FRANKLY SPEAKING ……..

FOREIGN DIRECT INVESTMENT (A more balanced View).

<u>The Issue in Context</u>.

The reality of our present day trade is one of Economic Partnership Agreements (EPA) with the European Economic Community and various proposed trading arrangements with countries of North and South America involving OECS countries and DOMINICA, in particular. These arrangements have the potential for open door and unfettered access to local economies and markets (admittedly with possibilities for reciprocal access). From my observation, precious little discussion or even attention has been given to the implications of Direct Foreign Investment in these economies. Indeed, while there has been an implicit acknowledgement of potential contributions by outside investors in the economic recovery and development of Dominica, there has been no further comment on priority or preferred areas for such investment activity or the degrees of sensitivity of various areas of the economy to such outside involvement or control. Might Foreign Direct Investment be the critical factor that levels the playing field between such unequal partners, or could it worsen the current imbalances?

Such comments as are forthcoming appear to be focused on issues of a "locals first" option in accessing alluring investment possibilities within the geo-thermal energy sector or for greater constraints and regulation of non-national sand and gravel extraction operations. Little attention has been given to the significant non-national presence in the financial sector, including banking and insurance despite their historical domination of these activities. At the other extreme, both government and sections of the private sector have campaigned forcefully for foreign direct investment in some areas of the local economy (so far with limited success) such as in tourism accommodations and resort development, agro-processing and manufacturing. What are the implications and dimensions of this policy issue, and at what risk might a suitor like Dominica woo a temperamental mistress such as Foreign Direct Investment (FDI)?

The literature on the development of lesser developed areas such as the Caribbean does indeed caution that this is a policy area not to be ignored. This caution is even more heightened when FDI funding comes through multi-national corporations headquartered in the developed metropolitan centers. In the current context of globalization, and the reality of the intrusiveness of decision-making by outside entities, local host countries cannot be unconcerned over this risk and opportunities available to their national development efforts. Indeed, the relevant question may now be, how can developing area host countries design and structure their international (economic) relations such that they can optimize the best features FDI with

the least possible adverse impacts on their long run national aspirations and economic sovereignty? The cynics might say that the question is now largely academic and rhetorical given the agreements already entered into by jurisdictions like Dominica, but a more perceptive subtext suggests that there are still areas and opportunities for manipulating and manoeuvring in order to dull the worst aspects of foreign investment.

A Matter of Definition.

For purposes of this discussion, Foreign Direct Investment (FDI) is defined as the importation of private financing from foreign sources for investment in host countries with anticipation of economic returns. Accordingly, FDI is to be distinguished from government-to-government loans or grants and does not include non-government organization (NGO) charitable or philanthropic transfers. It logically includes funds transferred from nationals resident abroad (ie, Diaspora persons), so long as the quantum, regularity, receptors, investment activity, reporting of returns, and taxation payable are subject to direction, monitoring and control by a foreign government. Foreign Direct Investment may be induced by "invitation" and concessionary incentives such as is prevalent in most Caribbean jurisdictions. It may be selective in the sectors and activities by focusing on investments that are highly viable, yielding better than average returns-on-investment. Logically, such investors will remain as long as the potential for profits is better than the costs of relocation and start-up in another jurisdiction or the base-line option of close-down.

Expanding the "Free Trade" Agenda.

Until recently, the tentacles of globalization through foreign private investment were primarily centered in the economic sectors of Agriculture, Mining, Finance and Insurance (including Banking) with a lesser presence in Manufacturing and Processing. Currently, free trade agreements have expanded into a wider range of "commodities and services" as companion trade items with conventional goods and raw resources. Consequently, communications and information services, utilities such as energy, health and education facilities, services and products procurements, entertainment and recreation all are likely to be "fair game" for competition with foreign agreement partners. Poor consolation that developing countries have graciously been given equal access to compete for the same "commodities and services" within developed countries since the quality and standards tests of what is acceptable are primarily dictated by the developed countries in the first place, and market demands on quantity are often beyond the capacity of most developing countries of the OECS to satisfy in the second.

What then are the potential benefits of FDI (within or outside trade agreements) for small, developing, exposed economies like Dominica? How may such host countries use FDI assets to their advantage?

Growing the Local Economy.

Significant FDI participation in the local economy theoretically assumes that there are shortfalls in the generation of savings (and by extension investment) in the host economy. In such cases, FDI might be seen to supplement local investment funds to finance productive activity. However, the anomaly of the Caribbean is that of surplus savings which has historically and continues currently to be siphoned off to metropolitan money markets, leaving the local host economy investment poor, either due to inability or unwillingness to use these resources. To this one might add accusations of too-demanding or too-inflexible lending policies on the part of local branches of foreign financial institutions or preference for loans often out of step with national development priorities. One may identify other issues such as the lack of business acumen and experience within the local population and a resistance to take investment risks. But other reasons may additionally include the fact that while attractive business opportunity may exist within various sectors, successful ventures require technologies or management skills that are unavailable locally. Foreign Direct Investment may then serve as a means of transferring such "technologies" to the host country with inevitable local spin-offs.

Within some economic activities, existing investments may by size, strength and/or influence enjoy a virtual monopoly which other local investors are unwilling to challenge. The entry of FDI in opening up competition and by offering alternative choices, may result in improved levels of service, better and wider range of goods and services, and lower prices to the benefit of the general economy.

One of the more valuable contributions of FDI is that of expanding the host economy by the creation of new production and employment opportunities. Such activities are especially prized when the foreign investor replaces or displaces formerly imported goods or services, or produces a more acceptable product for export, or causes a local product to enter a protected or more discriminating foreign market or results in higher levels of foreign exchange earnings for the local economy. Where FDI introduces new and improved production, management, servicing and marketing techniques or

gives rise to more modern supply and delivery systems, or demands better and higher quality inputs or skills, or introduces better human relations policies, these all help to ready a formerly marginalized economy for the international marketplace.

On the other hand, Foreign Direct Investment is not without its drawbacks. Chief of these is the issue of repatriation of profits to the home country instead of local re-investment. Should the foreign investor have been allowed to displace local investment, the eventual result might even be a net outflow of investment funds over time. Foreign investors who enter the local economy under a protective umbrella of incentives might rightly be held to an obligatory schedule of re-investments at an agreed to rate. This would be a condition equally applicable to a local investor without any underlying implication of differential and prejudicial treatment.

The Scope for Policy.

Given these potential benefits and caveats, the appropriate policy question is whether or not all aspects of the local economy should be open for foreign private investment and if not, what principles or guidelines might guide those that should be, and those that should not. One might simply highlight the more significant factors that might go into such a determination and leave it to the nuances of the individual host economy to determine how these might apply in each individual case:

- **(a) Presence or absence locally of the required business acumen and technological skills;**
- **(b) Existence of the desirable international linkages such as marketing and distribution networks, and their growth potential;**
- **© Access to services, facilities, infrastructure and capacity required to compensate for any deficits that might not be readily available;**
- **(d) Whether or not protection of local investment, local employment, locally desirable social/cultural investments is necessary;**
- **(e) Importance of controlling and managing ecologically sensitive resources through appropriate technologies and processes;**
- **(f) Ensuring the integrity of national cultural sites, features, observances and resources including radio and television, newspapers, magazines, schools and their curricula;**
- **(g) Security of major national instruments and services and the manner of their use in the national development agenda. This might include, though is not limited to (i) financial services sector, (ii) power generation and distribution, (iii) water services, (iv) ports, airports and harbor facilities and services.**

The key issue in all of the above is that of resisting the urge to apply separate and distinctly different rules to foreign investment as against local. Instead, the prime objective must be to ensure that critical and sensitive national concerns are addressed satisfactorily. Accordingly, the rules must be clear and be applied impartially. It requires little emphasis to suggest that depending on the principles involved, local jurisdictions must be able to design and implement legislation and regulations that meet international trading agreements. (By the same token, future "trading" agreements need to be designed with primary concern for the implications for the local society, and the growth of the local economy).

<u>Operational Criteria</u>.

Even where a new foreign corporation is considered desirable, a detailed submission and analysis of its proposed operations should ensure that the maximum possible benefits accrue to the local economy, while not jeopardizing its profitability. Conceivably, this might include such issues as local labor versus imported machinery; pre-manufactured imported components versus locally manufactured items; foreign personnel in place of locally trained staff. Techniques of operation should ensure results that are in compliance with locally approved environmental assessments established by policy, enforced under regulations and consistently and fairly applied.

Little is gained from FDI which enters and targets the local economy with minimal prospect for adding to the vitality of the economy such as net increases in employment, increased exports or additional foreign exchange earnings. Various measures may be adopted to assess the desirability of FDI all of which illustrate the potential beneficial effects of having strategic infusions of foreign capital as the means of generating growth in lagging sectors and regions. For consideration are pre- and post investment-to-output ratios; tracing of inter-sector linkages; again pre- and post-investment multipliers; economic diversification and stability; employment quantity and quality including skills transfers; and, saving/investment changes. However, an effective FDI attraction program can only be successful within the framework of an over-all national development programming concept and an efficient, open and impartial regulatory framework. More specifically:

- **(a) Full disclosure of FDI related programs and policies;**
- **(b) Current regulations affecting FDI programs;**
- **(c) Prompt dispute resolution;**
- **(d) Supportive business services - - personnel and programs;**
- **(e) Continuous monitoring, feedback and refinements.**

Even so, and notwithstanding the generally presumed advantages of a well-designed FDI program, there are still potential pitfalls. Foreign investment is assumed by those undertaking it to be highly risk-laden, and those who venture in expect a higher than normal profit return. Where foreign capital is desirable, host countries should therefore move to remove or reduce any factors that support a perception of undue risk. Among others one might include; political instability, perception of corruption, social disaffection and unrest, labor volatility, unstable currency and poor administrative practices, to name a few.

Given a receptive climate and attractive opportunities for satisfactory returns-on-investment, the FDI program should actively seek to eliminate the conditions that caused the investment gap in the first place, so as to minimize continuing foreign penetration into the local economy, except for areas where there is slow local take-up.. The host society should also be sensitive to the profile, history and connections of the foreign investor….whether it is an individual private corporation, or a branch of a transnational corporation or a proxy or dummy corporation for a foreign government entity. The last supposes an active foreign government policy of establishing an economic presence as a "beach-head" for whatever purpose and poses an unfair competition to local investors.

For micro-states such as Dominica, because land resources are at a premium, government may justifiably limit the size and number of land parcels which may be bought by non-nationals. As an alternative, and depending on the nature of the investment proposed, government may promote leasehold arrangements under varying conditions of duration, of renewals, buybacks and other disinvestment provisions. Pointedly, it should be recognized that a "one shoe fit all" approach to investment incentives is unimaginative, insensitive to the unique requirements of each investment proposal and potentially unresponsive to the nuances of the national interest. The challenge is whether or not defensible, attractive and transparent frameworks can be established to effect the flexibility implied, and whether or not there are persons professional and capable enough to implement them.

In order to ensure that the local economy benefits as much as possible from the effects on foreign investment, provision for the repatriation of capital and profits should be sensitive to the impacts of such withdrawal on the economy. This is not to suggest that repatriation should be prohibited. That would be counter-productive. But attempts should be made to monitor and regulate the volume and rate of such repatriation. As well, the investor might be invited and encouraged to consider diversifying into other high priority attractive operations whether related to or separate from the initial investment.

Foreign investors should be obligated to employ local staff wherever they are available in place of imported non-nationals or to agree to provide for training of locals and the replacement of expatriates within the earliest possible timeframe.

Where foreign (and local) investments have been initiated under local incentive and shelter schemes such as tax holidays, import duty exemptions, site/services/building subsidies etc., the assumption should be to mature such incubator enterprises for open international competition and indeed the form and nature of governmental assistance may in fact need to change as the investment grows and matures. This therefore calls for a close monitoring of the circumstances of each investor and appropriate and timely response by government.

Summary and Conclusions.

In summary, the issue of Foreign Direct Investment especially for small developing states like Dominica is clearly a two-edged sword. Even for large developed countries it poses major policy challenges that demand the closest scrutiny and Dominica can learn from such experiences. This is especially true within the framework of Free Trade Agreements that superficially suggest open borders for the movement of capital, for investment and takeovers, for competition with national corporations, for transference of technologies, for movement in and out of management and technical personnel, for taxation and repatriation of profits etc. Even here, discerning and adept governments should be able to distinguish with defensible reasons, circumstances when some degree of government intervention is necessary to stem or deflect foreign investments. In practice, three prevalent criteria have been generally adduced in justification of such intervention:

(a) The Principle of "Net Benefit". Even though a foreign investment interest is demonstrated in some economic area, should the host government be satisfied that in the overall, its economy will be worse off as a result of that investment, it may defensibly intervene to obstruct such investment, particularly where the intended investment is by way of a "takeover" of a corporation that has benefited in the past from public financial support. On that basis, the Government of Canada intervened to justify refusal of landing privileges by commercial aircraft of the United Arab Emirates, as a threat to the viability of the National carrier and subsidiary dependent commercial operations.

(b) The Principle of "Strategic Interest". Under this argument, a country may intervene to bloc a foreign intervention or takeover in an economic area which is critical for the overall development of the country or its key sectors. Relying on this principle, the Government of Canada recently intervened in support of the Government of the Province of Saskatchewan in denying a takeover attempt by an Australian mining company (BHP Billiton) of the Potash Corporation of Saskatchewan (PotashCorp). This is the world's largest potash producer; the world's largest fertilizer producer; the world's third largest producer of phosphate and the fourth largest producer of nitrogen. The Canadian government relied on grounds of its importance to the national agricultural sector and particularly stability of fertilizer production. To this might be added the concern of the provincial government concerning reduced taxation revenues consequent on such a takeover, if it were allowed to proceed.

© The Principle of "National Safety, Security and Sensitivity". This defense proceeds on the grounds that there are overriding issues for the safety and security of the nation in ensuring that the ownership and operational decisions affecting a particular investment proposal should be squarely vested in nationals and subject to unimpeded national control. Again, under this principle, the Government of the United States of America blocked attempts by Saudi Arabian interests to acquire ownership and control of the San Francisco Port Authority.

Arguably then, it is left to potentially impacted states to adduce defensible reasons for valid exceptions from the open sesame portals assumed to exist under Free Trade Agreements or other trading arrangements, and to insist that provisions be made for such exceptions in these and similar negotiations. It will be left to the ingenuity of host countries, either through negotiated exemptions or innovative interpretations to secure only positive and nationally compatible Foreign Direct Investments, bearing in mind that trading partners have the right of relying on similar arguments.

Finally, with specific reference to the territories of the Caribbean, experience has taught us that despite the best of intentions, efforts at attracting Foreign Direct Investment, if pursued independently by each territory in isolation might be frustrated through competition among the various jurisdictions. Through negative bidding on the part of investors, territories might be induced to lower their priorities, objectives, principles and standards as each country is played off against the other. This clearly suggests the desirability of a regionally agreed minimum threshold of process and conditions of approvals above which individual territories might proceed depending on their unique endowments and comparative advantages. For example, all

territories might agree to the preparation, documentation and submission of a commonly prescribed Environmental Impact Statement for projects of a minimum size and significance, subject to a public review of this proposal document and prior to determination on an application to proceed.

In closing, this discussion does not address the persistent concern that too demanding requirements and performance criteria placed on prospective investors might scare them away. It is true that jurisdictions with open door attitudes towards investment, with poor labor laws, with weak environmental regulations, with unrestricted profit repatriation and even with well-known "under-the-table" official assistance have been successful in attracting certain levels of FDI. Equally demonstrably, it is investors such as these that are quickest to take flight at the smallest threat of disturbance to their privileged sanctuary or with the slightest inducement by a competing jurisdiction. The best investors are those who arrive with full knowledge of the rules of operation and are assured that they will be fairly applied; who are willing to expose their record to legitimate scrutiny and who are willing to be seen as responsible corporate citizens.

Increasingly, the corporate boardrooms of developed countries are being pressured by their shareholders to exercise considerations beyond the financial bottom line in their investment decisions. A large cross-section of such corporations have adopted and are vigorously pursuing Mission Statements and agendas committed to Human Dignity, Social Responsibility, Ecological Sustainability, Economic Fairness, Community Re-investment, to name a few. On-the-ground, these objectives might translate into decision on where overseas should economic activity occur; what elements of the host society might be best served by decisions; what beneficial, secondary, non-financial spin-off might ensue from investment; how best might investment assist stated public goals of national development; and, what may be an acceptable rate for repatriation of profits. It is the task of local national development corporations to seek out, identify and attract such enlightened investors and incorporate them into a rational "Public-Private-Partnership" of national growth and development. But the initiative, leadership, drive and effectuation lie squarely on local development planners. Sadly, in most cases, they may not be up to the task!

The small and vulnerable jurisdictions of the Eastern Caribbean, such as Dominica, need to be finally aware of the many faces of FDI. Even when superficially registered as a private corporation, the legislation of countries of origin may permit levels of "official direction and control" to the extent that such corporations are nothing more than proxies for foreign state intervention. As a result, should such FDI corporations mature into positions of economic dominance they could become effective instruments of

foreign political influence. This reality is not unknown to the Caribbean, having surfaced from the manipulative control of colonial policy through such institutions as the former Colonial Development Corporation (CDC). So while Foreign Direct Investment may come at a price, it should not be, at any price Foreign Direct Investment (FDI).

That's the way I see it, anyway!

[This is the second in a series of four essays in memory of Dr. Joseph Bernard Yankey, public servant, colleague and friend.]