overcoming past excessive, inefficient state interventions. However, the mid-1990s have seen a revival of active government policies to promote business competitiveness, based on the assumption that market forces have not been enough to foster private initiatives to attain fast growth. This policy revival is not a return to past import-substitution policies, but a search for

¹⁷ The first free zone in the country was established in Kingston in 1976 (The Economist Publications, 1988). This was followed by the Montego Bay Free Zone in 1985 and the GARMEX Free Zone (also in the Kingston area) in 1987 (Willmore, 1993a).

¹⁸ Tariffs are gradually being reduced. A Common External Tariff applies to imports from outside the Caribbean Community. Tariffs for raw material and capital goods are 5%, while those for imports of oil and steel are 20%. Garments and other manufactured goods have to pay a 20% tariff (JAMPRO, 1996).

new policy approaches and instruments consistent with a more open trade and financial environment. Peres (1996) identifies three types of policy perspectives in the region: (a) countries that have issued formal industrial-policy documents to guide their actions in this field (e.g., Mexico and Brazil in 1996); (b) countries that prefer to tackle competitiveness in a broader sense than that implied by the term industrial policy (e.g., the policy proposals of most of the Andean and Central American countries which follow Michael Porter's methodology), and (c) countries that concentrate on horizontal, non-discriminatory policy areas (such as technology diffusion, human-resources development and export promotion) with only a few or no explicit references to sector-based policies (e.g., Chile and Uruguay).

Jamaica and Costa Rica fit easily within this policy typology. The former is a clear case of a country with a specific industrial programme (the National Industrial Policy of March, 1996), while the latter follows an approach to competitiveness and industrial modernization very much based on Porter's competitive analysis (Porter, 1990). For the Dominican Republic, it is still too early to identify the policy approach that will guide that the actions of the new government, which took office in the second semester of 1996. Given this constraint, this section will concentrate in the cases of Costa Rica and Jamaica.

(a) Jamaica's 1996 National Industrial Policy¹⁹

In March 1996, the Government of Jamaica introduced the National Industrial Policy.²⁰ This was the culmination of almost two years of public debate on the subject, as well as extensive consensus-building activities and research by technical teams in specific industries.

For many years, Jamaica pursued inward-looking industrialization policies based on import substitution. In the 1970s and 1980s the Jamaican economy faced serious balance-of-payments and fiscal crises, exacerbated by external shocks. The adjustment process which followed in the mid-1980s involved abandoning policies of protection and heavy Government involvement in the economy, in keeping with the neoliberal policy prescriptions advocated by international lending institutions. Jamaica opted for trade liberalization and other economic reforms designed to strengthen the market mechanisms and support export-oriented growth. Within this context, industrial policy generally came to be regarded with suspicion, because the country's economic problems were attributed to inappropriate policies, particularly an overvalued exchange rate, fiscal expansionism and excessive state intervention. In the new policy model, the private sector was considered the engine of growth, and export promotion was the main strategy.

Concerns about the efficiency of existing markets had arisen by the mid-1990s and industrial policy is once more receiving serious consideration. This trend has become more pronounced since 1994 and has provided the immediate justification of the Government's effort to formulate a comprehensive industrial policy. Industrial policies were never completely abandoned, however, even during the earlier stages of structural

¹⁹ This section was prepared by Wesley van Riel, a consultant to the ECLAC/UNDP Regional Project RLA/88/039. For a detailed account, see van Riel (1996).

²⁰ The National Industrial Policy uses a comprehensive definition of industry. The entire productive sector is included in its scope, not merely the manufacturing sector. The new policy is detailed in Government of Jamaica (1996).

adjustment. Despite radical policy reforms centered on liberalization, deregulation and privatization combined with orthodox macroeconomic policies, sectoral policies geared to improving export performance have always been in place.

The Government position is that industrial policy is a necessary policy response to changes in the international environment and to the emergence of threats and opportunities for the country. In particular, industrial policy seeks to enhance the international competitiveness of Jamaican firms and to stimulate export growth. Sectoral interventions and other measures associated with industrial policy are justified in terms of the overall benefits to the economy. They do not imply a reversal of liberalization or orthodox macroeconomic policies.

The two strategic focuses of the National Industrial Policy are an export push in targeted areas of competitive advantage and an efficient process of import substitution. The most important policies considered in this strategy are technology diffusion, human resources development, export promotion and fostering small-enterprise development.

Policies for technology diffusion aim to improve competitiveness by the systematic application of science and technology to production. This is expected to proceed along four fronts: (i) strengthening scientific and technological capacity, particularly research and development activities by firms and government institutions, as part of a support infrastructure for industries; (ii) technical assistance at the enterprise level provided by government agencies; (iii) technology transfers through foreign direct investment; and (iv) stimulation of technological improvements and retooling by means of appropriate trade policies (e.g., no duties on all capital goods) and fiscal incentives (e.g., accelerated depreciation).

The National Industrial Policy incorporates multiple policy lines to foster investment. While macroeconomic stability is seen as a key precondition for sustained investment growth, the Government recognizes an important role for interventions that are geared to eliminate particular barriers to investment. The policies include traditional short-run fiscal incentives such as those established by the Export Industry Encouragement Act, although the limitations of these incentives are recognized. In the medium to long term, the tax system will be reformed to make it more "investor friendly", provide support services, facilitate investment financing—through the establishment of an investment facilitation board to expedite the processing of investment proposals—and reduce the quantity of paperwork required from investors.

Specific measures to promote foreign investment revolve around macroeconomic stability, market-oriented reforms, trade and investment facilitation and competitive cost and risk. Recent Jamaican experience, as well as that of the region as a whole, indicate that the ability to compete aggressively for FDI will be influenced less by the design of incentive programmes and other policy interventions, and more by the growth of investment opportunities in traditional and non-traditional areas.

Human resources development will be based on four policy considerations: (i) the large gap which exists between the demand for education and training and the capacity of existing institutions and programmes; (ii) the changing priorities in educational and training policies, which are determined by a fast-changing global environment and its impact on the country's competitiveness; (iii) the weaknesses in human resource capabilities, which directly affect the competitiveness of firms; and (iv) the problem of acute poverty and the role of education as a means to improve social equity. In this framework, priority will be given to meeting educational needs at the primary and secondary levels.

In addition to the export promotion schemes previously analyzed, the main innovations in the new policy are threefold: (i) a shift from sector-specific to broad-

based incentives;²¹ (ii) an amendment to the Export Free Zone Act to facilitate the establishment of single-entity free zones; and (iii) increased collaboration between the Government and the private sector in market development, research and development, the establishment of a one-stop facility for exporters, environmental standards and security for shipments.

Government initiatives to stabilize the economy are expected to improve the performance of the small-enterprise sector. In the short run, measures have been put in place to help neutralize the direct effects of the tight monetary and fiscal policies. In particular, differential interest rates will stabilize the cost of finance to small businesses. Small firms' access to more affordable factory space and technical assistance will also be facilitated.

The policies included in the Jamaican National Industrial Policy represent a mix of macro-level, sectoral and firm-level policies which try to increase the competitiveness of investment located in the country. In this sense, they are clearly part of the future policy package that Jamaica will use to lure new investors.

(b) Costa Rica's 1995-1998 Industrial Modernization Strategy

After a period of macroeconomic stabilization under the structural adjustment programme that was enacted in 1985, the Arias Administration (1986-1990) established an industrial restructuring programme to identify sectoral problems and propose solutions. Tripartite groups (government, business and labour) were organized to formulate specific policy and action proposals, but the programme lost credibility due to the lack of results. The funds originally assigned to industrial modernization were eventually used for other purposes. The Calderón Administration (1990-1994) effectively ended that programme and instead emphasized foreign trade and direct financial support to exporters oriented to countries outside the Central American Common Market. The end of the programme provoked uncertainty in the industrial sector, which felt that it was no longer a priority for governmental policy (Mortimore and Zamora, 1996). The Figueres Government (1994-1998) reinstated an industrial policy, which began to be implemented in January 1995.²²

The modernization strategy aims at six main objectives: (i) a continuous improvement in the country's competitiveness, (ii) an environmentally sustainable industrial development, (iii) increased valued-added through the systematic use of the science and technology infrastructure, (iv) the development of small- and medium-sized firms,²³ (v) the strengthening of the Central American Common Market, and (vi) the promotion of competitive markets (MEIC-MICIT, 1996). This strategy will be implemented through horizontal, non-discriminatory policies, as well as through sector-based actions.

As of mid-1996, the most important policies being implemented were the following: (i) the creation of a fund for industrial modernization in the form of specific credit lines in the national banking system; (ii) the establishment of a fund to provide

²¹ This does not imply that sectoral industrial policies will be abandoned. Rather, the Government seeks to place emphasis on the effective promotion of strategic sectors, evaluated on the basis of their competitive advantages.

²² The policy was outlined in Government of Costa Rica, *A Strategy for Industrial Modernization in Costa Rica*, San Jose, September 1994.

²³ Although small firms are expected to be the main beneficiaries of this policy, it includes government commitments and policy measures that go well beyond this universe of firms.

partial guarantees to small firms; (iii) the creation of a one-stop office for all certificates and permits needed by industrial firms;²⁴ (iv) the strengthening of the National Quality System; (v) the facilitation of small firms' access to subcontracting and technical assistance services; and (vi) the formation of five sectoral committees to channel the requests of industrialists and design specific actions to overcome administrative bottlenecks. Implementation of this modernization policy is subject to the authority of the tripartite High Council for Industrial Policy Negotiation created in September 1995 (Alonso, 1996).

Broad actions are already being implemented to further support industrial restructuring. These include the modernization of basic education and vocational training, as well as more limited actions in the field of science and technology (Labarca and Peres, 1997).

Although the Costa Rican modernization strategy may look modest in comparison to the Jamaican industrial policy, it also sets the basis for increasing the country's competitiveness and its potential attractiveness to foreign, as well as local, investors.

(c) The 1990 Dominican Republic New Economic Programme

In 1990, the Dominican Republic Government initiated an ambitious adjustment and reform programme called the New Economic Programme.²⁵ Its stated objectives were to reduce inflation and promote stable economic growth. In fact, the new programme mainly focused on reducing and eventually eliminating the public-sector deficit, combined with a restrictive monetary policy, the liberalization of credit and foreign exchange markets and a reform of the trade and tax systems. New rules governing foreign investment and free-zone investment were also enacted in 1990.

The shift towards opening up foreign trade by reducing tariffs and eliminating non-tariff barriers put strong competitive pressure on non-free-zone companies to restructure their operations. Despite foreign trade liberalization, import policies are still implemented on a discretionary basis. For example, customs continues to require local importers, as well as free-zone companies, to pay for a consular invoice and for the legalization of shipping documents. Although customs has greatly improved since the reform, the importation of goods can still be a slow, difficult process. The main problem seems to be that customs bases its tariff collection on a highly discretionary valuation system for assessing duties on imports, which is permanently under revision. Uncertainty is thus never overcome (Vicens and Martínez, 1996).

As discussed above, a new foreign investment law that eliminates most of the residue of the previous protectionist policies has recently enhanced this liberal stance. Although it is too early to forecast the actions the new Administration will carry out under the new industrial policy, the differences among the approaches to competitiveness policies in the Dominican Republic, Jamaica and Costa Rica can hardly be overstated.

²⁴ This action is part of a broader deregulation effort to reduce the cost and time required to create an enterprise.

²⁵ This section draws heavily on Vicens and Martínez (1996).

5. MEASURING POLICY COMPETITION

The wide array of policy lines in the countries under consideration, as well as differences in their implementation, makes it very difficult to present a general overview of policy competition without the help of a quantitative indicator. Using a methodology developed by AXIS Estrategias Empresariales,²⁶ we present a general index to measure how attractive a country is for investment originating in the United States. Given the large share of the United States in total investment flows to the Caribbean Basin, the index provides a good proxy for a country's attractiveness for foreign investment in general. Moreover, because the set of conditions that lure foreign investment includes the set of conditions that attract domestic investors, the index also serves as a good indicator of a country's capability to attract investment in general.

The index that measures a country's capability to attract investment (CAI) from the United States incorporates the weighted average of 64 variables that economic theory and practice consider to be the most relevant for United States investors when they decide to invest abroad. The variables were integrated into one index through a four-stage process of weighted averages.²⁷

The main sources of statistical data for those variables were published by the following organizations: the International Monetary Fund (IMF) for most economic indicators; the United Nations Economic Commission for Latin America and the Caribbean for complementary economic indicators; the World Bank for health indicators; The Economist Intelligence Unit for political risk; and the United Nations Educational, Scientific and Cultural Organization (UNESCO) for education indicators. Since most of the variables are based on "objective" data, the resulting index may be quite different from the "subjective" image a given country conveys abroad. This is a big plus for the CAI.

The index was used to study the period 1989-1993 for nine Caribbean Basin countries: Barbados, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Jamaica and Trinidad and Tobago. Data for some specific indicators (e.g., the stock of a particular production factor) were only available for an earlier date, however. The set of first- and second-stage variables included in the index are summarized in table 18, as well as their respective weights.

²⁶ Dr. Imelda Cisneros, President of AXIS Estrategias Empresariales (AXIS Business Strategies), a consulting firm in Caracas, Venezuela, provided the necessary information for developing the analysis included in this section.

²⁷ AXIS assigned weights to each variable or set of variables on the basis of its rather orthodox approach to economic theory.

Table 18
VARIABLES INCLUDED IN THE CAPABILITY TO ATTRACT INVESTMENT (CAI) INDEX

| First-stage variables | Second-stage variables | Weights (percentages) | Number of fourth stage variables |
|---------------------------------|---|--------------------------|--|
| Country risk | | 40 | 18 |
| | Economic stability | 24 | 8 |
| | Political and social stability | 16 | 10 |
| General business climate | | 40 | 19 |
| | Foreign direct investment climate ^a | 24 | 10 |
| | Prevalence of market conditions | 16 | 9 |
| Production factor endowments | | 20 | 27 |
| | Production factors | 10 | 14 |
| | Production services and infrastructure | 10 | 13 |

Source: AXIS Estrategias Empresariales, Caracas, 1994.

^a The ten fourth-stage variables included are justice administration, bilateral investment treaties, multilateral investment treaties, profit and capital repatriation, sectors reserved for domestic investors, corporate tax, value-added tax, other taxes, double taxation treaties and tax exemptions and incentives.

The CAI and its first-stage variables for the nine countries are presented in table 19. Results for Chile are also included, as this country is generally considered to be the best performer in Latin America and the Caribbean during the period under consideration.

Costa Rica and Jamaica fall in the medium range of attractiveness for foreign investors. The Dominican Republic should be included in the lower range, although the new law on foreign direct investment should improve its ranking. The ranking produced by the CAI is closely related to the growth stage of each country. Richer countries (e.g., Chile, Trinidad and Tobago, and Barbados) receive a much higher CAI than do the poorest (e.g., Honduras and Haiti), while middle-income countries occupy the middle ground. Jamaica looks more attractive for investors than what could have been expected from its economic performance in the last decades.

The most relevant component of the CAI for an analysis of policy competition for FDI is probably the general business climate. For the countries under study, this set of variables is the least correlated to the CAI, showing a rather high level for some low-CAI countries (e.g., El Salvador and Guatemala) and a low level for some high-CAI countries (e.g., Barbados and Trinidad and Tobago). The business climate is one of the few components of the CAI that may be improved by policy lines that imply the elimination of constraints (e.g., trade liberalization, deregulation, lower taxes, less state intervention) rather than direct action. On the other hand, Costa Rica, Jamaica and the Dominican Republic show a remarkable consistency in all three components of the CAI.

Interestingly, no clear correlation arises between low labour costs and attractiveness to investors. Some of the countries with lower labour costs rank very badly according to the CAI (e.g., Haiti and the Dominican Republic), while some countries with high labour costs rank much better (e.g., Trinidad and Tobago, and Barbados). In the general framework of policy competition, labour cost is just one of a large set of determinants.

Table 19
THE MAIN COMPONENTS OF CARIBBEAN BASIN COUNTRIES' CAI

| Countries ^a | CAI | Country risk | | General business climate | | Production factor endowments | |
|------------------------|------|--------------------|---------|--------------------------|---------|------------------------------|---------|
| | | Index ^b | Ranking | Index ^b | Ranking | Index ^b | Ranking |
| Chile ^c | 0.73 | 0.667 | 2 | 0.714 | 1 | 0.700 | 1 |
| Trinidad and Tobago | 0.60 | 0.626 | 3 | 0.560 | 5 | 0.612 | 2 |
| Barbados | 0.57 | 0.697 | 1 | 0.530 | 7 | 0.450 | 4 |
| Costa Rica | 0.56 | 0.604 | 4 | 0.543 | 6 | 0.528 | 3 |
| Jamaica | 0.53 | 0.578 | 5 | 0.565 | 4 | 0.425 | 5 |
| El Salvador | 0.49 | 0.443 | 7 | 0.607 | 2 | 0.305 | 7 |
| Guatemala | 0.48 | 0.509 | 6 | 0.581 | 3 | 0.308 | 8 |
| Dominican Republic | 0.43 | 0.402 | 8 | 0.453 | 8 | 0.292 | 9 |
| Honduras | 0.39 | 0.318 | 9 | 0.448 | 9 | 0.342 | 6 |
| Haiti | 0.27 | 0.293 | 10 | 0.277 | 10 | 0.178 | 10 |

Source: AXIS Estrategias Empresariales, Caracas, 1994.

^a Countries ranked according to their capability to attract investment (CAI).

^b A higher index means a lower country risk.

^c Included only as a reference.

Finally, table 20 presents the results for an important second-stage variable, the climate for FDI, and its third-stage components, legal security for investment, regulations, and tax treatment. The weights of the third-stage components are 50%, 30% and 20% respectively. Of the three focused countries, the best climate is provided by Costa Rica, followed by Jamaica and the Dominican Republic in a distant third. In the third-level variables, these countries present an extremely heterogeneous performance. Although Costa Rica fares well regarding security for investment, its tax treatment is just average and investors are overburdened by regulations. On the other hand, a very favourable tax treatment in the Dominican Republic is more than compensated by excessive regulation and poor security for investment. Jamaica's lack of security for investment can hardly be compensated by means of few regulations and an attractive tax regime. The poor ranking of our benchmark country (Chile) regarding tax treatment and its excellent performance attracting FDI further indicate that low taxes are a rather weak instrument for incentives-based competition.

Table 20
THE CLIMATE FOR FOREIGN INVESTMENT IN CARIBBEAN BASIN COUNTRIES

| Countries ^a | CFDI | Security or investment | | Regulations | | Tax treatment | |
|------------------------|-------|------------------------|---------|--------------------|---------|--------------------|---------|
| | | Index | Ranking | Index ^b | Ranking | Index ^b | Ranking |
| Chile ^c | 0.695 | 0.850 | 1 | 0.750 | 1 | 0.225 | 10 |
| Costa Rica | 0.566 | 0.688 | 2 | 0.400 | 7 | 0.513 | 5 |
| Trinidad and Tobago | 0.564 | 0.563 | 3 | 0.600 | 4 | 0.513 | 6 |
| Guatemala | 0.528 | 0.500 | 5 | 0.650 | 2 | 0.413 | 7 |
| Jamaica | 0.510 | 0.400 | 7 | 0.650 | 3 | 0.575 | 2 |
| El Salvador | 0.508 | 0.500 | 6 | 0.500 | 5 | 0.538 | 4 |
| Barbados | 0.508 | 0.525 | 4 | 0.400 | 8 | 0.625 | 1 |
| Dominican Republic | 0.386 | 0.338 | 8 | 0.350 | 9 | 0.563 | 3 |
| Honduras | 0.350 | 0.275 | 9 | 0.450 | 6 | 0.388 | 8 |
| Haiti | 0.290 | 0.250 | 10 | 0.350 | 10 | 0.300 | 9 |

Source: AXIS Estrategias Empresariales, Caracas, 1994.

^a Countries ranked according to the climate for foreign direct investment (CFDI).

^b A higher index means fewer regulations or a better tax treatment.

^c Included only as a reference.

6. THE DYNAMICS OF POLICY COMPETITION AND THE LIMITS OF NATIONAL POLICY

6.1 THE EXTENT OF POLICY COMPETITION

Policy competition for FDI in the Caribbean Basin is harsh. Besides rules-based and factor-creation competition, bidding wars are taking place among countries and even among different regions within individual countries, despite their small geographical size. Several pieces of evidence indicate different dimensions of that competition.

The most important domestic factor that led to the expansion of the EPZs were the competitive exchange rate devaluations of the early 1980s, which took place both in Caribbean Basin countries and elsewhere in Latin America (see figure and table 21).²⁸ The onset of the debt crisis forced countries to reduce domestic absorption and generate foreign exchange surpluses to serve their debts (principal and interest). Although exchange rate depreciation was not directly aimed at attracting FDI, it was instrumental to that goal because it implied a sharp reduction of wages measured in dollar terms. Since the late 1980s, stabilization programmes anchored on fixed nominal exchange rates have reversed the trend, but the Mexican devaluation of December 1994 once again put pressure on other countries to follow suit.²⁹

Competition among countries is also taking place at a very detailed microeconomic level, as they compete for the investments of individual firms.³⁰ To limit rivalry among member states for the location of industrial activities and to assist in rationalizing the criteria for granting incentives to firms, CARICOM enacted a Scheme for the Harmonization of Fiscal Incentives to Industry in 1973 (UNCTAD, 1996). However, CARICOM Secretariat (1993) finds that its impact has not been important, at least in the more developed countries of the region.

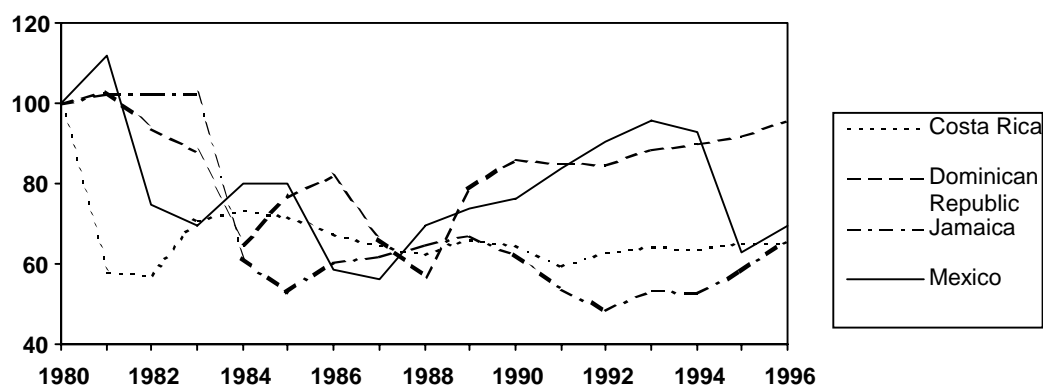
Competition is also taking place among regions or cities in individual countries. For example, the Dominican Republic provinces put pressure on the Government to have their own EPZs, which resulted in 35 such parks by 1996. A national average of less than 13 firms per park suggests that competition has resulted in the buildup of excess capacity. In fact, some of those parks are almost empty.

²⁸ Kaplinski (1993) indicates that Costa Rica, the Dominican Republic, Jamaica and other Caribbean countries had to keep a very high exchange rate for the United States dollar to increase their competitiveness during the 1980s. Besides devaluating, their currencies were kept closely clustered to avoid losing competitiveness relative to each other. This would show that an actual bidding war on real wages took place during the whole crisis decade.

²⁹ The competitive impact of the Mexican devaluation may be approximated by taking into account that the ratio of wages to *maquiladora* exports fell almost 4 percentage points from 13.3% in 1993 to 9.6% in 1995.

³⁰ An outstanding example—the struggle for Intel's investment in a new microprocessor plant—is presented later in this section.

Figure

REAL EXCHANGE RATE FOR EXPORTS ^a

Source: ECLAC on the basis of official data from the International Monetary Fund (IMF).

^a National currency in United States dollars.

Table 21
REAL EXCHANGE RATE FOR EXPORTS

| | Costa Rica | Dominican Republic | El Salvador | Guatemala | Honduras | Jamaica | Mexico |
|------|------------|--------------------|-------------|-----------|----------|-------------------|--------|
| 1980 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1981 | 58.3 | 103.0 | 117.8 | 110.1 | 106.6 | 102.2 | 111.9 |
| 1982 | 57.3 | 93.8 | 130.8 | 108.2 | 113.1 | 102.4 | 74.7 |
| 1983 | 71.0 | 88.2 | 143.1 | 107.9 | 120.0 | 102.2 | 69.5 |
| 1984 | 73.4 | 64.6 | 157.5 | 107.1 | 123.7 | 61.3 | 79.9 |
| 1985 | 71.9 | 76.5 | 183.3 | 120.8 | 124.4 | 52.8 | 80.0 |
| 1986 | 67.6 | 81.7 | 117.9 | 87.4 | 117.2 | 60.5 | 58.4 |
| 1987 | 65.0 | 66.0 | 139.4 | 67.8 | 110.2 | 62.1 | 56.3 |
| 1988 | 62.2 | 56.9 | 159.9 | 67.0 | 109.9 | 64.6 | 69.3 |
| 1989 | 66.0 | 78.7 | 167.9 | 66.7 | 118.4 | 67.3 | 73.8 |
| 1990 | 64.7 | 86.0 | 139.0 | 57.0 | 66.4 | 62.3 | 76.2 |
| 1991 | 59.7 | 85.4 | 141.2 | 64.8 | 61.6 | 53.6 | 83.6 |
| 1992 | 62.8 | 84.9 | 141.5 | 65.5 | 65.0 | 48.6 | 90.6 |
| 1993 | 64.2 | 88.8 | 159.0 | 64.6 | 59.0 | 53.1 | 95.5 |
| 1994 | 64.0 | 90.1 | 165.6 | 67.0 | 53.0 | 52.7 | 93.0 |
| 1995 | 65.4 | 92.1 | 171.8 | 69.0 | 59.1 | 57.9 | 62.9 |
| 1996 | 65.4 | 95.5 | 183.8 | 69.1 | 57.9 | 61.8 ^a | 69.6 |

Source: ECLAC, on the basis of official data from the International Monetary Fund.

^a Estimated.

6.2 IS POLICY COMPETITION INTENSIFYING?

Policy competition is not only pervasive, but it is also intensifying everywhere in the region. Three main forces are pushing in that direction.

The most important force is the erosion of tariff preferences derived from CBI, GSP and Lomé IV. Trade diversion based on unilateral trade concessions—mostly from the United States, but also from the European Union—have been the driving force behind EPZ garment and electronics exports. New developments in international trade are causing those advantages to deteriorate, and they will be eliminated before the middle of the next decade. The advantages of CBI are not as important as the preferences Mexico received through the North American Free Trade Agreement (NAFTA); Lomé IV runs out in February 2000; and the results of the Uruguay Round imply that the Multifibre Arrangement (MFA) will end in 2005. The most threatening of these events is by far the elimination of the MFA, because it will put Caribbean Basin garment exports under pressure from extremely competitive East Asian suppliers, especially China.

In the near future, however, the initiatives on NAFTA parity in the United States market will be relatively more important, due to the current negative impacts of NAFTA on the economies of most Caribbean countries. In the case of the apparel industry, Mexican products enjoy a 6-percentage-points tariff advantage over imports from the members of the United States Caribbean Basin Initiative II (USITC, 1995b). Two attempts in the United States Congress to obtain parity have failed. Furthermore, Mexican apparel is not subject to quotas in the United States market, because its access is determined by the norms of origin of the NAFTA. These two advantages could easily produce FDI diversion from Caribbean Basin countries to Mexico (USITC, 1995a; ECLAC, 1994). They were undoubtedly factors in the decisions of two prominent apparel assemblers operating in the Caribbean Basin, Warnaco and Sara Lee, to open new plants in Mexico.³¹

While plans for parity have stalled in the United States Congress, the impact of NAFTA on the Caribbean economies has meant 150 plant closures and 123,000 lost jobs in the apparel industry.³² Since 1994, the Dominican Republic has lost 10,000 jobs in garment and footwear plants, and 7,000 jobs have been eliminated in Jamaica. Although Caribbean Basin economic problems cannot be ascribed only to NAFTA, the strong trade diversion to Mexico is deteriorating the rather weak trade diversion of the CBI.

Another process that is changing the competitive balance in the region is the onset of peace in El Salvador and Guatemala. These countries, which are the most populated in the region except for Cuba, are providing increasingly competitive bases for new EPZ investments, particularly given the prevailing low wages and, in the case of El Salvador, business acumen. More competitors will quite probably mean more competitive pressures. These pressures are well summarized in the recommendation of the Dominican Republic top private-sector association that “attention should be paid that minimum-wage increases do not surpass those of competing countries” (CNEP, 1995).

³¹ “NAFTA and Caribbean Textiles”, *Latin American Economy and Business*, May, 1995, p. 11.

³² “Impact of NAFTA pounds economies of the Caribbean”, *The New York Times*, January 30, 1997, pp. A1 and A4.

Despite that recommendation, however, wage regulation and labour flexibility cannot produce any sharp improvement for competitiveness in the region. Wages in EPZs are equal to or higher than those in comparable private-sector industrial firms outside of free zones, but earnings are still very low (usually about US\$ 100 per month³³). Any further reduction would not change total production costs significantly. Union activity in the EPZs is minimal or non-existent, which is not much different to what happens in the private sector in most countries in the region. EPZ investment did not create poor labour conditions in the region; conditions are actually better in the EPZs than in the rest of industry, except in large, state-owned enterprises. Slow economic growth, fast population increase and the debt crisis made the attractiveness of EPZs irresistible. The free zones were a reaction, not a cause.

A much more positive response to competition pressures is evident in the increasing scale and productivity of apparel firms. In the Dominican Republic, for example, EPZ exports grew from US\$ 1.78 billion in 1995 to US\$ 1.87 billion in 1996, while the number of firms decreased from 469 to 434.³⁴ Growth has been accompanied by technical progress and some firms are introducing modern modular production systems.

6.3 THE IMPACT OF POLICY COMPETITION

It is difficult to arrive at definitive evaluations of the costs and benefits of policy competition for FDI. Such information tends to be scarce, and it is a complicated task to casually relate FDI flows to the provision of incentives. Most sources agree that incentives, while clearly not negligible, are a relatively minor factor in the locational decisions of TNCs. Other advantages, such as market size and growth, production costs, skill levels, political and economic stability and the regulatory framework play a much stronger role (UNCTAD, 1996, p. 51). Nevertheless, fiscal incentives do tend to be more attractive for footloose, export-oriented investments (Bergsman and Pirnia, 1996), like the apparel and electronics industries in the Caribbean Basin. Another difficulty for causal analysis is that incentives may influence different TNC investment decisions in the same way but for different reasons, in accordance with their specific corporate strategies. Finally, unlike incentives, the net benefits for the host country are quite difficult to measure with any degree of precision, and the benefits themselves must be interpreted in terms of the goals of Government strategy, something that is usually not explicit and often changes appreciably over time.

For these reasons, a few cases may better illustrate the impact of policy competition for FDI than do strictly theoretical or conceptual considerations. Two examples from Costa Rica help clarify a number of the above concerns and point to the negative- or positive-sum outcomes of policy competition for FDI. A third example will be used in the next section of this paper, which addresses the implications of the policy competition for FDI.

Case 1. Coskoa S.A., a small assembler of women's suits, is a Group III company in the Costa Rican garment industry.³⁵ The company is a subsidiary of Gilmor Trading Corporation of Hialeah, Florida, in the Miami Metropolitan Area. The parent

³³ Overtime and other benefits may increase monthly earning to about US\$ 150.

³⁴ Data from the Central Bank of the Dominican Republic.

³⁵ See section 3 of this paper for the definition of a Group III company.

company began in 1980; ten years later, it was a small trading company with 100 employees and sales of about \$19 million competing for contracts from buyers such as J.C. Penney and Liz Claiborne. Its principal products were relatively undifferentiated standard ones which did not undergo any major changes in terms of technology, fashion or design and which resulted from a relatively unsophisticated, labour-intensive production process. Because the company faced a deteriorating competitive situation in the United States market, it established the Costa Rican subsidiary in 1989 to reduce production costs in order to compete better for buyers' contracts. Costa Rican operation was successful: by 1995, it accounted for about one-half of the sales of the parent company.

Coskoa's principal competitors were other assembly operations in Colombia, Guatemala and Honduras. Although Coskoa enjoyed a very special advantage in Costa Rica,³⁶ it complained that its competitors in other countries benefited from even lower labour costs. From 1989 to 1996 Coskoa attempted to strengthen the competitive situation of its parent firm by producing low-cost women's suits in Costa Rica, taking advantage of the fiscal incentives of the EPZ regime, the relatively low wages, and the HTS production-sharing mechanism for components sourced in the United States. It simply could not keep pace, however. Without notice, it closed its Costa Rican operation, leaving behind substantial unpaid wages and social security contributions.

This case presents both positive and negative aspects. On the positive side, the company provided an FDI inflow, the creation of about 600 jobs and a steady export stream. On the negative side, it tended to operate like a sweatshop with a fly-by-night mentality. The operation did not incorporate any local physical inputs in the production process, the company displayed no concern for upgrading production to include more technologically complex or sophisticated goods, and sales were limited to one market. It was a short-term, defensive survival strategy. If one assumes that Government priorities included increased local integration (i.e., greater local content), technological upgrading and export market diversification to help extend the national industrialization process, then the incentives received by Coskoa were for the most part a dead loss. The company turned out to be a free rider: it enjoyed the incentives offered by the country but contributed little in the way of what the Government was expecting from its fiscal and other incentives. This is clearly a negative-sum result and something to be avoided.³⁷

Case 2. Sara Lee Corporation of Chicago, Illinois, has two undergarment-producing subsidiaries in Costa Rica that correspond to Group I operations.³⁸ Sara Lee began in 1941; in 1990 it had sales of about US\$12 billion and 100,000 employees. Sara Lee is a diversified producer of various food products and women's undergarments, including hosiery, brassieres, girdles and allied garments. Bali, Hanes and L'eggs are the better-known trademarks of this leader in the garment business. The garment products are sophisticated and technologically complex, and fashion, design and quality are important considerations for consumers. The first Costa Rican subsidiary was set up in 1978, before the sharp currency devaluations of the 1980s; the second was established in 1987. These subsidiaries provide the parent company both production cost

³⁶ It was the first company allowed to operate under the EPZ regime without being physically located in a formal free zone, thereby allowing it to source even cheaper labour.

³⁷ This case does demonstrate that, in certain circumstances, it is a clearly positive result when a footloose firm moves on, even if job losses are a consequence.

³⁸ See section 3 of this paper for the definition of a Group I operation.

advantages and great flexibility to adapt to the changing competitive situation in the international market.

The principal competitors of these subsidiaries are other TNCs in the United States market and other subsidiaries or contractors of Sara Lee in the Dominican Republic, Honduras, El Salvador, Puerto Rico and Mexico. One of the Costa Rican subsidiaries serves as the Central American headquarters for many of the operational aspects of the other producers there. These subsidiaries have expanded forcefully in Costa Rica. They seem to have adapted to rising wage rates through continuous increases in labour productivity, as well as through technological upgrading of the production process for the specialized fashion products. They helped their parent companies win back United States market shares from Asian competitors. The 1995 "calls" made by the United States Government on undergarment imports from Costa Rica put a damper on their rate of expansion,³⁹ but a decision by the World Trade Organization (WTO) which was favourable to Costa Rica would appear to have resolved that problem.

These subsidiaries have had important positive effects for Costa Rica, including significant FDI inflows, the creation of about 4,000 jobs and very significant export streams. In the course of their long-term relationship with Costa Rica, they have contributed in a major way to the training of specialized workers, the technological upgrading of their operations, and, in a more minor way, to export market diversification. Both stated that they would further expand their work force if they could find what they needed. On the negative side, little in the way of improved national integration has resulted, although one subsidiary did attempt unsuccessfully to source thread and cardboard locally and the other hopes to extend the local production process to include cutting cloth sourced in the United States. The increased advantages of the Mexican subsidiary, however, could limit further expansion in Costa Rica if NAFTA parity is not attained. This case represents a notably positive-sum result. These subsidiaries are at the center of the Costa Rican export success of the 1980s and 1990s, and an effort should be made to increase the links between this kind of operation and the national economy.

The specific examples have demonstrated how negative- or positive-sum outcomes evolve from the combination of distinct TNC strategies (e.g., cheap labour versus corporate flexibility) and Government goals (e.g., FDI inflows, job creation, export streams, national integration, technological upgrading and export market diversification). Simply keeping up with the FDI incentives offered by other countries does not guarantee success. Furthermore, unfocused FDI incentives produce less predictable results. Government policy makers face a more generic problem, however, with regard to FDI incentives based on EPZ operations. The Governments' desire to deepen the national industrialization process is directly challenged by the use of the EPZ regime as an incentive for FDI. Assembly operations based on components sourced in the United States via HTS 9802 may actually truncate that industrialization process, because of the application of tariffs on local inputs on entry into the United States market. This dilemma represents a major limitation to the success of national policy in the wider sense, that is, goals beyond simply increasing FDI inflows.

³⁹ A United States firm which feels that it has been unduly prejudiced by an abnormal increase in imports to the United States can request a decision by the Department of Commerce to determine if import disruption has taken place. The Department of Commerce can issue "calls" (or, warnings) to the local textile offices which allocate quotas in exporting countries in order to restrain the growth of such items.

6.4 POLICY IMPLICATIONS

When developing countries are not able to offer financial incentives to influence the siting decisions of TNC investments, it is not enough simply to match the fiscal and other incentives of one's competitors, especially in the form of EPZs. An integral, active policy focused on wider national goals is required.

For the small, open economies of the Caribbean Basin, an active policy must contemplate at least three separate elements. First, some kind of international accord must recognize that bidding wars can spin out of control to no one's benefit except the TNC receiving the incentives. Since developing countries cannot compete with the financial incentives of developed countries, they rightfully propose the institution of some kind of incentive cap. This is difficult, as even *The Economist* comments: "Some developing countries complain that, while rich-country governments are keen to see foreign investors given greater protection against interference from host governments (an OECD agreement on this is due to be completed by May), they are less eager to call a halt to FDI auctions".⁴⁰ Initiatives can rightfully be made through the OECD Multilateral Agreement on Investment and through the Working Group on Investment (chaired by Costa Rica) of the Free Trade Area of the Americas (FTAA) negotiations, among others.

Second, the Caribbean Basin countries must act in concert to achieve parity with Mexico regarding access to the United States market, as analyzed above.

Third, and most important component, general incentives policy must be reassessed in the context of a new, more competitive international market. Clearly, the incentives have to become more effective. Four operational policy guidelines may help to accomplish this.

- (i) Actively target relevant TNCs. Officials should actively seek out those TNCs that are most likely to further the Government's wider goals, such as the industrialization strategy.
- (ii) Focus incentives to promote industrial goals, such as the creation and upgrading of clusters. The aim is, first, to use incentives to promote a concrete strategy, which could work very well in the apparel and electronics industries, and, second, to involve national companies in the evolution of these clusters.
- (iii) Link the receipt of incentives to investment, transfer of technology, value added, training or other aspects of the subsidiary's operation. The aim is to avoid free riders.
- (iv) Limit incentives in time, clearly specifying deadlines and requirements for renewal or extension. The aim is to avoid creating incentive-dependent operations.⁴¹

Incentives should become less universal and more focused on national goals, if they are to contribute more to the advancement of small, open economies in the Caribbean Basin. These recommendations are not far from current practice in other parts of the world, especially developing Asia. Costa Rica has successfully applied similar practices in the electronics industry, which grew by 47% in 1995. Government policy

⁴⁰ "Uncommercial travelers", *The Economist*, 1 February 1997, p. 25.

⁴¹ For example, a tire producer created in the 1960s as an "integration industry" in the context of the Central American Common Market is today requesting EPZ status in Costa Rica.

has attracted a number of important electronic firms (including Intel, Motorola, Acer America, DSC Communications, Bourns, C&K Components, Panduit, Conair, Panasonic, Hitachi, Siemens, Square D and GTE Sylvania) and has produced the beginnings of an important new industrial cluster.⁴² Costa Rica's strategy for the electronics sector has advanced considerably compared to that used for the apparel industry in the 1980s.

Case 3. Intel is the world's largest semiconductor company, with 90% of the core market for PC processors and 9% of the total world semiconductor market. In 1996, it enjoyed revenues of US\$16.2 billion, profits of US\$3.6 billion and a stock market capitalization of US\$103.9 billion.⁴³ The company's MMX technology promises further growth in the future.⁴⁴ Negotiating a major new investment—valued at US\$300-500 million—with so important global player was a very significant accomplishment for Costa Rica. This project alone is predicted to raise GDP growth by 0.5% in 1997.⁴⁵

The new plant in Costa Rica is an assembly and test facility for the low-technology end of a technology-intensive industry. It forms part of a group of five such Intel plants worldwide; the others are in Shanghai (China), Manila (the Philippines), Penang (Malaysia) and Arizona (the United States). At the end of the first stage of the investment project, the plant will cover 4,000 square meters and have 2,000 direct employees. Operations are scheduled to begin in early 1998. FDI by associated suppliers could reach an additional US\$500 million, and the 15% value added of the Intel production process will appreciably augment the net value of Costa Rican exports. Negotiations between a special task force of the Costa Rican Investment and Trade Development Board (CINDE)⁴⁶ and Intel began in November 1995 and more recently involved the direct participation of the President of the country. Costa Rica won out over the offers of Brazil, Chile and Mexico.

How important were incentives and what was the nature of the negotiating process? Both CINDE and Intel claimed that no special treatment or special investment incentives beyond the EPZ regime were offered or received. An Intel spokesman indicated that their principal concerns were always "infrastructure, the operating environment and labour. No matter how many economic incentives a country may offer, if you can't operate the facility it won't come into contention as a site".⁴⁷ However, Intel received several specific advantages in each one of these categories. Because the Intel operation was to become the principal consumer for electrical energy in Costa Rica, the Intel subsidiary was promised its own electrical substation and electrical energy at about one-half the normal rate. With regard to labour, the Government made commitments to train workers, some of whom would participate in training programmes in Intel's plants in the United States.

⁴² Information from the Costa Rican Investment and Trade Development Board (CINDE) web site at <http://www.cinde.or.cr>

⁴³ "Intel and microchips: Squeeze, gently", *The Economist*, 30 November 1996, p.65.

⁴⁴ "Make way for MMX computers", *Business Week*, 3 February 1997, p.22.

⁴⁵ Intel invested a total of \$5 billion on capital projects and R&D in 1996; about every nine months it was putting up a new chip plant, usually costing about US\$2 billion each. See "Intel's amazing profit machine", *Fortune*, 17 February 1997, p. 63.

⁴⁶ A profile of CINDE, including interviews with its Investment Director and a member of Intel's Costa Rican site selection and start-up team is found in *FDI News*, vol. 1, Number 3, Foreign Investment Advisory Service (FIAS), Washington, D. C., December 1996.

⁴⁷ *FDI News*, vol. 1, Number 3, Foreign Investment Advisory Service (FIAS), Washington, D.C. December 1996, p. 13.

This case clearly support the recommendations listed above. First, the Costa Rican policy team actively targeted Intel until they were finally invited to make a presentation at Intel's headquarters in Santa Clara, the result of which was the inclusion of Costa Rica as a possible location. Second, Costa Rica's new policy identified the electronics industry as a potential vehicle for advancing policy goals and focused specific incentives in that area, although concrete measures to increase the involvement of national firms were not defined. The third and fourth recommendations —linking incentives to performance and limiting them in time— are not apparent in this case, but both are relevant and attainable in the future. For example, Intel responded to criticism of its new US\$2-billion, 5,000-employees, computer-chip plant in Albuquerque, New Mexico, in the United States: "Economists grumble that the plant has sucked more out of the state in tax breaks than it has contributed to the economy. Contribute, Intel has embarked on a number of schemes to improve its popular standing, among them a commitment to buy 40% of its supplies in New Mexico —which should be worth \$170 million to the state economy each year."⁴⁸ Intel is clearly susceptible to this kind of pressure. Finally, by limiting the time period for the Intel incentives (especially electricity rates), government policy could attempt to induce Intel to upgrade the plant from the low-tech end of the industry, deepening the local industrialization process at the same time.

Developing countries can thus influence TNC siting decisions and produce important national impacts, which the governments of the industrial countries accomplish through direct financial incentives. In a world where competition is intensifying, policy makers must focus FDI incentives on priority activities, such as the creation of industrial clusters and their technological upgrading. In the apparel and electronics industries of the Caribbean Basin, this entails combining a focused incentive policy with a defined industrial strategy in order to increase specialization and improve international competitiveness. Those economies must seek to boost exports through authentic international competitiveness, rather than by bidding up incentives to FDI and soliciting special access to one market.

⁴⁸ "New Mexico: Flirting with the future", *The Economist*, 4 January 1997, p. 27.

7. CONCLUSIONS

Policy competition for FDI in the Caribbean Basin, as derived from the study of Costa Rica, the Dominican Republic and Jamaica, is characterized by the following ten elements.

- (i) At the enterprise level, very little can be expected from competition through fiscal and financial incentives to firms that are already established. The larger, more efficient firms have undertaken their investments based more on their headquarters' strategy than on a country's incentives. The smaller, less efficient firms will not become more competitive through the incentives they receive. The prevailing growth pattern in the area, which is strongly based on EPZs and closely integrated to international production chains, renders the traditional fiscal and financial incentives even less significant.
- (ii) Legal frameworks for foreign investment tend to converge quite rapidly towards a general pattern of national treatment, while countries try to do their best to attract foreign investors, preferably for export-related activities. Virtually all countries try to access the international system of guarantees for investment. The only area other than tax regimes where substantial differences remain is the specification of which economic sectors are open to foreign investors. The recent debate on the privatization of the Mexican petrochemical industry shows that it will be difficult to eliminate such differences. Other than deterring investors who are directly interested in those sectors, the general impact will probably be minor.
- (iii) Countries make important efforts to present a good image to investors. They use a wide array of variables to highlight that, despite being low-wage countries, their main advantages lie elsewhere: geographical location, efficient human resources, a stable democratic political system and so on. Although not always accurate, images do matter. Countries have learned that investors care more about a dynamic competitive advantage than about a static comparative advantage. Future policy competition, even when actually based on negative-sum games or bidding wars, will probably be presented as a positive-sum game. Rules-based and factor-creation competition will be integral to country images and even country behavior.
- (iv) Homogenization of incentives is another trend in policy competition for investment in export platforms, particularly export processing or free zones. Countries compete through incentives and rules that have to be matched by other competitors, as is shown by the Dominican Republic's need to enact a non-interventionist foreign investment law in 1995. Moreover, competition put pressure on countries to transform temporary incentives (e.g., limited-time authorizations to operate under the temporary admission or free-zone regimes) into permanent ones, whenever a competitor allows for automatic authorization renewals. These cases show how easily incentives-based and

rules-based competition can become a bidding war when no international standards set a lower limit to those rules.

- (v) A significant type of rules-based competition is the integration into broader trade areas by means of reciprocal and non-reciprocal free trade agreements. All the countries under consideration are beneficiaries of the Caribbean Basin Initiative II, the Generalized System of Preferences, and one regional common market (either CARICOM or the Central American Common Market). Jamaica and the Dominican Republic are also beneficiaries of the Lomé IV Convention, while Costa Rica has a bilateral free trade agreement with Mexico. Although all three consider their membership in these agreements highly attractive for foreign investors, their main concern is that NAFTA may make the market-access benefits provided by CBI and GSP less significant. This would substantially affect the economic activity of their free trade zones. All countries are extremely interested in joining NAFTA or obtaining NAFTA-parity.⁴⁹
- (vi) Competition based on general competitiveness policies differs widely, from a modernized interventionist industrial policy in Jamaica to a formal laissez-faire in the Dominican Republic, to a mild, active policy approach in Costa Rica. In practice, however, differences are not so wide. Policy implementation is very poor in those countries, as elsewhere in Latin American and the Caribbean (Peres, 1996). The interventionist Jamaican policy may therefore lead to results not so different than those of laissez-faire marred with bureaucratic inefficiencies in the Dominican Republic. Low implementation limits the effects of competitiveness policies in the competition for FDI.
- (vii) The three countries under consideration occupy the middle ground in the Caribbean Basin regarding attractiveness to foreign investors. They achieve consistent results in the three main components of the CAI index, although they are surpassed by some of the poorest countries in the region in general investment climate. This may suggest that for policy competition countries have the most freedom in developing a pro-business investment climate. Policy competition through deregulation and the elimination of constraints may prove easier to tackle in the short and medium terms than developing factor endowments, infrastructure or a stable macroeconomic and political environment.
- (viii) Policy competition in the Caribbean Basin is intensifying, because of the erosion of tariff preferences implicit in CBI, GSP and Lomé IV. New players in the area will further increase that competition.
- (ix) Although FDI incentives are functional during the early period of EPZ development, they become increasingly less effective. For Costa Rica, Jamaica and the Dominican Republic, FDI incentives were significant during the crisis period of severe macroeconomic dislocation which followed the onset of the international debt crisis. As the region began to return to normality, however, FDI incentives produced increasingly random results. They sometimes caused positive-sum results with significant, beneficial impacts for the developmental trajectory of the host country, as did the long-term relationships established with the large, modern subsidiaries of

⁴⁹ As of early 1998, the interim trade programme for the Caribbean Basin submitted by the Clinton Administration to the United States Congress had not been enacted.

Sara Lee, and they sometimes presented negative-sum results which actually provoked damage to that trajectory, as did the fly-by-night sweatshop operation called Coskoa. To improve the probability of better results after the initial stage, it is necessary to focus FDI incentives.

- (x) Developing countries cannot compete with rich countries in using direct financial incentives to influence the siting decisions of TNCs. They are not in the same league. However, developing countries can adopt more pro-active policies and can better focus their fiscal and other incentives to get more predictable results, as the Costa Rican negotiations with Intel demonstrate. To get the maximum benefits from this kind of negotiation, the Government must develop a clear strategy for pursuing its national priorities, in terms of the industrialization process, the promotion of specific industrial clusters and the role of national firms as contractors, subcontractors, licensees, suppliers, strategic partners, etc. This strategy must be functionally linked to the range of policy instruments at the Government's disposition. Only in this fashion can small, open developing countries make the most of their limited resources and finite incentives for the promotion national priorities.

Policy competition for foreign investment in the Caribbean Basin has achieved good results mainly in relation to export processing of garments for the United States market. Transnational corporations' strategies proved to be more important for those results than country strategies per se. Although EPZs account for a significant share of manufacturing employment and exports in the three countries under consideration, the long-term implications of such a growth pattern are by no means clear.

Some authors (e.g., Kaplinski, 1993) argue that this is a case of "immiserizing employment growth", in which dependence on EPZs, under the regulations established by the United States for guaranteed access to its market, has led to low value-added production with minimal backward linkages to the domestic economy. Policy competition for foreign investment has been detrimental to these countries because it operated in an economic environment in which only two enclave sectors (i.e., free zones and tourism) have been attractive enough for foreign investors.

In contrast, other authors (e.g., Willmore 1993a, 1993b) have argued that most of the negative outcomes were a result not of the free-zone growth pattern per se, but of the fact that the countries under consideration have followed the wrong policies. Policy mistakes such as interventionism and overreached import substitution have prevented stronger backward linkages and higher value added in the free-zone exports. Nevertheless, capacity building and learning has taken place through human resources and technological spillovers from the free zones to the customs territory.

We tend to agree with the second position. Positive-sum games, although not pervasive, are present in the region. Technological upgrading in Costa Rica and productivity growth in the free zones of the Dominican Republic are examples that could be generalized. Furthermore, introducing one-third or more of the manufacturing labour force to the dynamics and discipline of the assembly line cannot be considered a minor feat. Future incentives-based competition may lead to a policy environment more conducive to a more efficient articulation of the relation between the free zones and the rest of the national economy. However, an international set of enforceable rules is necessary to prevent incentives-based and rules-based competition from degenerating into bidding-wars, fought through the deterioration of labour and environmental standards. Finally, targeted factor-creation competition—which was so successful in

attracting Intel's investment to Costa Rica— demands a much better implementation of improved competitiveness policies. The time for this effort is just beginning, after more than a decade of adjustment and the ideological predominance of laissez-faire cum discretionary decision-making.

8. BIBLIOGRAPHY

- Alonso, E. (1996), *Agenda para la modernización industrial en Centroamérica. Informe de Costa Rica*, San Jose, Costa Rica, United Nations Industrial Development Organization (UNIDO) and ECLAC subregional headquarters in Mexico, Mexico City.
- AXIS (1994), Posición relativa de Venezuela como polo de atracción de inversión directa estadounidense frente a Argentina, Colombia, Chile, México, Perú, Centroamérica y el Caribe, Caracas, AXIS Estrategias Empresariales.
- Bergsman, J. and N. Pirnia (1996), "Do Incentives Work?", in FDI News, Volume 1, No. 2, FIAS, Washington, D.C., March.
- Caribbean Community Secretariat (1993), "Proposals for a harmonized system of incentives to industry, tourism and other services and agriculture for CARICOM", Guyana, unpublished.
- CENPRO (Center for the Promotion of Exports and Investments)/PROCOMER (Foreign Trade Corporation)/Zona Franca (Export Free Zone Corporation) (1996), Exporters 96: Costa Rican Export Directory, San José, Costa Rica.
- CNEP (National Council for Private Enterprise) (1995), Agenda empresarial para el desarrollo integrado, Consejo Nacional de la Empresa Privada, Santo Domingo, 10 November.
- Costa Rica, MEIC-MICIT (Ministry of Industry and Trade/Ministry of Science and Technology) (1996), Política de modernización industrial. Un pueblo en marcha. Informe de la gestión 1994-1996, XI Congreso Nacional de Industriales, San José, Costa Rica, June 27th.
- Costa Rica, Ministry of Foreign Trade (1996), Costa Rica's Free Zones. Profit Center of the Americas, Export Free Zone Corporation, San Jose, Costa Rica,
- ECLAC (Economic Commission of Latin America and the Caribbean) (1995), "La inversión extranjera en América Latina y el Caribe. Informe 1995" (LC/G.1890), Santiago, Chile.
- _____ (1994), "Centroamérica y el TLC: efectos inmediatos e implicancias futuras" (LC/MEX/R.494 (Sem.68/3)), Mexico City.
- Government of Jamaica (1996), National Industrial Policy: A Strategic Plan for Growth and Development, Kingston, Jamaica.
- IRELA/IDB (Institute for European-Latin American Relations/Inter-American Development Bank) (1996), Foreign Direct Investment in Latin America in the 1990, Madrid.
- Kaplinski, R. (1993), "Export Processing Zones in the Dominican Republic: Transforming Manufactures into Commodities", World Development, vol. 21, No. 11, pp. 1851-1865.
- Labarca, G. and W. Peres (1997), "Políticas de desarrollo productivo en Costa Rica", Políticas de competitividad industrial. América Latina y el Caribe en los años noventa, W. Peres (editor) Mexico City, Siglo XXI Editores.
- Mayorga, R. (1996), Foreign Investment Regimes in Countries Within the Hemisphere: Legal Challenges, Document presented to the Seminar Investment Policies and

- Multilateral Rules of Investment in Latin America, Organization for Economic Cooperation and Development, Inter-American Development Bank, Ministry of Foreign Affairs (Brazil) and Ministry of Trade (Spain), Rio de Janeiro, 16-18 July.
- Mortimore, M. and R. Zamora (1996), *The International Competitiveness of the Costa Rican Clothing Industry*, Joint ECLAC/UNCTAD Unit, ECLAC, Santiago, Chile.
- Mortimore, M. (1995a), "América Latina frente a la globalización", *Desarrollo productivo series*, No. 23 (LC/G.1867), ECLAC, Santiago, Chile, August.
- Mortimore, M. (1995b), "Paths Towards International Competitiveness: a CANalysis", *Desarrollo productivo series*, No. 25 (LC/G.1869), ECLAC, Santiago, Chile.
- Oman, C. (1996), *Policy Competition and Foreign Direct Investment. A Background Document*, OECD Development Center, Paris, February.
- Pellerano and Herrera (1996), *Doing Business in the Dominican Republic*, Santo Domingo, Federation of European Chambers of Commerce of the Dominican Republic.
- _____ (1995), *Legal Guide to the Free Zones of the Dominican Republic*, Santo Domingo. Secretariat of State for Industry and Trade/National Council on Export Free Zones.
- Peres, W. (1996), *The Revival of Industrial Competitiveness Policies in Latin America and the Caribbean in the 1990s*, ECLAC/UNDP regional project RLA/88/039 "Policies to promote innovation and competitiveness in the Latin American and Caribbean Business Sector", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC).
- Porter, M. (1990), *The Competitive Advantage of Nations*, The Free Press, New York.
- PROCOMER (Foreign Trade Corporation) (1997), *Exporters 97: Costa Rican Export and Import Directory*, San Jose, Costa Rica.
- Russin, Vecchi and Heredia Bonetti (1996), "Doing Business in the Dominican Republic", Information Dossier prepared for the Central Bank of the Dominican Republic, Santo Domingo.
- The Economist Publications (1988), *Tax-free Exporting Zones, A User's Manual*, Special Report No. 1135, London, The Economist Publications Limited.
- UNCTAD (United Nations Conference on Trade and Development) (1996), *Incentives and Foreign Direct Investment, Current Studies, series A, No. 30*, New York, United Nations publication, Sales No. E.96.II.A.6.
- USITC (United States International Trade Commission) (1995a), *Caribbean Basin Economic Recovery Act: Impact on U.S. Industries and Consumers, Tenth Report 1994*, U.S. International Trade Commission, Washington, D.C.
- _____ (1995b), *Production Sharing: Use of United States Components and Materials in Foreign Assembly Operations, 1990-1993*, USITC Publication 2886, Washington, D.C., May.
- Valdez, H. (1996), *El nuevo clima de inversión en República Dominicana*, Central Bank of the Dominican Republic, Santo Domingo.
- Van Riel, W. (1996), *Policies to Strengthen Competitiveness of the Jamaican Industrial Sector*, ECLAC/UNDP regional project RLA/88/039 "Policies to promote innovation and competitiveness in the Latin American and Caribbean business sector", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC).
- Vicens, L. and E. Martínez (1996), *The International Competitiveness of the Garment Industry in the Dominican Republic, Interregional Project on the Impact of Transnational Corporations on Industrial Restructuring in Developing Countries*,

Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC).

Willmore, L. (1993a), Export Processing in Jamaica: Ownership, Linkages and Transfer of Technology (WP 93-15), Port of Spain, Trinidad and Tobago, ECLAC, subregional headquarters for the Caribbean, September.

_____ (1993b), Export Processing in the Dominican Republic: Ownership, Linkages and Transfer of Technology (WP 93-13), Port of Spain, Trinidad and Tobago, ECLAC, subregional headquarters for the Caribbean, September.

Desarrollo Productivo series *

- | No. | Title |
|-----|---|
| 16 | "Reestructuración y competitividad: bibliografía comentada" (LC/G.1840), Restructuring and competitiveness, November 1994 |
| 17 | "Síntesis del planteamiento de la CEPAL sobre la equidad y transformación productiva" (LC/G.1841), Restructuring and competitiveness, December 1994 |
| 18 | "Two studies on transnational corporations in the Brazilian manufacturing sector: the 1980s and early 1990s" (LC/G.1842), Transnational corporations and foreign investment, December 1994 |
| 19 | "Tendencias recientes de la inversión extranjera directa en América Latina y el Caribe: elementos de políticas y resultados" (LC/G.1851), Transnational corporations and foreign investment, December 1994 |
| 20 | "Empresas transnacionales manufactureras en cuatro estilos de reestructuración en América Latina. Los casos de Argentina, Brasil, Chile y México después de la sustitución de importaciones" (LC/G.1857), Transnational corporations and foreign investment, May 1995 |
| 21 | "Mexico's incorporation into the new industrial order: foreign investment as a source of international competitiveness" (LC/G.1864), Transnational corporations and foreign investment, May 1995 |

* *Desarrollo productivo* is the continuation, under a new name, of the *Industrialización y desarrollo tecnológico* (IDT) series, published periodically by the ECLAC Division of Production, Productivity and Management. This new name has been chosen as a more accurate reflection of the issues dealt with in this series. The articles will be grouped into at least three categories: i) restructuring and competitiveness; ii) transnational corporations and foreign investment; and iii) agricultural and rural development. These topics broadly reflect the internal organization of the Division (Joint ECLAC/UNIDO Industrial and Technological Development Unit, Joint ECLAC/UNCTAD Unit on Transnational Corporations and Agricultural Development Unit), as well as the networks of public and private entities linked to these Units.

The Division welcomes contributions to this series from all staff members of the ECLAC and United Nations systems, and particularly from members of the institutions comprising the networks, as well as distinguished specialists from Latin America and the Caribbean outside the region.

Readers interested in back numbers in this series should request them in writing from the Division of Production, Productivity and Management, ECLAC, Casilla 179-D, Santiago, Chile.

- 22 "Informe sobre la competitividad internacional de las zonas francas en la República Dominicana" (LC/G.1866), Transnational corporations and foreign investment, August 1995
- 23 "América Latina frente a la globalización" (LC/G.1867), Transnational corporations and foreign investment, August 1995
- 24 "Los flujos de capital extranjero en la economía chilena: renovado acceso y nuevos usos" (LC/G.1868), Transnational corporations and foreign investment, September 1995
- 25 "Paths towards international competitiveness: a CANalysis" (LC/G.1869), Transnational corporations and foreign investment, June 1995
- 26 "Transforming sitting ducks into flying geese: the Mexican automobile industry" (LC/G.1865), Transnational corporations and foreign investment, October 1995
- 27 "Indicadores de competitividad y productividad. Revisión analítica y propuesta de utilización" (LC/G.1870), Restructuring and competitiveness, September 1995
- 28 "The Taiwanese experience with small and medium-sized enterprises (SMEs). Possible lessons for Latin America and the Caribbean" (LC/G.1872), Restructuring and competitiveness, August 1995
- 29 "Fortalecimiento de los gremios empresariales en América Latina" (LC/G.1885), Restructuring and competitiveness, October 1995
- 30 "Historia evolutiva de una planta metalmecánica chilena: relaciones micro-macro y desarrollo tecnológico" (LC/G.1887). Restructuring and competitiveness. July 1997
- 31 "Desempeño global y comportamiento industrial de América Latina en el período 1970-1993" (LC/G.1910). Restructuring and competitiveness. July 1997
- 32 "Integración económica e inversión extranjera: la experiencia reciente de Argentina y Brasil" (LC/G.1911). Transnational corporations and foreign investment. July 1997
- 33 "Sistemas de innovación y especialización tecnológica en América Latina y el Caribe" (LC/G.1913). Restructuring and competitiveness. March 1996

- 34 "Industrial policy and competitiveness in open economies" (LC/G.1928). Restructuring and competitiveness, November 1997
- 35 "Reestructuración y competitividad: segunda bibliografía comentada. Publicaciones de carácter general y de la región de América Latina y el Caribe", Volumen I (LC/G.1933) y "América Latina y el Caribe: publicaciones por países", Volumen II (LC/G.1933/Add.1). Restructuring and competitiveness, October 1996
- 36 "Encadenamientos, articulaciones y procesos de desarrollo industrial" (LC/G.1934). Restructuring and competitiveness, November 1996
- 37 "Las economías asiáticas emergentes: treinta años de dinamismo exportador" (LC/G.1935). Restructuring and competitiveness, February 1997
- 38 "Revisión de escenarios agrícolas y comerciales mundiales hacia el 2020" (LC/G.1940). Agricultural and rural development, October 1996
- 39 "La posición de países pequeños en el mercado de importaciones de los Estados Unidos: efectos del TLCAN y la devaluación mexicana" (LC/G.1948). Restructuring and competitiveness, December 1997
- 40 "Empresas transnacionales y competitividad internacional: un CANálisis de las experiencias de Asia en desarrollo y América Latina" (LC/G.1957), Transnational corporations and foreign investment, July 1997
- 41 "Quality management and competitiveness: the diffusion of the ISO 9000 standards in Latin America and recommendations for government strategies" (LC/G.1959). Restructuring and competitiveness, December 1997
- 42 "Quality management ISO 9000 and government programmes" (LC/G.1960). Restructuring and competitiveness (forthcoming)
- 43 "El empleo agrícola en América Latina y el Caribe: pasado reciente y perspectivas" (LC/G.1961). Agricultural and rural development, September 1997
- 44 "Restructuring in manufacturing: case studies in Chile, Mexico and Venezuela" (LC/G.1971). Restructuring and competitiveness (forthcoming)

- 45 "La competitividad internacional de la industria de prendas de vestir de la República Dominicana" (LC/G.1973), Transnational corporations and foreign investment, February 1998
- 46 "La competitividad internacional de la industria de prendas de vestir de Costa Rica" (LC/G.1979), Transnational corporations and foreign investment (forthcoming)
- 47 "Comercialización de los derechos de agua" (LC/G.1989), Agricultural and rural development (forthcoming)
- 48 "Patrones tecnológicos en la hortofruticultura chilena" (LC/G.1990), Agricultural and rural development, January 1998
- 49 "Policy competition for foreign direct investment in the Caribbean basin: Costa Rica, Jamaica and the Dominican Republic" (LC/G.1991), Restructuring and competitiveness, May 1998