

**Foreign Direct Investment and Employment
in the
English and Dutch-Speaking Caribbean**

by

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ILO Subregional Office for the Caribbean

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Executive Summary

Investment expenditure is an important contributor to economic growth and employment. In the Caribbean, foreign direct investment (FDI), although small by world standards, accounts for the bulk of total investment, as domestic saving is usually inadequate to meet local financing needs.

Some Caribbean countries, for example Bermuda, the Cayman Islands and Trinidad and Tobago, have been more successful in attracting FDI over the past three decades, largely because these countries have either vibrant international business and financial services industries or abundant natural resources, particularly oil and other petroleum products. In the case of the other Caribbean countries, FDI has been directed mainly toward tourism and tourism-related activities, as well as to the mining and manufacturing industries. These trends are expected to continue over the medium to long term. The ongoing liberalization of trade, which has resulted in the gradual reduction of preferences in manufacturing and finance, as well as the deregulation of the telecommunications industry, could attract greater FDI inflows in the future.

The bulk of FDI to the Caribbean region originates in the United States and Asia. In most cases, FDI inflows have resulted in the transfer of new technologies, specialized knowledge and skills to local managers and supervisors. However, local managers usually do not take over the company and the concentration of ownership usually remains with foreign owners.

More importantly, the empirical results, derived using panel data methods, suggest that an increase in FDI in the entire sample of Caribbean countries leads to an approximate one-to-one increase in employment, an outcome supported, despite considerable gaps in the employment data, by an evaluation of the stylised facts on FDI flows over the past three decades. The impact of FDI on employment is greatest in the first year and is enhanced when trade policies, absorption and financial development are considered. This

latter result suggests that FDI flows work better in a stable and healthy macroeconomic environment.

Several policies are used by host governments to influence the location of FDI and these can be neatly classified into the following categories: (1) investment incentives; (2) domestic infrastructure and local skills; (3) regulatory environment; (4) state agencies; and, (5) international governing arrangements. The most popular of these policies appears to be investment incentives. However, more can be done to evaluate their effectiveness, in particular with regard to trade agreements, since there is a void in the empirical Caribbean economic literature. A survey questionnaire undertaken on employment conditions revealed that the main problems FDI-enterprises experienced in relation to the labour market were retrenchment policy, union recognition and contract employment.

Future research could explain the distributional effects of the FDI and examine the specific impact of the various investment promotional policies across industries and countries. Research could also investigate the specific effects or importance of the improvement in skills and technological transfers from the foreign investment, most likely captured in the positive productivity effects in FDI industries. Indeed, these suggestions could improve the significant data gaps that exist in most Caribbean economies.

1. Introduction

Investment expenditure is a critical contributor to a country's productive capacity and by extension, the rate of output growth and employment. In the Caribbean, foreign direct investment (FDI), although small by world standards, accounts for most of the total investment, as domestic saving is usually inadequate to meet local financing needs. In fact, FDI inflows to countries such as Bermuda and the Cayman Islands have consistently exceeded gross domestic investment during the past twenty years. In terms of the distribution of FDI flows by industry, the bulk is sourced by primary industries (mainly mining and oil exploration) and tertiary activities, chiefly tourism and international business and financial services. Most of the FDI to the region originates in the United States (with Bermuda being the largest recipient of US investment) and Asia.

Despite varied potential theoretical benefits of FDI, the majority of the empirical research has focused on its influence on economic growth with mixed results (see Balasubramanyam, Salisu and Sapsford, 1999; Blomstrom, Lipsey and Zejan, 1994; De Mello, 1999). However, a highly desired outcome of attracting FDI is the potential for creating employment opportunities in the host country. Unfortunately, a search of the literature unearthed only one previous study (Fu and Balasubramanyam (2005) on China) on the role of FDI in employment determination. This article found a strong linkage between FDI and employment as well as FDI and exports. The authors estimate that a 1 per cent increase in FDI raises employment growth by about 3 per cent and exports by almost 9 per cent, concluding that FDI tends to provide an outlet for surplus productive capacity and labour in the receiving country.

An examination of the positive relationship between FDI and employment is the key objective of this study. Judging by the sample data, it appears that this objective was achieved in the 20 English- and Dutch-speaking Caribbean countries investigated, as employment in FDI industries almost doubled during the period 1990 to 2000. Moreover, the data suggest that the proportion of the labour force employed in FDI industries has been rising and that both the level and growth in productivity (output per

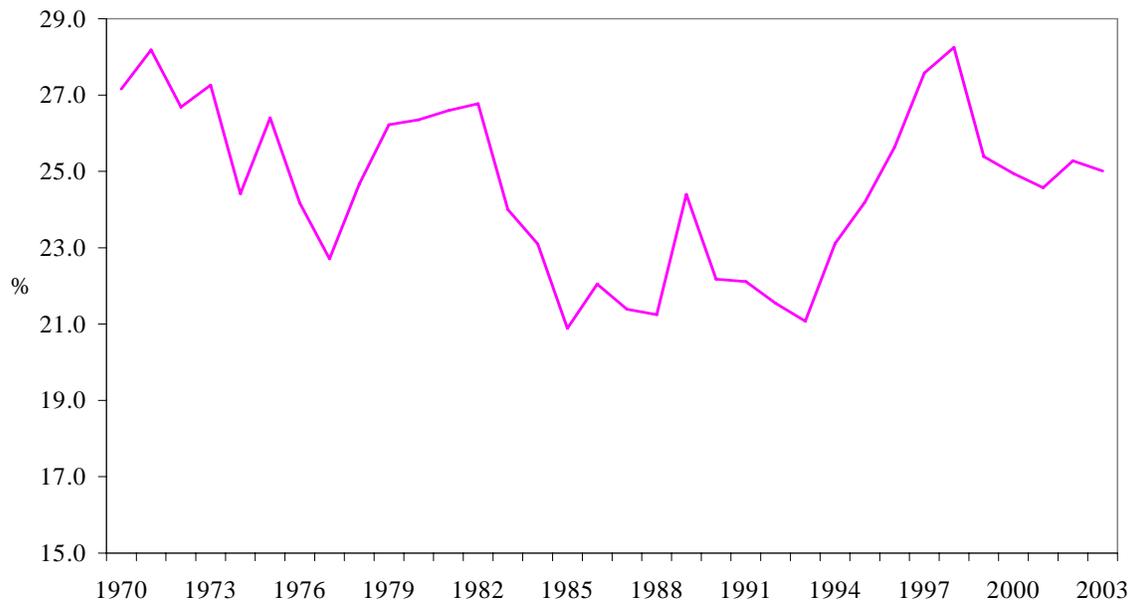
person) is higher in these industries. These stylised facts were collaborated, initially using correlation estimates and Granger (1969) panel causality tests, which revealed a positive causal relationship between FDI and employment for the 20 English- and Dutch-speaking Caribbean nations over the entire sample. The limitations of these methods necessitated a more robust approach. Therefore, a labour demand equation was estimated using panel techniques. The empirical results support the previous findings, indicating that FDI is positively and significantly related to employment. However, the largest impact appears to occur within the first year, and gradually declines thereafter. Drawing on the FDI–economic growth relationship literature, this positive result between FDI and employment may be conditional on other factors in the host economy. Hence, the effects of trade openness, greater absorption and financial development were taken into consideration, and it was found that FDI flows have an enhanced impact on employment. This finding suggests that a stable and healthy macroeconomic environment may be required for better working of FDI flows.

The next section discusses the stylised facts on gross investment and FDI in 20 English- and Dutch-speaking Caribbean countries. Section 3 outlines the empirical relationship between FDI and employment. In the final section, the policies used to attract FDI are discussed, with the view to informing the way forward for Caribbean economies.

2. Stylised Facts on Investment in the Caribbean

The gross domestic investment (GDI) as a percentage of the gross domestic product (GDP) of the 20 countries under analysis for the years 1970 to 2003 is presented in figure 1 below. During most of the 1970s, the ratio exhibited a general downward trend, which was reversed briefly during the early 1980s.

Figure 1: Gross Domestic Investment in Caribbean Countries (% of GDP)



Source: United Nations National Accounts Statistics Database

However, the ratio of GDI to GDP fell dramatically afterwards and remained on average at around 22 per cent until the mid 1990s when there was a sharp rise to approximately 28 per cent. Since 1999, the GDI to GDP ratio declined to slightly above the level of the previous decade. Interestingly, the annual average investment over the entire sample period was approximately 25 per cent of GDP, which was generally in line with the rest of the world.

As shown in table 1, GDI varies significantly across countries. On average, the ratios were highest for Anguilla and Saint Kitts and Nevis (at around 40 per cent). Most of the

other countries recorded ratios of between 20 to 40 per cent. In Bermuda and Barbados, however, the ratio of GDI to GDP remained below 20 per cent for most of the review period.

Table 1: Gross Domestic Investment (% of GDP)

Country	1970-1979	1980-1989	1990-1999	2000-2003
Anguilla	42.9	45.9	32.5	33.4
Antigua and Barbuda	22.0	34.9	37.3	50.1
Aruba	33.9	31.7	30.1	23.2
Bahamas	29.0	25.6	23.4	21.9
Barbados	23.2	19.5	15.9	17.0
Belize	27.9	23.4	24.7	24.0
Bermuda	13.0	19.2	16.1	19.2
Cayman Islands	23.9	23.4	21.7	22.9
Dominica	25.2	32.6	30.7	25.4
Grenada	13.2	36.7	40.8	45.7
Guyana	26.6	27.6	44.6	37.6
Jamaica	23.8	21.6	27.2	29.4
Montserrat	39.5	40.5	50.6	50.3
Netherlands Antilles	22.5	22.1	26.8	26.0
St. Kitts and Nevis	23.8	36.7	43.6	50.3
St. Lucia	34.4	31.1	26.0	24.3
St. Vincent and the Grenadines	31.9	30.0	29.9	30.3
Suriname	28.6	21.3	29.0	65.5
Trinidad and Tobago	27.7	22.8	20.8	18.5
British Virgin Islands	41.2	31.7	25.7	24.9

Source: United Nations National Accounts Statistics Database

A well established observation is that FDI usually exceeds total domestic investment. Indeed, this has been the case for the Caribbean. The FDI inflows to Bermuda and the Cayman Islands are more than ten times larger than domestic investment. Excluding these two countries, the average FDI to GDI ratio for the remaining countries was about 35 per cent. In particular, the relatively smaller Organisation of Eastern Caribbean States (OECS) received the bulk of FDI, with an average ratio of about 41 per cent. Moreover, FDI inflows to Trinidad and Tobago have increased substantially since 2000, with a ratio of about 47 per cent between 2000 and 2003, up from 8 per cent in the 1980s.

FDI has expanded significantly with the reduction in the barriers to the free flow of financial capital across borders. According to the World Bank CD Rom 2005, total world FDI flows were about US\$9 billion in 1970. By 1980, this figure had jumped to US\$57 billion and to US\$1.5 trillion by 2000. In the following four years, however, world FDI fell to just over US\$500 billion. Most developing countries still maintain some form of controls on capital account transactions, and therefore a large proportion (76 per cent) of this FDI still circulates within the high income Organisation for Economic Cooperation and Development (OECD) countries.

Nevertheless, the Caribbean has witnessed a significant increase in FDI inflows in recent years. Total FDI rose from US\$419 million in 1970 to US\$22 billion some 20 years later, representing average annual growth of 171 per cent. Since 1999, FDI has fallen somewhat inline with world trends to about US\$9.6 billion in 2004. In table 2, total FDI is disaggregated by country and by decade to allow for a country-specific analysis.

Table 2: Foreign Direct Investment (US \$Million)

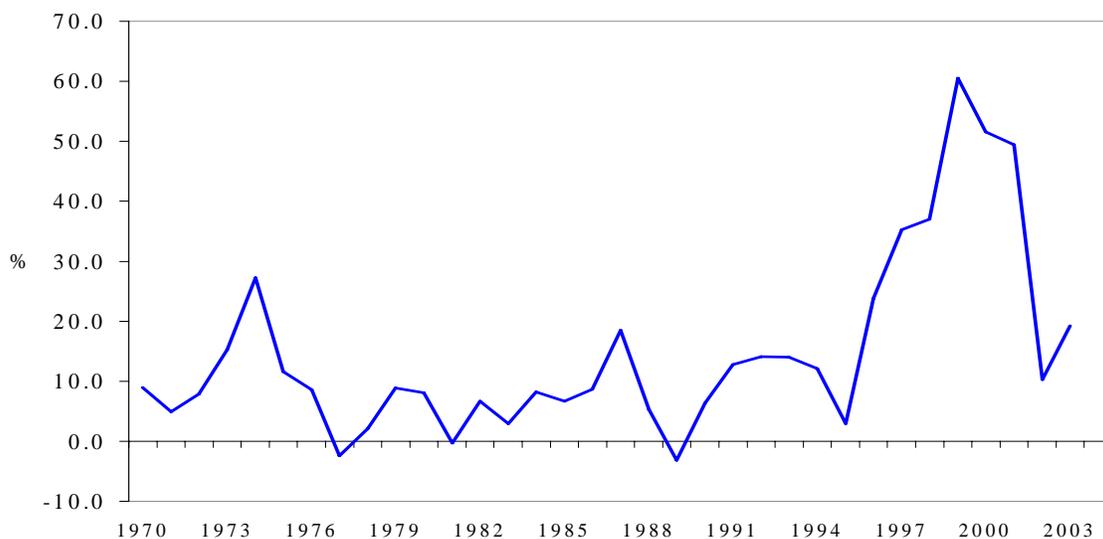
Country	1970-1979	1980-1989	1990-1999	2000-2003
Anguilla	n.a.	n.a.	19.1	36.3
Antigua and Barbuda	1.3	22.7	34.6	109.4
Aruba	n.a.	4.9	103.7	28.0
Bahamas	54.3	6.0	73.4	163.0
Barbados	9.8	5.9	12.8	28.3
Belize	3.1	8.2	20.2	62.6
Bermuda	419.1	883.9	3 273.5	7 009.2
Cayman Islands	33.8	149.7	1 635.1	3 780.1
Dominica	0.1	6.5	20.3	15.3
Grenada	0.7	7.0	26.8	61.3
Guyana	2.5	1.0	65.8	48.2
Jamaica	53.7	7.9	223.3	571.1
Montserrat	n.a.	7.6	4.3	2.3
Netherlands Antilles	73.5	(33.5)	(25.9)	(35.2)
St. Kitts and Nevis	n.a.	11.1	29.5	84.4
St. Lucia	15.7	20.7	49.7	69.6
St. Vincent and the Grenadines	0.1	4.0	42.2	37.8
Suriname	(4.8)	(56.0)	(1.3)	(68.4)
Trinidad and Tobago	99.0	110.9	434.5	778.4
British Virgin Islands	(1.1)	11.7	1,042.5	310.8

Source: UNCTAD FDI Database, available at <http://www.unctad.org/>

Most glaringly, Bermuda and the Cayman Islands have been significant recipients of FDI. In particular, between 2000 and 2003, FDI inflows to Bermuda and the Cayman Islands averaged about US\$7 billion and US\$3.8 billion, respectively, or about 82 per cent of total FDI to the region. In addition, Trinidad and Tobago (US\$778.1 million), Jamaica (US\$571.1 million) and the British Virgin Islands (US\$310.8 million) were other major beneficiaries of FDI inflows. Abstracting for these major countries, FDI inflows to the remainder of the Caribbean were less impressive. Indeed, inflows to most countries were about US\$23 million per year, rising on average by approximately US\$1 million annually. This compares to an average annual increase of US\$269 million when the large recipients of FDI are included.

Although the (absolute) value of FDI to the Caribbean represents a small proportion of the total world FDI, these inflows are nonetheless an important source of investment. Omitting the 1998 to 2000 period, Figure 2 shows that FDI as a proportion of GDP, ranged between 10 and 20 per cent. In contrast, total world FDI as a per cent of GDP was less than 6 per cent. For Latin American and high income OECD countries, the ratio is usually around 5 per cent, 1 per cent in the Middle East and North Africa and less than 1 per cent in South Asia.

Figure 2: Total Foreign Direct Investment Flows to the Caribbean (% of GDP)



Source: UNCTAD FDI Database, available at <http://www.unctad.org/>

Table 3 presents the average FDI as a percentage of GDP at market prices for each Caribbean country. Again, the figures for the Cayman Islands and Bermuda are quite amazing, as FDI inflows to both were about twice as large as their GDP. Those apart, the average for the remainder of the region was significantly lower, about 11 per cent of GDP, but still above the world average.

Table 3: Foreign Direct Investment (% of GDP)

Country	1970-1979	1980-1989	1990-1999	2000-2003
Anguilla	n.a.	n.a.	23.8	32.4
Antigua and Barbuda	1.1	11.7	8.1	17.3
Aruba	n.a.	0.5	7.1	1.3
Bahamas	8.8	0.3	1.8	3.3
Barbados	3.3	0.5	0.7	1.1
Belize	5.1	2.8	3.4	6.9
Bermuda	89.6	62.3	122.0	199.6
Cayman Islands	39.5	51.4	136.2	262.5
Dominica	0.2	5.3	9.3	5.8
Grenada	1.0	4.9	10.6	17.4
Guyana	0.8	0.3	12.6	6.7
Jamaica	3.3	0.2	3.8	7.0
Montserrat	n.a.	16.6	8.6	6.2
Netherlands Antilles	13.5	(3.1)	(0.9)	(1.2)
St. Kitts and Nevis	n.a.	11.3	13.2	24.6
St. Lucia	18.7	12.6	9.2	10.3
St. Vincent and the Grenadines	0.0	3.0	15.0	10.6
Suriname	(0.5)	(4.0)	(0.1)	(7.2)
Trinidad and Tobago	5.8	1.7	7.7	8.6
British Virgin Islands	(6.2)	11.9	198.1	43.4

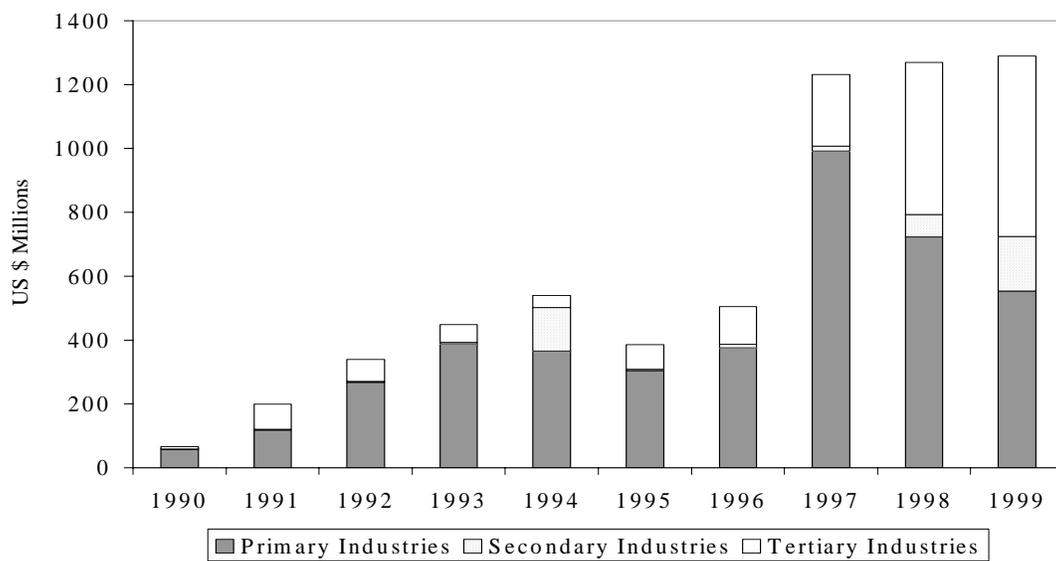
Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and United Nations, Statistics Division, National Accounts Main Aggregates Database available at <http://unstats.un.org/unsd/snaama/introduction.asp>

Most noteworthy, FDI as a per cent of GDP to the OECS countries were at the higher end of this average: Anguilla (32.4 per cent), Grenada (17 per cent), Saint Kitts and Nevis (24.6 per cent), Saint Lucia (10.3 per cent) and Saint Vincent and the Grenadines (10.6 per cent). In the larger Caribbean territories, Jamaica and Trinidad and Tobago, the ratios of FDI to GDP were between 7 and 9 per cent.

While most countries reported rising ratios of FDI to GDP, Barbados, Montserrat and Saint Lucia reported declining ratios. The International Monetary Fund (2005) has attributed the low ratio of FDI to GDP in Barbados to three key factors: financial repression, the presence of capital controls and some undercounting. The Central Bank of Barbados still maintains administrative controls over the minimum deposit rate, which is used on occasion to achieve monetary goals. However, if this interest rate is not consistent with international macroeconomic conditions, the attractiveness of the country to foreign investment is likely to be reduced. In addition, while FDI inflows should have been classified as such, some investors actually register FDI inflows as loans, thereby resulting in a degree of under-counting in reported statistics. The decline in FDI to Montserrat was primarily the result of damages caused by the Mount Soufriere volcanic eruption, while the drop in FDI to Saint Lucia was due to a significant growth in the non-tradable sector, especially construction, assuming that FDI flows to the tradeable sectors.

Figure 3 shows the distribution of FDI by industry to the Caribbean countries. A considerable portion of FDI went to primary industries, particularly the oil industry in Trinidad and Tobago.

Figure 3: Foreign Direct Investment Flows to Primary, Secondary and Tertiary Industries



Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and the Eastern Caribbean Central Bank.

By 1997 FDI inflows had reached just under US\$1 billion, but then fell to about US\$553.9 million two years later. Although less dramatic, FDI inflows into tertiary industries were also significant, doubling every year from 1990 to 2003. These inflows were directed primarily at the tourism and international business and finance industries, especially in the OECS, which have been attempting to diversify their economies from producing primary commodities for export to Europe (on preferential arrangements), to more service-driven areas. Given the regional high cost of labour, there was only limited foreign investment in intermediate industries during the review period.

Table 4: Foreign Direct Investment, Equity (% of Total FDI)

Country	1970-1979	1980-1989	1990-1999	2000-2003
Anguilla	n.a.	n.a.	42.2	56.6
Antigua and Barbuda	n.a.	n.a.	37.0	29.6
Aruba	n.a.	n.a.	n.a.	n.a.
Bahamas	0.8	73.5	108.6	39.9
Barbados	n.a.	n.a.	n.a.	n.a.
Belize	n.a.	(2.1)	65.9	21.9
Bermuda	n.a.	n.a.	n.a.	n.a.
Cayman Islands	n.a.	n.a.	n.a.	n.a.
Dominica	n.a.	n.a.	51.1	72.3
Grenada	n.a.	n.a.	37.7	49.2
Guyana	n.a.	n.a.	n.a.	14.3
Jamaica	n.a.	102.9	52.0	61.5
Montserrat	n.a.	n.a.	15.6	58.8
Netherlands Antilles	(44.3)	32.1	26.2	(356.3)
St. Kitts and Nevis	n.a.	n.a.	22.2	69.8
St. Lucia	n.a.	n.a.	3.4	4.9
St. Vincent and the Grenadines	n.a.	n.a.	73.5	22.0
Suriname	(20.5)	2.2	0.4	n.a.
Trinidad and Tobago	8.7	(1,944.2)	59.0	104.0
British Virgin Islands	n.a.	n.a.	n.a.	n.a.

Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and Eastern Caribbean Central Bank.

Table 5: Foreign Direct Investment, Reinvested Earnings (% of Total FDI)

Country	1970-1979	1980-1989	1990-1999	2000-2003
Anguilla	n.a.	n.a.	24.1	12.1
Antigua and Barbuda	n.a.	n.a.	17.1	9.3
Aruba	n.a.	n.a.	n.a.	n.a.
Bahamas	n.a.	n.a.	n.a.	n.a.
Barbados	n.a.	n.a.	n.a.	n.a.
Belize	n.a.	6.2	18.0	25.9
Bermuda	n.a.	n.a.	n.a.	n.a.
Cayman Islands	n.a.	n.a.	n.a.	n.a.
Dominica	n.a.	n.a.	33.7	75.5
Grenada	n.a.	n.a.	17.5	27.6
Guyana	n.a.	89.0	n.a.	8.9
Jamaica	(384.3)	(23.1)	35.0	25.9
Montserrat	n.a.	n.a.	50.6	35.3
Netherland Antilles	685.4	(287.1)	47.6	(5.7)
St. Kitts and Nevis	n.a.	n.a.	16.3	5.1
St. Lucia	n.a.	n.a.	40.2	21.5
St. Vincent and the Grenadines	n.a.	n.a.	24.5	29.3
Suriname	n.a.	n.a.	n.a.	n.a.
Trinidad and Tobago	96.3	1,640.7	46.4	n.a.
British Virgin Islands	n.a.	n.a.	n.a.	n.a.

Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and Eastern Caribbean Central Bank.

Table 6: Foreign Direct Investment, Inter-Company Loans and Other (% of Total FDI)

Country	1970-1979	1980-1989	1990-1999	2000-2003
Anguilla	n.a.	n.a.	42.1	34.7
Antigua and Barbuda	n.a.	n.a.	50.0	64.0
Aruba	n.a.	n.a.	n.a.	n.a.
Bahamas	99.2	26.5	(8.6)	80.1
Barbados	n.a.	n.a.	n.a.	n.a.
Belize	n.a.	127.7	29.0	11.1
Bermuda	n.a.	n.a.	n.a.	n.a.
Cayman Islands	n.a.	n.a.	n.a.	n.a.
Dominica	n.a.	n.a.	28.4	12.4
Grenada	n.a.	n.a.	57.4	37.8
Guyana	102.0	81.7	100.0	76.7
Jamaica	484.3	102.5	13.1	12.6
Montserrat	n.a.	n.a.	93.1	10.5
Netherland Antilles	(551.9)	326.4	40.5	461.3
St. Kitts and Nevis	n.a.	n.a.	63.9	29.0
St. Lucia	n.a.	n.a.	69.8	103.8
St. Vincent and the Grenadines	n.a.	n.a.	26.5	52.0
Suriname	120.5	98.2	71.1	n.a.
Trinidad and Tobago	(4.1)	448.5	1.8	(4.0)
British Virgin Islands	n.a.	n.a.	n.a.	n.a.

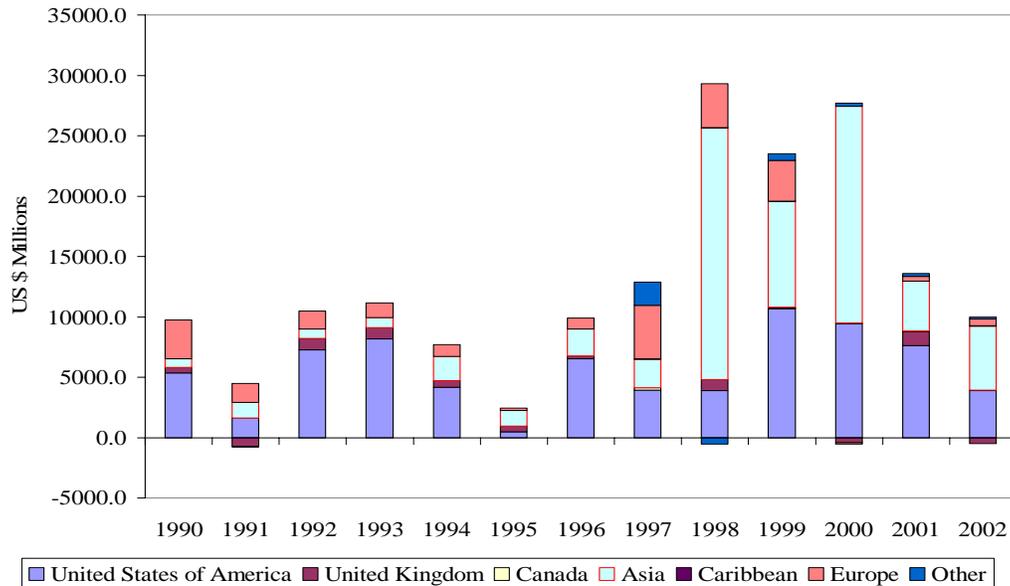
Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and Eastern Caribbean Central Bank.

Tables 4-6 disaggregate FDI into equity, reinvested earnings and inter-company loans for each Caribbean country for the ten-year periods from 1970 to 1999 and the four years ending in 2003. The tables show that most FDI inflows are in the form of inter-company loans to Caribbean entities, representing about 75 per cent of total FDI inflows. This form of FDI is probably chosen because of the existence of capital controls in some Caribbean countries. With controls on foreign currency outflows, a foreign investor would have to apply to either the government or the central bank to repatriate profits. However, if the investment is classified as a loan, profits can be repatriated through debt service payments. Most of the FDI inflows to the OECS and Guyana originate from this source. In contrast, the majority of FDI inflows to Belize, Jamaica and Trinidad and Tobago are in the form of equity or reinvested earnings.

Between 1990 and 2002, on average about half of total FDI to the Caribbean came from companies based in the United States of America (see Figure 4 and Table 7). By far the largest recipient of FDI flows from the United States (US), Bermuda in 2002, received approximately US\$4.2 billion in FDI. This was more than the total for all the remaining Caribbean countries. Trinidad and Tobago and the British Virgin Islands also benefited from significant investment from the US. Asia was the region's second-largest source of FDI.

At the beginning of the 1990s, FDI from Asia totalled less than US\$ 1 billion, but by the latter part of the decade and until 2002, it rose to be almost on par with FDI from the US. Most of these flows were directed at the larger offshore financial centres: the British Virgin Islands, the Cayman Islands and, to a lesser extent, Bermuda. However, countries such as Barbados, Belize, the Bahamas, the Netherlands Antilles and Trinidad and Tobago also benefited from investment by Asian companies. The other major sources of FDI were the United Kingdom, other European countries and the rest of CARICOM.

Figure 4: Foreign Direct Investment Flows, Distribution by Country and Region



Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and the Eastern Caribbean Central Bank.

Table 7: Foreign Direct Investment from the United States of America (US\$ Million)

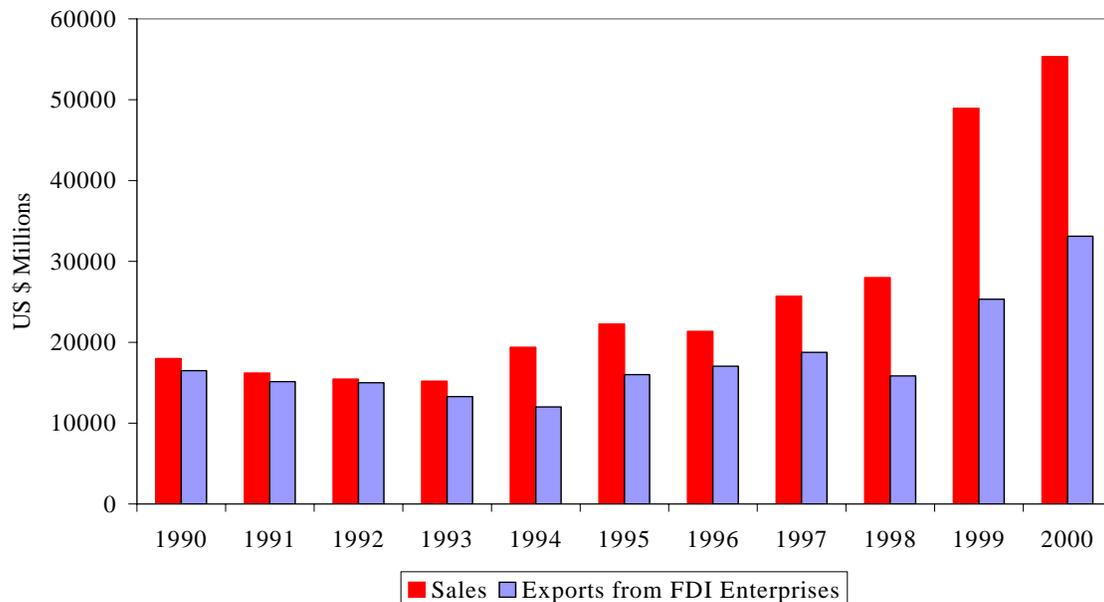
Country	1990-1999	2000-2003
Anguilla	10.5	44.0
Antigua and Barbuda	0.2	50.8
Aruba	894.0	580.0
Bahamas	403.0	-1108.0
Barbados	2469.0	-595.0
Belize	41.0	97.0
Bermuda	25211.0	20305.0
Cayman Islands	0.0	0.0
Dominica	15.7	8.2
Grenada	3.7	79.6
Guyana	81.0	-24.0
Jamaica	2237.0	889.0
Montserrat	0.0	0.0
Netherland Antilles	9696.0	317.0
St. Kitts and Nevis	44.8	68.1
St. Lucia	101.1	16.7
St. Vincent and the Grenadines	7.3	13.7
Suriname	89.0	75.0
Trinidad and Tobago	2844.9	0.0
British Virgin Islands	8040.0	250.0

Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and Eastern Caribbean Central Bank.

As noted by the CARICOM Secretariat (2000), data on cross-border investment in the region is limited. The Secretariat reports that the main source countries of intra-CARICOM flows were from the more developed countries in the region: Trinidad and Tobago, Barbados and Jamaica. These flows were directed primarily to the OECS countries, probably due to limited levels of technological and entrepreneurial endowment relative to their more developed neighbours. Another characteristic of these intra-CARICOM flows, and one worth highlighting, is that they tend to be chiefly invested in the financial, light manufacturing and distribution industries.

Given the size of the Caribbean market, a large proportion of FDI firms invest for export. For example, a foreign investor may establish an offshore bank, which is primarily aimed at wealthy individuals, or the investor may invest in a hotel or other tourism-related establishment. Figure 5, which plots the data on sales and exports from FDI enterprises between 1990 and 2000, shows that more than 50 per cent of the sales of FDI enterprises went to foreign markets, especially in the early 1990s. By the end of 2000, FDI enterprises in the Caribbean reported sales of about US\$55 billion, or about 136 per cent of total GDP for the region. This figure was considerably higher than at the beginning of the 1990s when total sales of FDI enterprises amounted to US\$18 billion or 72 per cent of total GDP. As expected, sales from FDI enterprises in Bermuda accounted for most of this growth, although sales of FDI enterprises in Barbados, Belize and the British Virgin Islands doubled between 1990 and 2000.

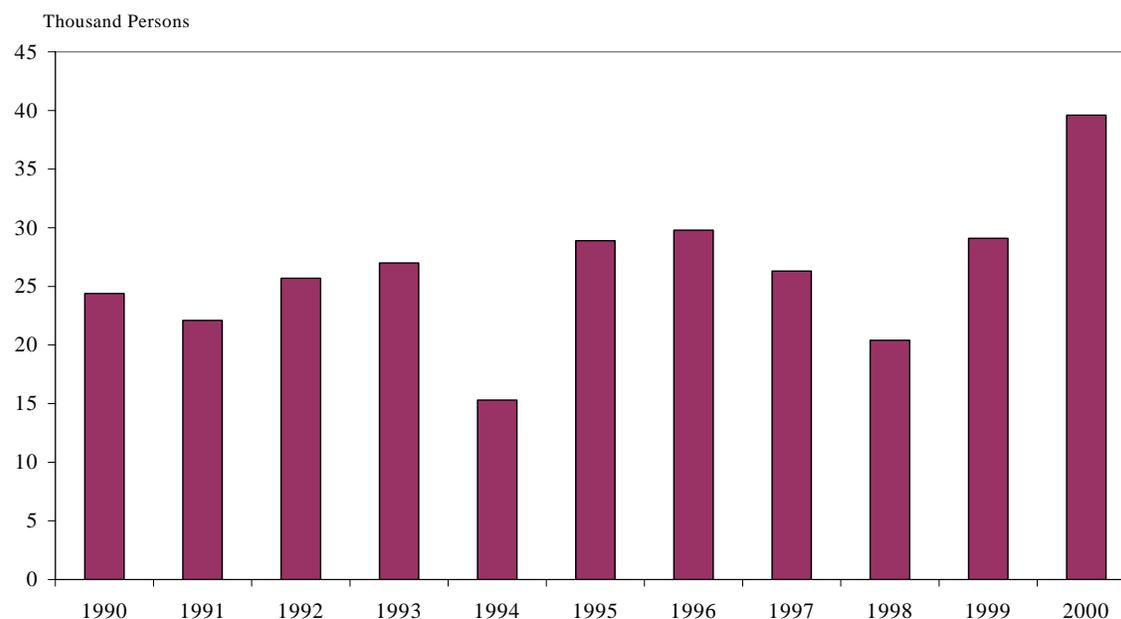
Figure 5: Exports and Sales of FDI Enterprises



Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and the Eastern Caribbean Central Bank.

One of the aims of attracting FDI is to improve regional economic and social development. Attracting foreign firms to relatively under-developed countries can provide a direct impact on employment and capital creation and in turn, potential indirect effects via spillovers to local firms (Hymer, 1976; Dunning, 1977). Figure 6 indicates that employment in FDI enterprises rose from twenty-four thousand persons in 1990 (about 1.1 per cent of total employed persons in the Caribbean) to forty thousand persons by 2000 (or about 1.6 per cent of the total). These figures are conservative, as employment data for all the sample countries were not available. Nevertheless, the data show that a large proportion of the Caribbean labour force is employed in FDI enterprises and the ratio of employment in FDI enterprises to total employment has been rising over the last ten years.

Figure 6: Employment in FDI Enterprises



Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and the Eastern Caribbean Central Bank.

The literature establishes that the productivity differential between foreign and domestic firms favours the former (see for example, Djankov and Hoekman, 2000). As such, Table 8 presents estimates of output per person and the growth in output per person for the sample countries. Both are significantly larger for FDI enterprises. On average, output per person in FDI enterprises is about US\$144,222, or just over seven times larger than for domestic firms.

The growth in productivity of FDI enterprises reflected a similar pattern to output per person. Table 8 shows that the productivity growth in FDI enterprises was about fourteen times greater than for domestic entities: average growth in productivity for domestic firms was about 1.6 per cent per annum, while for FDI enterprises, average annual growth was estimated at 22.4 per cent.

Table 8: Productivity in Domestic and FDI Enterprises (US\$)

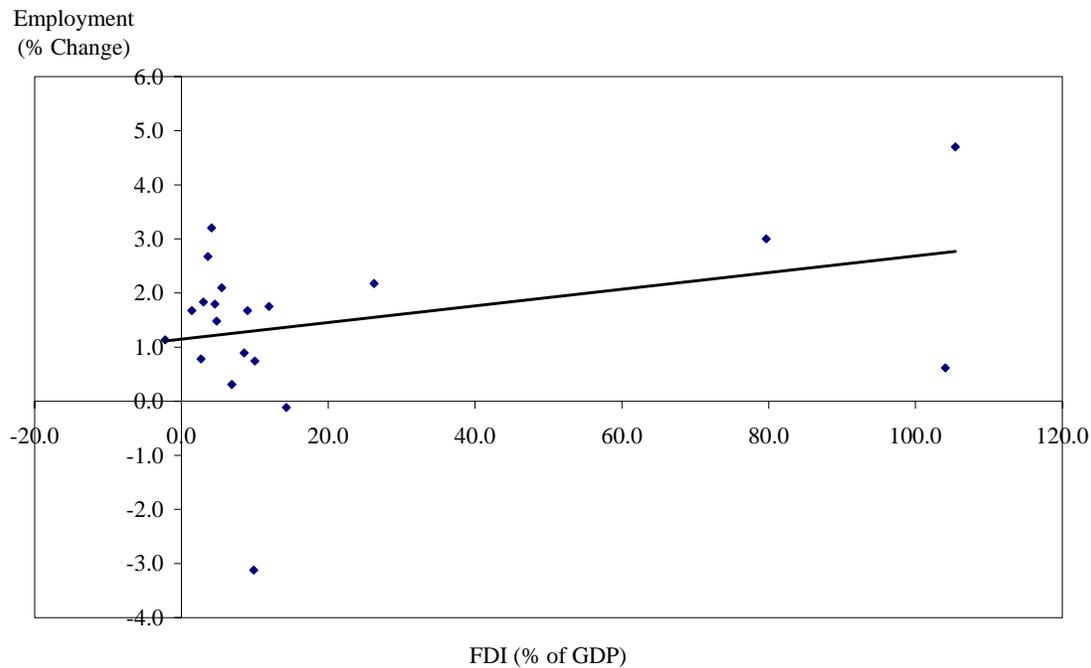
Country	Output Per Person		Average Growth in Output Per	
	Domestic	FDI	Domestic	FDI
	Enterprises	Enterprises	Enterprises	Enterprises
Anguilla	17 206.30	8 089.43	2.8	-1.3
Antigua and Barbuda	13 042.22	n.a.	1.1	n.a.
Aruba	38 246.85	142 109.51	2.0	18.1
Bahamas	25 974.25	86 240.16	1.2	13.9
Barbados	15 070.21	342 205.26	-0.1	44.2
Belize	8 182.64	81 539.03	-0.1	96.7
Bermuda	66 416.38	353 748.02	3.0	5.9
Cayman Islands	38 330.80	n.a.	-3.3	n.a.
Dominica	7 182.89	n.a.	1.3	n.a.
Grenada	7 586.71	n.a.	3.2	n.a.
Guyana	2 280.50	27 278.87	2.0	6.0
Jamaica	5 236.51	41 419.97	-0.4	-7.2
Montserrat	12 124.01	n.a.	4.0	n.a.
Netherlands Antilles	42 201.47	124,704.97	0.5	n.a.
St. Kitts and Nevis	12 040.80	13 189.53	4.0	3.8
St. Lucia	8 320.05	455 741.24	-1.8	-2.3
St. Vincent and the	7 875.94	n.a.	2.9	n.a.
Suriname	18 009.52	89 430.89	0.5	n.a.
Trinidad and Tobago	14 240.11	n.a.	3.4	n.a.
British Virgin Islands	35 529.62	109 195.66	5.7	68.4
Average	19 754.89	144 222.50	1.6	22.4

Source: Author's calculations

3. Does greater Foreign Direct Investment lead to increased Employment?

The average growth in employment and FDI (as a percentage of GDP) are plotted for each country and a regression line is fitted to the points (see figure 7). The upward sloping line suggests a positive relationship between the two variables. However, this analysis does not take into account lags in the relationship between both variables and the effects of other factors that might explain the change in employment.

Figure 7: Cross-Plot Growth in Employment and FDI



Source: UNCTAD FDI Database, available at <http://www.unctad.org/> and the Eastern Caribbean Central Bank.

Table 9 provides the correlation ratios for employment and lagged values of FDI (percentage of GDP). For all countries except Saint Kitts and Nevis, and Suriname, there is a positive relationship between employment and FDI. This analysis is however limited, as it cannot state whether FDI “causes” an increase in employment. Therefore, Granger (1969) panel causality tests were done to evaluate the causal relationship between the two variables.

Table 9: Correlation between FDI and Employment

Country	Emp(t), FDI(t)	Emp(t), FDI(t-1)	Emp(t), FDI(t-2)	Emp(t), FDI(t-3)	Emp(t), FDI(t-4)	Emp(t), FDI(t-5)
Anguilla	0.661	0.732	0.903	0.773	0.752	0.739
Antigua and Barbuda	0.750	0.673	0.642	0.595	0.506	0.435
Aruba	0.215	0.225	0.133	-0.036	0.216	0.365
Bahamas	0.569	0.508	0.469	0.417	0.387	0.274
Barbados	0.296	0.207	0.043	0.145	0.380	0.302
Belize	0.759	0.719	0.690	0.675	0.760	0.789
Bermuda	0.623	0.601	0.602	0.647	0.655	0.616
Cayman Islands	0.709	0.697	0.659	0.734	0.686	0.624
Dominica	0.090	0.216	0.367	0.330	0.350	0.547
Grenada	0.769	0.746	0.748	0.721	0.750	0.762
Guyana	0.697	0.651	0.689	0.675	0.682	0.628
Jamaica	0.633	0.590	0.556	0.518	0.494	0.445
Montserrat	0.457	0.469	0.570	0.601	0.618	0.740
Netherlands Antilles	-0.364	-0.360	-0.287	0.107	0.235	0.448
St. Kitts and Nevis	-0.495	-0.373	-0.258	-0.078	-0.020	-0.116
St. Lucia	0.823	0.802	0.763	0.709	0.668	0.733
St. Vincent and the Grenadines	0.727	0.685	0.616	0.580	0.645	0.669
Suriname	-0.305	-0.331	-0.317	-0.408	-0.383	-0.166
Trinidad and Tobago	0.856	0.862	0.863	0.858	0.835	0.798
British Virgin Islands	0.427	0.440	0.480	0.492	0.518	0.518

Source: Author's calculations

A variable x is said by Granger to cause y if one is able to better predict y using lagged values of x (see Appendix I). The Hurlin and Venet (2001) approach to panel Granger causality testing was utilized, as it permits the use of both cross-section and time series information to test causal relationships. The first step consists of testing the null hypothesis of homogenous non-causality – that is, country-level causal relationships do not exist. If the null hypothesis of homogeneous non-causality is rejected, Hurlin and Venet (2001) note that two configurations could appear: homogenous causality (HC), which implies that there is an identical causal relationship between FDI and employment in all of the countries, or heterogenous non-causality (HNC), where the causal relationship differs for some or all of the countries.

The causality tests are presented in table 10. Using both levels and first differences, the null hypothesis of HNC is strongly rejected in the sample, despite the choice of lag order. This implies that there does exist a Granger-causal relationship from FDI to employment

for the entire sample of Caribbean countries. Given the rejection of the null of HNC, the test of the HC was carried out. This hypothesis imposes strict homogeneity between FDI and employment. These tests are also presented in table 10 and the null of a non-homogenous causal relationship is rejected at all lags, as well as for levels and first differences of the two variables. These results suggest that there is a similar causal relationship between the FDI and employment in the Caribbean. It is possible that because of size differences in the economies/labour markets in the region, a single country or group of countries could significantly influence the results. As a test of the robustness of the results, the model was estimated without Bermuda, the Cayman Islands, Jamaica and Trinidad and Tobago, whether individually or together. However, the main findings of the causal relationship between FDI and employment were unaffected.

Table 10: Causality from FDI to Employment

Lags	Levels		First Difference	
	F_{hmc} Hypothesis	F_{hc} Hypothesis	F_{hmc} Hypothesis	F_{hc} Hypothesis
1	9.843*	4.392*	8.823*	1.465*
2	6.084*	2.580*	6.725*	2.271*
3	5.380*	2.564*	8.022*	3.020*

*: significant at 5% level

Granger causality tests, however, do not provide an evaluation of the relative impact of one variable on another. To obtain an empirical estimate of the effect of FDI on employment, the micro-foundations of the relationship are examined, from which an aggregate employment function is derived (see Appendix II) to obtain the following demand for labour function:

$$\ln N_{it} = \theta_0 + \theta_1 \ln(w_{it} / c_{it}) + \theta_2 \ln Q_{it} + \theta_3 T + \theta_4 FDI + \varepsilon_{it} \quad (1)$$

θ_1 is expected to be negative, since firms would demand less labour if wages are rising faster than the user cost of capital, while θ_2 is expected to be positive because firms would demand more labour if output is increasing. θ_3 and θ_4 are to be empirically determined and respectively reflect on employment, the effects of technology and FDI

knowledge spillovers. If θ_4 is positive, it suggests that greater FDI investment leads to an expansion in employment. On the other hand, a negative θ_4 means that FDI is likely to result in a substitution away from labour. Similar to the Granger causality model, the Lagrange Multiplier and the Hausman test statistics are employed to choose between the fixed and random effects estimator. The fixed effects estimator is chosen and the empirical estimates of Equation (1) are provided in table 11.

Table 11: Determinants of Employment (Dependent Variable = $\ln N$)

Variable	(2)	(3)	(4)	(5)
Constant	8.649 (0.111)**	8.645 (0.139)**	8.731 (0.162)**	8.939 (0.164)**
$\ln(w/c)$	-0.105 (0.068)	-0.060 (0.051)	-0.056 (0.050)	-0.036 (0.042)
$\ln Q$	0.307 (0.020)**	0.312 (0.024)**	0.298 (0.028)**	0.265 (0.028)**
$\ln T$	0.004 (0.001)**	0.006 (0.001)**	0.006 (0.001)**	0.007 (0.001)**
$\ln FDI$	-	0.009 (0.005)*	0.010 (0.005)*	0.012 (0.005)**
$\ln FDI_{t-1}$	-	-	0.000 (0.004)	0.001 (0.005)
$\ln FDI_{t-2}$	-	-	-	0.003 (0.004)
R-squared	0.990	0.991	0.991	0.991
S.E. of Regression	0.125	0.116	0.113	0.110
Observations	483	450	441	433

*, ** indicates significance at the 10 and 5% level, respectively

The table provides the estimated coefficients for the basic labour demand equation and the extended equation that includes FDI and its lags as explanatory variables. As reflected by the R-squared values, the equations seem to adequately account for most of the regional variation in employment. In line with *a priori* expectations, the ratio of wages to the user cost of capital has a negative impact on employment, while the growth in output leads to increased labour demand. The coefficient on the time trend suggests that employment tends to rise as technology advances.

The third column of table 11 gives the coefficient estimates of the labour demand equation augmented with FDI. The signs of the ratio of wages to the user cost of capital, real output and the time trend concur with those obtained from the basic labour demand equation. FDI, the variable of interest, is positively and significantly related to employment. The coefficient estimate suggests that a 1 per cent increase in FDI should result in employment demand rising by around 1 per cent as well. Lagged values of FDI are also included in the regression (columns 4 and 5) to examine the dynamics of the relationship between FDI and employment. The maximum influence of FDI on employment seems to occur within the first year of the initial inflow, and gradually declines thereafter. Using these dynamic models of the FDI-employment relationship, the full impact of FDI on employment is estimated to rise between 1 and 1.6 per cent.

Table 12: Impact of Openness, Financial Development and Absorption on the Determinants of Employment (Dependent Variable = $\ln N$)

Variable	(2)	(3)	(4)	(5)
Constant	8.645 (0.139)**	9.919 (0.183)**	8.746 (0.144)**	9.673 (0.224)**
$\ln(w/c)$	-0.060 (0.051)	-0.041 (0.040)	-0.038 (0.039)	-0.040 (0.035)
$\ln Q$	0.312 (0.024)**	0.120 (0.032)**	0.300 (0.026)**	0.140 (0.037)**
$\ln T$	0.006 (0.001)**	0.011 (0.001)**	0.006 (0.001)**	0.011 (0.001)**
$\ln FDI$	0.009 (0.005)*	0.032 (0.059)	0.011 (0.005)*	0.021 (0.070)
Trade Openness	-	0.003 (0.001)**	-	-
Financial Development	-	-	0.001 (0.002)	-
Absorption	-	-	-	0.016 (0.006)
R-squared	0.991	0.991	0.991	0.991
S.E. of Regression	0.116	0.109	0.113	0.110
Observations	450	366	445	347

*, ** indicates significance at the 10 and 5% level, respectively

As noted earlier, most empirical studies find that FDI augments growth contingent on additional factors in the host economy. The main conditional factors are trade policy, human capital and domestic absorption. Consequently, trade openness, absorption (as a per cent of GDP), and financial development are included in the labour demand function (see Appendix III for definitions). Unfortunately, a regression with the human capital variable could not be estimated, since this variable was unavailable over a sufficiently long time period. Table 12 shows that when trade, absorption or financial development are included in the regression equation, the coefficient on the FDI variable rises. These results could imply that more liberal trade policies, greater domestic absorption and financial development might increase the benefits, in terms of increased employment, that accrue from FDI inflows.

4. A Review of Investment Policies used to attract FDI

The result from the previous section, that FDI has a positive impact on employment in the Caribbean region, merits some discussion of investment policies for an understanding of the factors that may affect its location. In general, policies used to attract FDI can be neatly classified into the following categories: (1) investment incentives; (2) domestic infrastructure and local skills; (3) international governing arrangements; (4) state agencies; and, (5) regulatory environment. The English- and Dutch-speaking Caribbean nations have utilized all of these policies to attract FDI (see table 13). However, because of data limitations and the fact that the empirical work on these countries has been lumped together in cross-section studies with those from the wider world, it is difficult to ascertain the effectiveness of these policies in the Caribbean region. Hence, in many instances below, only general statements can be made concerning the impact of these policies on Caribbean economies.

Investment Incentives

By far the most popular tool is investment incentives to foreign-owned companies. Incentives can be divided into fiscal encouragement such as tax holidays and lower taxes, and financial incentives, for example, grants and preferential loans, as well as market preferences, infrastructure, and sometimes even monopoly rights. (See UNCTAD (1997) and Brewer and Young (1997) for further discussion of the definitions of the various FDI incentives). Investment incentives have been utilized by many countries, including the English- and Dutch-speaking Caribbean, to promote FDI aimed at alleviating macroeconomic problems of low output growth and rising unemployment and/or as a sustained development strategy. These investment incentives have become more prominent with the ushering in of globalization, regionalization and trade liberalization.

Table 13: The Attractiveness of the Investment Environment in the Caribbean

	Barbados	Jamaica	Trinidad and Tobago	Guyana	The Bahamas	Antigua and Barbuda	Grenada	St. Lucia	St. Kitts and Nevis	St. Vincent and the Grenadines	Dominica	Suriname	Netherland Antilles (Aruba, Curacao)
Market Access to US/EU	√	√	√	√	√	√	√	√	√	√	√	√	√
Political Stability and Good Governance	√	√	√		√	√	√	√	√	√	√		√
Domestic Infrastructure (Utilities)	√	√	√	√	√	√	√	√	√	√	√	√	√
International Transport Links	√	√	√	√	√	√	√	√	√	√	√	√	√
Fiscal and Other Investment Incentives	√	√	√	√	√	√	√	√	√	√	√	√	√
State Investment Promotion Agency	√	√	√	√	√	√	√	√	√	√	√		
Export Processing Zones	√	√	√	√	√	√	√	√	√	√	√	√	√
Caricom Bilateral Investment Treaties	√	√	√	√	√	√	√	√	√	√	√		
Double Taxation Agreements	√	√	√	√	√	√	√	√	√	√	√	√	

Source: Caribbean Trade and Investment Report, 2000: Dynamic Interface of Regionalism and Globalisation

Blomström and Kokko (2003) argue that global trade liberalization and regional integration have allowed for increased market integration and have reduced the importance of market size as a determinant of investment location. At the same time, many of the traditional instruments, for example, trade policy, used to promote competitiveness, employment and welfare, have been lost. Moreover, executives of multinational enterprises (MNEs) have stated (see Easson 2001, p. 272)] and recent econometric studies have confirmed that FDI incentives, especially fiscal preferences, have become significant determinants of international direct investment flows. This is especially so with the manufacturing, petroleum and services industries (see, for instance, Taylor (2000)). Of course, it is not easy to estimate the cost of these incentives programmes, since it requires knowing what the quantity of FDI inflows would be in the absence of incentives. Likewise, it is difficult to make explicit comparisons of how different kinds of incentives would influence investment flows. [Blomström and Kokko (2003)] Traditionally, incentives for FDI in most Caribbean economies have been concentrated in the manufacturing, tourism and oil industries and is usually in the form of subsidized infrastructure, land for export processing zones, industrial estates, as well as the popular incentives schemes of tax holidays and other fiscal measures that do not require payments of scarce public funds. A recent study, Sosa (2006), using the marginal effective tax rate (METR) approach, examines the incentives for investment in the corporate sector offered by the tax system in the Eastern Caribbean Currency Union. The main finding was that METRs are substantially lower in firms granted incentives relative to those firms that did not have concessions. This implies that there may be important misallocation of resources by the governments, especially with schemes that are offered on a discretionary basis.

Domestic Infrastructure and Local Skills

Domestic infrastructure includes transportation facilities such as road networks, ports and airports, telecommunications networks, and information and energy availability. (See World Bank (1994) for indicators of different aspects or Kumar (2001) for a composite index). Availability of good quality physical infrastructure could improve the investment climate for FDI by subsidizing the cost of total investment, thus raising the rate of return. Further,

MNEs may be particularly sensitive to infrastructure availability for locating their investments, as these are efficiency-seeking in nature. The favourable role of physical infrastructure in influencing the patterns of FDI inflows and their export-orientation has been corroborated by several studies, including Loree and Guisinger (1995), Mody and Srinivasan (1996) and Kumar (2001).

Human resource development (HRD) is enhanced through MNE training and education, and governments raise incoming FDI levels by making the domestic investment climate attractive to foreign investors. This is done through the direct effect of upgraded skill levels of the workforce, as well as via indirect effects such as improved socio-political stability and health (World Bank, 2003; UNESCO and OECD, 2003). To be effective, there must not only be an intensive investment in human capital, but also, (i) sound policy and an attractive investment climate; (ii) coordination between formal education and training policies; (iii) collaboration among all stakeholders of HRD, including host governments, investment promotion agencies, MNEs and educational institutions; and, (iv) identification of the type of MNEs that would most benefit host countries in terms of human capital development and technology transfer. Emphasis could be placed on high value-added MNEs, which are more likely to bring new skills and knowledge to the domestic economy, and which can be tapped by domestic enterprises (Miyamoto, 2003). In addition, there must be a concerted effort to facilitate HRD for small and medium-sized domestic enterprises, which usually do not invest sufficiently in training employees, although these firms stand to gain the most from education and training. Discussions with a human resources development professional in Barbados and the Director of the Barbados Employers' Confederation confirmed that most small and medium-sized enterprises in the Caribbean are capital constrained and do not devote sufficient attention and financial resources to staff training. This situation becomes even more pronounced in times of economic difficulties, as training budgets are the first to be cut to mitigate against organizational challenges.

State Agencies

Establishing an investment promotion agency has become an important tool in promoting FDI. A comprehensive study undertaken by Morisset (2003) on 58 countries showed that greater investment promotions are associated with higher cross-country FDI flows. However, this result is qualified on several grounds: First, agency effectiveness depends on the country's environment in which it operates; an agency investment climate is less effective at attracting investment. Second, the scope of activities that an agency undertakes influences its performance. Agencies devoting more resources to policy advocacy are more effective because such activity is beneficial to domestic, as well as foreign investors. In contrast, investment generation or targeting strategies appear expensive and risky, especially in countries with a poor investment climate. Thirdly and finally, certain international characteristics of the agencies are associated with greater effectiveness. The agencies that have established reporting mechanisms to the country's highest policymakers or to the private sector have been systematically more efficient at attracting FDI. Such institutional links are crucial because they contribute to strengthening government commitment as well as to reinforcing the agency's credibility and visibility in the business community.

Table 13 displays those Caribbean countries with state investment promotion agencies. Morisset's (2003) group of countries included Guyana, Jamaica, Trinidad and Tobago and Saint Lucia, but his cross-section study makes it difficult to reach any reasonable conclusion about FDI promotion in the Caribbean. Therefore, it would seem that this is an avenue the region can look at and for those who have an agency, a full assessment should be undertaken concerning their effectiveness.

International Governing Arrangements

Most countries undertake international investment agreements (agreements that address, at least in part, investment issues) to help attract FDI. Essentially these arrangements make the regulatory framework for FDI more transparent, stable, predictable and secure. They also reduce obstacles to future FDI flows, for example, setting entry conditions for foreign investors, improving standards of treatment and enhancing benefits from FDI inflows

(UNCTAD, 2003). As a result, the number of these agreements is increasing, especially at the bilateral and regional levels, and more are under negotiation. Empirically, however, the majority of studies have found that they do not have a robust positive impact on FDI (see Davis, 2003; Hallward-Driemeier, 2003). Moreover, these cases show that the rights given to foreign investors may not only exceed those enjoyed by domestic investors, but also expose policymakers to potentially large-scale liabilities and curtail the feasibility of different reform options. This suggests that policymakers should be cautious in examining the specific terms and broader implications of such agreements.

There is little research written on international investment agreements and FDI that focus on the Caribbean. A recent study by Neumayer and Spess (2005), which examined the effect of bilateral investment treaties on FDI in developing countries, incorporated eleven of the twenty Caribbean countries analysed above, and showed that a higher number of bilateral investment treaties raises FDI flows.

Regulatory Environment

Stronger regulatory regimes can be expected to attract foreign investment. Regulatory incentives are simply those administrative conditions offered by governments to foreign firms outside of the special fiscal or financial treatment. Examples include property rights and market access, environmental protection, and labour standards. In such cases, to prevent undue distortions in investment behaviour, the appropriate mix of incentives and the institutional framework must be established.

Foreign investors fear expropriation of fixed assets and more relevant, any uncertainty regarding patent rights, which can affect the 'quality of investment' reflected on the technology transferred as part of affiliates' activities or joint ventures. In essence, evidence from US, Japanese and German firms suggests that older technologies are transferred to countries with weak intellectual property protection (Mansfield, 1995; FitzGerald, 2002). Another dimension of property regulation with relevance to foreign investment is that the recent 'mergers and acquisitions' and the withdrawal of public enterprises in fields such as

utilities, banking and telecommunications, meant that regulation for the new privatized sectors may lead to effective protection for established firms (Warner, 1996).

The empirical evidence does confirm that private sector restrictive practices discourage FDI, especially in retail distribution, bidding for public sector contracts, in airline ticketing and quality standards (Noland, 1999; FitzGerald, 2002). In some countries, for example Japan, closed share ownership means that local capital markets become an effective barrier to FDI.

With projects that have national resource extraction (including the industrial use of water) and polluting manufacturing sectors such as chemicals, paper and metal processing, environment impacts are unavoidable. However such contracts with foreign investors are usually negotiated on an ad hoc basis (including clean-up provision) rather than conducted under fixed national or international rules (Schrijver, 1997). In fact, there is considerable evidence of investors pressuring governments to modify environmental prohibition, using royalty and tax income to the state to override environmental concerns of the majority of the population or of vulnerable groups. The evidence on the impact of environmental standards on FDI is mixed (FitzGerald, 2002). Some studies (Oman, 2000) claim that firms rarely move their operations to take advantage of lower standards in another country, while others (UNCTAD, 1993), based on interviews with multinational enterprises' executives, suggest that less stringent regulation does have an attractive effect on plant location.

Unlike the situation with property and environment protection, internationally agreed norms on labour standards do exist (see ILO, 1991). These refer to 'core' labour standards, such as the right of association or the prohibition of slave and child labour. They do not relate to wage levels, working conditions or contractual forms. Flexibility of employment contracts and reduced non-wage labour costs has been a quest by foreign investors for many years. Recently, the desire for flexibility of labour by employers has re-emerged to reorganize production, as opposed to the search for low wages or working conditions. Hence the move towards shorter employment contracts and reduced social security costs.

Developing countries with intensive low-skill employment and attempts to attract ‘footloose’ industries like textiles and clothing, are most vulnerable to potential lowering of labour standards in the form of piece–rates and employment contracts. These less stringent labour regulations appear most prevalent in the free trade zones that attract light industries like electronics, clothing and footwear (ILO, 1998). Foreign investors, therefore, tend to receive better than national treatment in this regard.

With the above in mind, a survey of employment laws and regulations, relevant constitutional provisions, as well as industry practices was undertaken. The latter was necessary because formal legal rules are not fully indicative of what happens in practice, especially where a voluntary system governing employers and trade union relations exists. The survey broadly covered the conditions of employment in FDI enterprises, the participation of FDI-enterprises in the domestic economy and the industrial relations practices of FDI-enterprises (see Appendix IV for the survey form). Employers were asked a series of questions that captured the conditions of employment and behaviour of FDI-enterprises in each country. A “Yes” response was given a score of ‘1’, while a “No” received a ‘0’ score. The average score was then obtained for each category and multiplied by 100. The results are presented in table 14.

The higher the value of the index for the conditions of employment (column 2), the more restrictive are labour standards, while for the other two indices (columns 3 and 4), the larger the index value, the greater the participation of FDI-enterprises in the domestic economy and the greater the difference in industrial relations practices of FDI enterprises. The table shows that employment conditions are by-and-large quite similar across the region. Therefore, they do not seem to be a significant determinant of cross-country FDI inflows.

Table 14: Index of Employment Conditions in FDI Enterprises

	Conditions of Employment in FDI Enterprises	Participation of FDI Enterprises in the Domestic Economy	Industrial Relations Practices of FDI Enterprises	FDI (% of GDP)
Antigua and Barbuda	75	100	100	17.3
Barbados	75	100	0	1.1
Bermuda	75	100	0	199.6
Dominica	100	100	50	5.8
Saint Lucia	75	100	0	10.3
Suriname	100	67	50	-7.2
Trinidad and Tobago	75	100	0	8.6
St. Vincent	75	100	0	10.6
Jamaica	100	67	0	7.0

Source: Survey Returns to ILO Sub-regional Office for the Caribbean

Survey participants were also asked to list – in order of importance – the main contributions that foreign investors made to the country. The most popular responses were foreign exchange, employment and national income – inline with the empirical findings reported earlier in the document.

In spite of these advantages, some FDI-enterprises have problems with labour market regulations in the country, including the retrenchment policy, union recognition and contract employment.

5. Conclusions and Policy Implications

Some Caribbean economies have been more successful in attracting FDI, particularly in the past 10-15 years. Indeed, the economies receiving the bulk of FDI have either vibrant international business and financial services industries (for example, Bermuda and the Cayman Islands) or natural resource endowments, such as oil in the case of Trinidad and Tobago. Regarding other Caribbean countries, FDI has been directed mainly to tourism and tourism-related projects, as well as to the mining and manufacturing industries; in the latter, foreign investors would have benefited from the level of market protection, fiscal and other incentives and the preferential access to the European market. The sizeable divergence of FDI inflows between the more successful countries and the others could be due to the considerably higher returns in the financial services and petroleum industries compared with the traditional areas, which are constrained by high production costs and small, saturated markets.

Current trends in the sectoral distribution of FDI in the Caribbean region are unlikely to change, especially in light of the favourable conditions in world oil markets. In addition, most Caribbean governments, particularly those of smaller territories, are firmly establishing tourism and international business and financial services as the focus of their long-term development agendas. Moreover, the continuing liberalization of trade and the erosion of manufacturing protection are likely to lead to a gradual decline in FDI to that industry. In this regard, ongoing regional liberalization of financial activity and the deregulation of telecommunications should result in greater investment in these areas in the future.

In most cases, FDI inflows have resulted in the transfer of new technologies and the development of specialized knowledge and skills for local managers. However, these managers usually do not take over the companies and the concentration of ownership usually remains with foreign owners.

More importantly, empirical results suggest that an increase in FDI in the sample of Caribbean countries leads to higher employment. Despite considerable gaps in the

employment data, these results are supported by an evaluation of the stylised facts on FDI inflows over the past three decades. More specifically, the impact of FDI is estimated to be greatest in the first year and enhanced when trade policies, absorption and financial development are considered. Indeed, the latter suggests that foreign investments generate better returns in a stable and healthy macroeconomic environment.

Several policies have been adopted to attract FDI to the Caribbean region, but for data unavailability and other reasons, their effectiveness has not been empirically evaluated. Indeed, the analysis undertaken here suggests that investment incentives appear to be beneficial as a policy tool, but additional research needs to be done on issues such as the impact of trade agreements, intellectual property rights (for indigenous products) and labour standards, in order to support the conclusions made. Labour reform is particularly critical, given the potential for strikes, work stoppages and other disruptions in the workplace, which are becoming more prevalent. For example, in Barbados, 40 incidences of work stoppages occurred in 2005, compared with 24 the previous year and 23 in 2003. These resulted in a cumulative loss of just over 2,000 man-days.

Further studies could also assess the distributional effects of the FDI and examine the specific impact of the various investment promotional policies in each country. Such studies might also examine the specific effects or the importance of the improvements in skills and of the technological transfers which have evolved from the foreign investment; these are most likely captured in the positive productivity effects in FDI industries, so popularly expounded by development economists. Indeed, these suggestions could act as a conduit to improve the significant data gaps that exist in most Caribbean economies and which have caused previous research for the Caribbean to be subsumed into analyses for larger regions.

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Appendix I – Granger Causality

A variable x is said to Granger cause y if one is able to better predict y using lagged values of x . Traditional panel data causality analysis is conducted using the approach put forward by Holt-Eakin et. al. (1988):

$$y_{it} = \alpha_i + \sum_{k=1}^p \gamma_k y_{it-k} + \sum_{k=0}^p \beta_{ik} x_{it-k} + \varepsilon_{it} \quad (\text{A1.1})$$

where each individual is denoted by $i = 1, 2, \dots, N$, time period $t = 1, 2, \dots, T$, α are the country-specific slope coefficients, γ and β are the regression coefficients on lagged values of y and contemporaneous as well as lagged values of x and ε is an error term assumed to be independently and identically distributed with a zero mean and variance σ_ε^2 . The Lagrange Multiplier (LM) and the Hausman (H) test statistics are utilised to choose between the fixed and random effects estimates. To eliminate the individual fixed-effect, which was chosen by the two test statistics, one can difference the data, resulting in the model of the following form:

$$y_{it} - y_{it-1} = \sum_{k=1}^p \gamma_k (y_{it-k} - y_{it-k-1}) + \sum_{k=0}^p \beta_{ik} (x_{it-k} - x_{it-k-1}) + (\varepsilon_{it} - \varepsilon_{it-1}) \quad (\text{A1.2})$$

One can therefore test the hypothesis that x Granger causes y with an F-test of the joint hypothesis:

$$\beta_1 = \beta_2 = \dots = \beta_K = 0$$

This specification suffers from the problem of simultaneity as the error term $(\varepsilon_{it} - \varepsilon_{it-1})$ is correlated with the regressor $(y_{it} - y_{it-1})$. As a result, most authors use a two-stage least squares estimation procedure with a time-varying set of instruments. Equation (2) also assumes that the coefficients on the explanatory variables are the same for each unit in the panel. While this restriction saves on degrees of freedom, it also implicitly assumes that causality occurs everywhere in the panel or nowhere in the panel.

As a result, the authors employ the Hurlin and Venet (2001) procedure that permits the use of both cross-sectional and time series information to test the causal relationship between two variables. The first step in the process consists of testing for homogenous non-causality

(*HNC*); the null hypothesis in this case is that there does not exist any individual causality relationships across N :

$$\begin{aligned} H_o : \beta_{ik} = 0 \quad \forall i \in [1, N], \forall k \in [1, p] \\ H_a : \exists(i, k) / \beta_{ik} \neq 0 \end{aligned} \quad (\text{A1.3})$$

Hurlin and Venet propose that this hypothesis can be tested by calculating the following Wald statistic:

$$F_{HNC} = \frac{(RSS_2 - RSS_1) / Np}{RSS_1 / [NT - N(1 + p) - p]} \quad (\text{A1.4})$$

where RSS_2 is the restricted sum of squared residuals obtained when the null hypothesis holds and RSS_1 is the residual sum of squares from Equation (1). If the null hypothesis is rejected, then there is evidence of Granger causality.

If the null hypothesis of homogeneous non-causality is rejected, Hurlin and Venet (2001) note that two configurations could appear: homogenous causality (*HC*), where all of the β_{ik} coefficients are identical for all lag k and are non-null, or heterogeneous non-causality (*HENC*), where some of the β_{ik} coefficients are different for each individual. The *HC* hypothesis test can be expressed as follows:

$$\begin{aligned} H_o : \forall k \in [1, p] / \beta_{ik} \forall i \in [1, N] \\ H_a : \exists k \in [1, p], \exists(i, j) \in [1, N] / \beta_{ik} \neq \beta_{jk} \end{aligned} \quad (\text{A1.5})$$

or that all the coefficients of the lagged explanatory variable x_{it-k} are identical for each lag k and differ from zero. To empirically test the *HC* one can calculate the following F statistic:

$$F_{HC} = \frac{(RSS_3 - RSS_1) / [p(N - 1)]}{RSS_1 / [NT - N(1 + p) - p]} \quad (\text{A1.6})$$

where RSS_3 is the residual sum of squares from Equation (1) when one imposes the homogeneity assumption for each lag k of the coefficients on x_{it-k} . The test of the *HENC* hypothesis, on the other hand, is specified as:

$$\begin{aligned} H_o : \exists i \in [1, N] / \forall k \in [1, p] \beta_{ik} = 0 \\ H_a : \exists i \in [1, N], \exists k \in [1, N] / \beta_{ik} \neq 0 \end{aligned} \quad (\text{A1.7})$$

The *HENC* test whether the null hypothesis for each individual $i = 1, 2, \dots, N$: for each i one can test the hypothesis $\beta_{ik} = 0, \forall k \in [1, p]$. Therefore one computes N statistics of the following form:

$$F_{HENC}^i = \frac{(RSS_2^i - RSS_1) / p}{RSS_1 / [NT - N(1 + 2p) + p]} \quad (A1.8)$$

where RSS_3^i are the residual sum of squares obtained from imposing the null hypothesis on the k coefficients associated to the variable x_{it-k} for individual i in model 1. This test allows one to identify the individual for which there is no causal relationship.

Appendix II – Derivation of Labour Demand Equation

To obtain an empirical estimate of the impact of FDI on employment, the authors examine the micro-foundations of the relationship, from which an aggregate employment function is derived. Following Greenaway, Hine and Wright (1999) and Milner and Wright (1998) the authors start with a Cobb-Douglas production function:

$$Q_{it} = A^\gamma K_{it}^\alpha N_{it}^\beta \quad (\text{A2.1})$$

where i and t denote the country and time respectively, Q is real output, N is the labour input, K is the capital stock, α and β are the factor share coefficients and γ allows for growth in the efficiency of the production process. Assuming that firms are profit-maximising, the marginal product of labour equals the wage rate, w , and the marginal product of capital, c , equals its user cost. Eliminating capital from the equation using these equations, one obtains:

$$Q_{it} = A^\gamma \left(\frac{\alpha N_{it}}{\beta} \cdot \frac{w_i}{c} \right)^\alpha N_{it}^\beta . \quad (\text{A2.2})$$

Taking logarithms and rearranging, the labour-demand equation can therefore be written as:

$$\ln N_{it} = \theta_0 + \theta_1 \ln(w_{it} / c_{it}) + \theta_2 \ln Q_{it} + \theta_3 \ln A + \varepsilon_{it} \quad (\text{A2.3})$$

where ε is the error term, which is assumed to have normal properties. θ_1 is expected to be negative, since firms would demand less labour if wages are rising faster than the user cost of capital. On the other hand, θ_2 and θ_3 are expected to be positive since firms would demand more labour if output and technology are rising.

If we assume that FDI leads to greater technical efficiency in the production process due to knowledge spillovers, the parameter A can be expressed as:

$$A_{it} = e^{\phi_0 T_i} FDI_{it}^{\phi_1}, \quad \phi_0, \phi_1 > 0 \quad (\text{A2.4})$$

where T is a time trend. Taking logarithms and substituting into Equation (A2.3) the estimated demand for labour function is given as:

$$\ln N_{it} = \theta_0 + \theta_1 \ln(w_{it} / c_{it}) + \theta_2 \ln Q_{it} + \theta_3 T + \theta_4 FDI + \varepsilon_{it} \quad (\text{A2.3})$$

If there is an FDI-induced expansion in labour the sign of the coefficient θ_4 is expected to be positive.

Appendix III – Data Issues

The study utilizes annual data from 1970 to 2003 for twenty (20) Caribbean countries. However, due to missing data there was a total of 450 observations in the database. The employment series observations are taken from the various sources: the International Monetary Fund's International Financial Statistics database; the World Bank's World Development Indicators CD-Rom (2005); various regional statistical departments and the International Labour Organisation. Missing observations are estimated by assuming that labour productivity remains unchanged from the last available year.

Gross domestic product, gross capital formation and price indices are obtained from the United Nations' Statistics Division, National Accounts Main Aggregates Database available at <http://unstats.un.org/unsd/snaama/introduction.asp>. Foreign direct investment is taken from the United Nations' Conference on Trade and Development (UNCTAD) FDI Database available at <http://www.unctad.org>. All the remaining series are obtained from the International Monetary Fund's International Financial Statistics database and the World Bank's World Development Indicators CD-Rom (2005). Trade openness is 'proxied' by the ratio of imports and exports as a ratio of GDP, financial development is the ratio of M2 to GDP, while absorption is the sum of consumption, investment, and government spending as a ratio of GDP.

Appendix IV – Questionnaire or Survey Form



ILO Subregional Office for the Caribbean

Questionnaire on Employers' organizations and their opinions on basic issues relating to Foreign Direct Investment and its Employment/Labour Market Impact

Introduction

The ILO Subregional Office for the Caribbean is currently organizing the ILO Caribbean Employment Forum (CEF) to be held in Barbados from 25 to 27 April 2006. This regional summit aims to identify the critical employment and labour market challenges in the region by presenting empirical evidence and policy options to governments, employers' organisations and trade unions.

The CEF is expected to adopt recommendations on employment strategies for the Caribbean based on National Employment Reports (NERs) and region-wide studies of key employment and labour market issues. The preparations on the regional and national level are expected to be mutually reinforcing and will be synthesized into the background paper for the CEF. However, the national preparations are essential to the success of the CEF. They will ensure that the conclusions of the CEF reflect actual country experiences and that recommendations offer realistic solutions. National preparations will also contribute to building the knowledge base and consultation mechanisms needed to facilitate the design and implementation of national employment strategies in the follow up of the CEF.

One of the region-wide studies being implemented is on investment levels in the English- and Dutch-speaking Caribbean with a focus on Foreign Direct Investment¹ (FDI) and recommendations on devising strategies to increase FDI. The report should take note of recent reports relating to investment, include critical investment indicators, identify obstacles to increased investment and summarize the main investment policies in the region with reference to the employment impact where the data are available.

The ILO CEF consultant Dr. R. Craigwell has indicated the need to include into the report employers' organizations and their opinions on basic issues relating to Foreign Direct Investment and its Employment/Labour Market Impact. This is presented to you in the form of a questionnaire but any additional information or policy papers that your organization has prepared will provide valuable input.

We would appreciate your contribution to this important CEF Report and look forward to receiving the completed form before 25 November 2005.

¹ See definition below.

Country

Name Employers' Organisation

Completed by:

Name: Position/title:

Foreign Direct Investment refers to investment of funds in enterprises in your country by non-residents that gives these non-residents control over the enterprise in case. FDI often takes the form of local subsidiaries of multi-national or trans-national companies but it is broader than that since it also applies to unincorporated enterprises established by individuals not resident in your country. FDI can take the form of participation (or total ownership) of equity capital, reinvestment of earnings of the enterprise or inter-company loans (coming from the mother or sister companies). Not included under FDI are loans (other than the inter-company loans referred to before), foreign capital supplied to enterprises under official development assistance as part of bilateral or multilateral development aid, or other short term capital transfers.

Foreign Direct Investment refers to investment of funds in enterprises in your country by non-residents that gives these non-residents control over the enterprise in case. FDI often takes the form of local subsidiaries of multi-national or trans-national companies but it is broader than that since it also applies to unincorporated enterprises established by individuals not resident in your country. FDI can take the form of participation (or total ownership) of equity capital, reinvestment of earnings of the enterprise or inter-company loans (coming from the mother or sister companies). Not included under FDI are loans (other than the inter-company loans referred to before), foreign capital supplied to enterprises under official development assistance as part of bilateral or multilateral development aid or other short term capital transfers.

1. Is the “right” to collective bargaining expressly granted by the Constitution?

Yes

No

Other comments

.....
.....
.....

2. Is collective bargaining promoted by Government’s (public) policy?

Yes

No

Other comments

.....
.....
.....

3. Are all national labour standards embodied in the current labour legislation also applicable to the enterprises operating under the foreign direct investment regime of your country?

Yes

No

Other comments

.....
.....
.....

4. Are all Government policies with respect to promoting collective bargaining also applied to the enterprises operating under the foreign direct investment regime of your country?

Yes

No

Other comments

.....
.....
.....

5. Are the enterprises operated by foreign direct investors participating in: (*more than one answer is possible*)

Your national employers' organization (*if this is also the Chamber of Commerce tick only this answer box*)

Special employers' organization exclusively for or dominated by foreign direct investors

The Chamber of Commerce

Other employers' organizations

Other comments

.....
.....
.....

6. Is the participation of enterprises operated by foreign direct investors in the main activities of your organization different than that of local investors/businesses?

Yes

No

Other comments

.....
.....
.....

7. Are you aware of special programmes/projects of foreign direct investors that aim at increasing or intensifying linkages of their enterprises with the local businesses?

Yes

No

Other comments

.....
.....
.....

8. Please list the three most important contributions -- in order of importance -- that foreign investors make to your country?

1.
.....
.....

2.
.....
.....

3.
.....
.....

9. Are the employment practices (hiring, firing, types of contracts, use of outsourcing, etc) of enterprises operated by foreign direct investors different than those of local investors/businesses?

Yes

No

Other comments

.....
.....
.....
.....

10. Are the labour or industrial relations practices of enterprises operated by foreign direct investors different than those of local investors/businesses?

Yes

No

Other comments

.....
.....
.....

11. Please list the three most frequent employment and labour practices that foreign investors have attempted to change in your country and what has been the response of your (employers') organization?

1.
.....
.....
2.
.....
.....
3.
.....
.....

Please provide us with any information (papers/folders/newsletter or other format) on special programmes or activities that your organization has with respect to foreign direct investment of the enterprises of foreign direct investors (including any statistics kept by or collected by your organization).