Foreign Direct Investment Flows to the Eastern Caribbean Central Bank Region

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Introduction

Foreign direct investment (FDI) has played an important role in facilitating growth and development in a number of developing countries, including those in the Eastern Caribbean Central Bank (ECCB) region, and more recently in some countries in transition. Flows of FDI have been growing in recent years, partly as a result of the increasingly close integration of national economies, driven by worldwide competitive pressures, economic liberalisation, and the opening up of new areas to investment. In addition, FDI has become the principal source of external capital in a number of countries, which are now more receptive to FDI as evidenced by changes in their investment policies. Global FDI flows increased from US$ 11.6 billion in 1986 to US$ 95.4 billion in 1995. As a percentage of capital inflows, FDI flows moved from 48.9 per cent in 1986 to 44.9 in 1995. The relative decline arose as a result of increased portfolio investment in emerging economies due to financial liberalisation and the improvement in economic fundamentals. In the ECCB region, FDI inflows were estimated to have increased from US$ 68.0m to US$ 172m in 1996. During the period, however, inflows to the region fluctuated widely and also varied among the ECCB member countries. This paper attempts to analyse trends in foreign direct investment flows to the ECCB region during the period 1986-96, examine factors influencing FDI flows by looking at the experience of some countries in Asia, and discuss the prospects for these inflows to the region. Section II of the paper deals with the definition and role of FDI. Section III discusses governments' policies towards FDI in the ECCB region, and analyses the trend in FDI inflows to this region during the period 1986-96. In Section IV the impact of FDI on a number of macoreconomic aggregates is explored. In secton V prospects for FDI flows to the region and policy prescriptions are outlined. Finally, a summary and conclusion of the study is provided.

I Definition of Foreign Direct Investment

Two forms of foreign investment have been identified. The first is *foreign portfolio investment or equity investment,* which is an indirect form of investment where a foreign investor simply buys a stake in an enterprise located in another country. The second form, which is the focus of this paper, is *foreign direct investment.* In this form of investment, the foreign investor not only buys a share or a security located in another country, but he is also directly involved in the management of the enterprise. The International Monetary Fund (IMF) describes FDI as an investment made by a resident entity in one economy in order to acquire a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise. According to the Fifth edition of the Balance of Payments Manual, prepared by the IMF, the foreign entity must own 10 per cent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise)" for its financing to be considered as foreign direct investment. The foreign entity can be individuals, incorporated or unincorporated private enterprises, or public enterprises.

FDI transactions can be classified into equity capital, reinvested earnings and other capital, largely associated with inter-company debt transactions, direct purchases of land and real estate purchases and sales for commercial and non-commercial purposes. In addition to transactions associated with a cash payment, they include changes in inter-company accounts that represent the accounting offset to goods, services, income and capital transactions between related enterprises not matched by a cash payment. Non-cash acquisition of equity, e.g. provision of capital equipment and manufacturing rights. FDI can be in the form of mergers and acquisitions whereby an existing concern is bought, and "greenfield" investment where the enterprise is started from scratch.

Role of FDI

Based on the literature and the experience of developing countries with FDI , there are a number of benefits to be derived from FDI. FDI provides financial resources for investments. In a number of developing countries FDI is the principal source for external capital. FDI inflows to developing countries, as a share of capital inflows increased from ... per cent in 1986 to ... per cent in 1996. It provides financing for balance of payments. An inflow of FDI provides balance of payments financing if it is not used for capital formation. For example, privatisation programmes in a number of countries have produced capital inflows in the form of FDI. The privatisation has not resulted in any new capital formation, only in the foreign ownership of an existing company and its capital assets. Similarly, a capital inflow used to acquire ownership of an existing firm in the form of FDI provides financing for the balance of payments.

FDI provides access to new technologies. Technology owners are more willing to make technology available to a partner if they can retain some degree of management control. Additionally, it provides management techniques. FDI brings in new knowledge and entrepreneurial skills, which are among the important benefits of international exchange of goods and services. Foreign direct investment can provide channels of communication that stimulate cross-border learning of production methods, product design, organisational methods, and market conditions. These help to employ domestic resources more efficiently and adjust the mix of products to obtain more value added per unit.

Access to marketing expertise and market links is also facilitated through these capital inflows.. Many foreign investors come to the host countries with established marketing networks and have more experience in international markets. FDI can also provide marketing links to a foreign partner as the local partner may be able to provide access to the local and possibly the regional market. Most importantly FDI is thought to stimulate economic growth. Through its mobilisation of domestic resources, FDI provides additional economic activity and generates employment. By permitting foreign firms to operate in a country, there is likely to be increased competition in the domestic market and quality upgrades of products and services by firms in the sector. Indirectly, FDI offers opportunities for the establishment of local firms providing services or supplying materials to the foreign firms, particularly when foreign firms engage in contractual arrangements with local firms. FDI can also accelerate economic transformation and restructuring, in the case of relatively well developed markets. In east Asia, FDI in Hong Kong; Republic of Korea; and Tapei, China resulted in very positive impacts on economic growth and restructuring. For the People's Republic of China, foreign investment is in fact the locomotive for economic development. For Hong Kong during the early stage of industrialisation, FDI played a considerable role as a source of capital, as well as a supplier of technology and managerial skill.[1]

The International Finance Corporation, an affiliate of the World Bank, which has a long association with FDI at both the investment and advisory levels, noted that FDI can also provide an operational link between an enterprise and a foreign partner. This link is necessary as the suppliers of know-how and technology may prefer to take an equity stake (FDI) so that they can exercise some degree of control over the use of their inputs and share in the financial rewards for taking risks. It is true that management, technology, marketing and know-how can be supplied under contract, but such arrangements usually involve less control and sometimes contracts are difficult for foreign firms to enforce in many countries. In addition, a foreign partner which has investment expertise, technology or market access not available in the host economy, can raise the productivity of the enterprise. [2]

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[1]See Chen Edward K.Y., "Foreign Direct Investment in East Asia", Asian Development Review, vol.11, no.1 (1993).

[2]See IFC/FIAS , "Foreign Direct Investment; Lessons of Experience; 5" (Washington D.C., 1997)

Despite the benefits and opportunities offered, there are a number of disadvantages to the host country receiving FDI. There is the likelihood that FDI may "crowd out" domestic private enterprise and also reduce pressure to foster such an enterprise because of the presence of competitive foreign enterprises. Tax and tariff exemptions, and other privileges granted for FDI can sometimes prove very costly to the host country and may result in a vicious circle if privileges granted to foreign investors give rise to hostile feelings against FDI in the recipient country. A new wave of regulations may be necessary and efforts to circumvent the restrictions may be intensified, possibly leading to a retreat of foreign investors and a decline in FDI inflows.

If financial and trade distortions exist in an economy, FDI can take from the host country more than it contributes. For example, Fry, 1994 states that the degree of protection for Vietnam's import-substitute industries, in which many joint venture investments have been made, produced economic distortions. Not only do these distortions provide strong incentives for FDI to produce solely for the protected domestic market, but they also ensure that private returns diverge from social returns or social welfare. Some FDI companies, particularly the assembly type, tend to be more footloose. Their sudden departure, depending on the scale of operations, can cause some disruptions in economic activity.

III An Analysis of FDI in the ECCB Region

The information on FDI flows to the ECCB region was obtained from the balance of payments statistics, which are compiled jointly by officials in the Statistical Unit of the member countries and staff from the ECCB. Data on FDI flows to Anguilla were not available for the period 1986-89 as compilation of BOP for Anguilla commenced in 1990. Estimates of FDI flows were based on annual surveys of some foreign direct investment enterprises operating in the ECCB member countries, on discussions held directly with some enterprises and the authorities involved in FDI approval, as well as on information obtained from other sources. Some adjustments were made for those enterprises which did not respond. It must be noted that these statistics on FDI inflows could be often understated and deficient for a number of the countries due to the great difficulty in obtaining reliable data from investors on the amount invested. In addition, the coverage of these inflows is not complete as it has been very difficult to capture all direct investment inflows. It is likely that some of these might be included in net errors and omissions in the BOP which for a number of countries have been very large. Difficulties are also experienced in getting data on FDI related projects under construction as in some cases the investors who reside overseas are beyond the reach of the domestic compiler, and the intermediaries in the host country do not have adequate information on the project.

FDI inflows to the ECCB region were estimated to have increased from EC$183.8m in 1986 to EC$464.7m in 1996, and as a share of GDP rose from 6.5 per cent to 7.5 per cent in 1996. During the period under consideration, however, FDI inflows to the region fluctuated. Between 1986-90, FDI flows more than tripled to reach EC$565.4m. These investments are basically lumpy and are linked with the project cycle of the venture. The sectoral composition of FDI flows was not readily available, but based on limited information the increase in FDI flows largely reflected inflows to finance hotel development, particularly in Antigua and Barbuda, St.Kitts and Nevis, and Antigua, as well as improvements to the telecommunications system and the purchase of land. FDI inflows contracted during the period 1991-94, to a level of $384.7m in 1993 as some projects neared the completion stage, while others were completed. In 1995, inflows of FDI to the region peaked at $593.0m (10.1 per cent of GDP), associated in part with investment in a manufacturing establishment - the purchase of Dominica Coconut Products by Colgate Palmolive - in Dominica. In some countries such as Anguilla which specialises in up scale tourism FDI accounted for as much as 37.7 per cent of GDP in 1996. However, inflows to the region contracted by an estimated 21.6 per cent in 1996. The largest concentration of FDI in the region during the period appeared to be in hotel development, reflecting, to some extent, the impact of governments' policies towards the development of the tourism industry to support the agricultural and manufacturing sectors.

The region as a whole accounted for the majority of flows into the Caribbean in 1986 (100 per cent) as there was significant disinvestment asssciated with economic or political instability in

Trinidad and Tobago, Suriname, and Jamaica. In 1989, the ECCB accounted for the second highest share of flows into the Caribbean region averaging 62.5 per cent of total flows. The ECCB's share have tended to decline over time to 18.0 per cent by the end of 1995. The decline in foreign direct investment share of the ECCB was due to higher flows into Jamaica, Dominican Republic and Trinidad and Tobago arising from advances made by these countries in preparation for entry into the North American Free Trade Area (NAFTA). When compared with overall flows into Latin America and the Caribbean the ECCB area accounted for 2.4 per cent of all FDI flows in 1986 but decline to approximately 1.0 per cent in 1995 (Table ???). This relative decline was explained by the faster rate of trade and capital account liberalization in a number of emerging markets in Latin America.[3]

The experience with FDI in the member countries varied during the period 1986-96. Antigua and Barbuda received the largest amount of FDI, averaging roughly EC$90.4m annually over the period 1986-96, followed by St.Lucia with an average of EC$85.3m and St.Kitts and Nevis with inflows estimated at an average of EC$62.9m. Of the other countries, inflows ranged from an average of EC$16.8m in Montserrat to EC$50.5m in Dominica. In the case of Antigua and Barbuda, FDI inflows were much higher in the first half of the period under consideration, averaging EC$113.7m annually during 1986-91, compared with an annual average of EC$62.4m in the period 1992-96. The higher level of inflows during the first half of the period reflected largely equity financing in relation to hotel development. FDI inflows tapered off during the second half of the period as a number of relatively large hotel development projects were completed. Substantial inflows of FDI were recorded for St.Kitts and Nevis in 1989-90, and St.Lucia in 1990-91; these inflows were associated largely with the construction of major hotels. In St.Vincent and the Grenadines, and Dominica FDI inflows were much higher during the period 1992-96 compared with the levels in 1986-91, partly refecting increased investments in manufacturing enterprise and hotel development. FDI inflows to Montserrat were associated largely with land purchase; these inflows tapered off during the period 1995-96 due to the disruptions in the economy caused by volcanic activity.

During the period 1986-96, the share of FDI in capital inflows to the ECCB region averaged roughly 44.0 per cent annually. FDI inflows as a share of capital inflows were higher than the regional annual average in three of the countries, namely St.Kitts and Nevis (57.9 per cent), St.Lucia (50.2 per cent) and Montserrat (46.7 per cent). In the other member countries, the share ranged from 32.2 per cent in Grenada to 39.9 per cent in St.Vincent and the Grenadines.

Looking at the composition of FDI inflows to the region, those in the form of equity participation was highest, averaging 34.0 per cent of FDI inflows, followed by "other investments" in the form of loans (24.3 per cent), land sales (22.7 per cent) and re-invested earnings (18.4 per cent). Equity inflows as a share of FDI was largest for Antigua and Barbuda (58.4 per cent), surpassing the regional average, and was concentrated in hotel development. This was followed by Grenada (55.5 per cent) and Dominica (34.4 per cent). In the case of "other investments", St.Kitts and Nevis accounted for the largest share (36.0 per cent), partly reflecting investments in residential construction, followed by St.Lucia (29.1 per cent) and St.Vincent and the Grenadines (24.9 per cent). The proportion of land sales in FDI was highest for Montserrat, reflecting to a large extent, real estate purchases by expatriates, for residential construction. St.Vincent and the Grenadines accounted for the largest average annual share of re-invested earnings in FDI (32.9 per cent), followed by St.Lucia (31.2 per cent). Inflows of reinvested earnings for the region were in relation to hotel development, upgrading of the telecommunications system and improvements to oil companies.

An analysis of FDI flows to the region showed some changes in the composition. Inflows in the form of equity fell from an annual average of 47.3 per cent of FDI in 1986-91 to an average of 19.2 per cent in 1992-96. By contrast, inflows in the form of re-invested earnings rose from an annual average of 12.7 per cent in 1986-91 to 25.2 per cent in 1992-96. Similarly, inflows from land sales increased form 18.9 per cent to 27.4 per cent in 1992-96, and those in relation to "other

[3] Mexico, Brazil, Argentina, Colombia and Chile accounted for 78.5 per cent of all FDI flows into Latin America and the Caribbean in 1995

investment" rose from an average of 21.1 per cent in 1986-91 to one of 28.2 per cent in 1992-96. The decline in the share of equity can be explained in part by the substantial investments (in the form of equity) in the construction of a number of major hotels during the first half of the period; investments in hotel construction tapered off in the latter part of the period as these hotels were completed.

An analysis of the sources of FDI flows was not possible due to the difficulty in obtaining this information. It is generally accepted however that most flows into the ECCB region orginate from the United States, Canada and in the European Union to a lesser extent. FDI flows are concentrated in the tourism sector where the majority of stay-over visitors originate from North America. FDI flows into the manufacturing sector also originated in the US due to special arrangements under the Caribbean Basin Initiative.(footnote here)

Government Policies to Promote FDI in the ECCB Region

During the 1960s and 1970s there was considerable interest in attracting FDI to the region as these flows were expected to contribute to the development of the countries. In an attempt to increase these flows a number of governments introduced a range of investment incentive measures which include tax incentives, investment guarantees, information on investment opportunities, establishment of industrial estates, exemption from import duties on necessary equipment and materials, the granting of tax concessions for the encouragement of desired new investments, and special legislation for the protection of foreign investments. Indeed, some governments in the member countries established a Unit to deal specifically with foreign investors. The Unit provides a one stop service for investors, evaluate private sector investment projects; determine eligibility for tax incentives provided for in the law; monitors foreign investment to provide basic data on investment flows, duty exempt imports, and repatriation of profits.

Foreign investors found the region attractive for a number of reasons which include the legal framework was favourable and governments provided tax incentives for investment projects in sectors such as tourism, manufacturing and agriculture. Other reasons are stable economic environment and a more secure environment for foreign investors by ratifying provisions of a number of bilateral investment protection agreements. Consequently joint ventures entered into by the member countries. Some of the member governments have established a number of joint ventures with foreign investors, primarily in the telecommunications and electricity sectors. These joint ventures were established with a view to minimise the degree of central government transfers to these enterprises, increase operating efficiency and new investments in infrastructure and technology.

Laws aimed at stimulating FDI flows offer tax incentives, lay out the legal framework in which foreign investors operate and making transparent and swift the investment approval process. The laws also provide for a number of incentives such as low corporate tax rate, exemption from taxes on corporate profits, also reinvested profits are exempted from corporate tax. Tax exemptions are linked to a number of economic and social criteria, output exported, use of local resources, technology and know how transfer. There are no taxes on distributed profits, exemption from import duties for inputs and equipment, exemption from export tax, no restriction on empolyment of foreign nationals who are management experts, technical personnel or skilled workers.

IV. Macroeconomic Impact of FDI on ECCB Economies

In this section we develop a macroeconomic model that encompasses investment, savings imports, exports and growth equations in order to evaluate the impact of FDI on these economies. In the gross investment equation, the ratio of investment to GDP is thought to influenced by the accelerator given the difficulties assosciated with the estimation of neoclassical investment model for developing countries (Blejer and Khan 1984); (Green and Villaneuva 1990) and (Wai and Wong 1982). Movements in the real exchange rate has both direct and indirect effects on the level and rate of investment. Changes in the real exchange rate affects both domestic demand and supply. A depreciation in the effective rate increases the overall domestic price level, reducing

the net worth of private sector assets and may precipitate a decline in private investm ent expenditures.

On the supply side the a depreciation may promote investment in the tradeable sector which may be muted however by dependence on the importation of a a now more expensive capital good. Credit availability is important in the rate of investment in developing countries as it is thought that impediment to investment is relted more to the quantity of financing rather than the cost of financing (Blejer and Khan 1984).

Following Masson (1987) and Fry (1996) a simple savings function was developed based on the life cycle hypothesis. This model assumes that young income earning households save to finance consumption when they old non-earning households (Fry, 1996). It is assumed that with positive growth over a lifetime, the resources of youg savers will exceed those of older dissavers leading to positive savings. According to Masson (1987) the rate of growth effect can only be positivve to the extent that household on average accumulate wealth when they are younger. In cases where households can borrow against future income and spend more cumulatively over a significant portion of their lifetime then this effect can be negative. FDI is though to affect savings as it results in an increase in liabilities of the domestic commercial banks. The duration of these liabilities can be offset through the accumulation of foreign assets. This accumulation of foreign reserves also results in an increase in the monetary base and the capacity of the commercial banks to supply loanable funds.

In terms of the impact of FDI on imports and exports. Increased flows in FDI is typically associated with an increases in imports. In the ECCB area most FDI flows are employed in the tourism sector to finance new hotel construction. The increase in imports is expected to result in a deterioration of the current account of the balance of payments unless there is compensation for this effect from exports. The real exchange rate adjusts to equate the import-export balance to the savings-investment balance. The role of exports in the import equation accounts for the adjustment of the desired level of imports to the availability of foreign exchange earned by exporters. Given that the composition of national income affects the volume of imports, groos investment is included to account for import intensity.

Finally the overall impact of FDI on growth is analysed as it affects both domestic investment and national savings. The interaction between capital inflows and domestic investment is expected to feed into the growth process. This has been the foundation of two gap savings-investment models put forward by Chenery and Strout (1966). FDI can not only affect the level of domestic investment but also its effciency as it is frequently associated with auxilary inputs such as new technologies, managment and marketing skills. FDI is expected to have a stronger impact on growth as unlike aid flows they are channelled to the private investment. Khan and Rheinhart (1990) have found the impact of private investment on growth to be stronger than that of public investment. Moreover FDI flows are typically associated with investment in the traded goods sector compared to public investment in infrastructure. The assumption of faster technical progress in the traded goods sector although an emprical matter, it is typically assumed among economists (de Melo, 1988; and van Wijnbergen 1986). The system of equations based on the above model is specified as follows:

$$IY_t = \beta_{10} + \beta_{11} FDI_t + \beta_{12} DCR_t + \beta_{13} RER_t + \beta_{14} GRW_t + \beta_{15} IY_{t-1} \quad (1)$$

$$SNY_t = \beta_{20} + \beta_{21} FDI_t + \beta_{22} GRW_t + \beta_{23} SNY_{t-1} \quad (2)$$

$$IMP_t = \beta_{30} + \beta_{31} FDI_t + \beta_{32} OCAP_t + \beta_{33} RER_t + \beta_{34} IY_t + \beta_{35} EXP_t + \beta_{36} IMP_{t-1} \quad (3)$$

$$EXP_t = \beta_{40} + \beta_{41} FDI_t + \beta_{42} RER_t + \beta_{43} EXP_{t-1} \quad (4)$$

$$GRW_t = \beta_{50} + \beta_{51} FDI_t + \beta_{52} IY_t + \beta_{53} EXP_t + \beta_{54} INGRW_t + \beta_{55} GRW_{t-1} \quad (5)$$

IY_t - Domestic Investment to GDP
FDI_t - Inflow of Foreign Direct Investment to GDP

DCR_t - Change in Domestic Credit to GDP
GRW_t - Real GDP Growth
SNY_t - National Savings to GDP
IMP_t - Imports to GDP
RER_t - Real Exchange Rate
$OCAP_t$ - Other Capital Flows
EXP_t - Exports of goods and services to GDP
$INGRW_t$ - Real Growth in OECD countries

Data Architecture and Estimation

The above model was estimated using data for Antigua and Barabuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines over the period 1980-96. The data were derived from ECCB annual publication and the IMF International Finance Statistics. The pooled cross section time series data was estimated using iterative three stage least squares to overcome problems in simultaneity, correction of heteroscedasticity and exploitation of contemporaneous correlation across disturbances. Lagged dependent variables in addition to the terms of trade, the world real interest rate and growth in OECD countries were used as instruments.

Results and Discussion

FDI was found impact positivelyon gross capital formation in the ECCB area. Lags of FDI were also explored but the relationship appears to be contemporaneous. In these economies, FDI does not appear to substitute or indeed crowd out domestic investment. It may increase the current account deficit by the equivalent magnitude of the capital inflow. The investment to GDP ratio also increased with growth and credit although the coefficient of the latter variable was not significantly different from zero. An appreciation in the real exchange rate was found to impact negatively on the investment ratio to the extent that it affects the competitiveness of the tradeable sector. The ambigous impact of the real exchange rate on investment is underscored by the fact that an appreciated real exchange rate would make investment goods cheaper thus having a positive effect on investment.

FDI was also found to have a weakly positive effect on savings. The growth effect on savings although positive was not significant. In the import equation the coefficient of FDI was positive but insignificant. Other capital flows were also insignificant while the foreign exchange receipts from exports positively impacted imports. An appreciated real exchange rate according to this data impacts positively on the import ratio although this effect was not statistically significant. This suggests that the loss of competiveness of the tradeable sector, and hence lower imports is offset by the substitution effect of imports to a more profitable non tradeable sector. The impact of FDI on imports was positive but the degree of significance varied over the sample period. It had its greatest impact during the 1980s and was statistically significant but was not signficant over the entire sample period or during the 1990s. The coeffcient of FDI in the export equation was significant but not of expected sign considering most of these flows are channelled into tradable sector activity in the tourism industry. Moreover, the tourism sector has in recent times emerged as the lead sector among the respective economies.

In the growth equation both ratios to GDP and real growth rates of the right hand side variables were explored. Estimation using real GDP growth and real per capita growth as dependent variables and ratios of the right hand side variables yielded poor estimates. However use of growth rates yielded better estimates. The estimated coefficient of FDI in the growth equation was not significantly different from zero. When the sample was divided to ascertain the impact of FDI across different periods the same results obtained. It appears that the FDI growth nexus is channelled through domestic investment and in particular private investment. The coefficient of the investment ratio was robust to the inclusion or exclusion of variables FDI and sample period (Tables %, & and $). Gupta and Islam (1993) using pooled cross section time series estimation for a large group of developing countries found that regardless of the type of equation and country grouping that the coefficient of FDI remained insignificant. Given the openness of these

economies and the high degree of trade dependence, both exports and industrial growth were important to the growth process.

V. Prospects for Future Flows and Policy Issues

The major factor contributing to FDI flows to developing countries has been the improvement in domestic economic fundamentals and the increasing degree of financial deregulation. The developments in the global financial markets, the movement of cross border funds through the domestic banking system have influenced the pattern of direct investment flows. These included the recent recession in some of the industrialised countries and the associated decline in interest rates. Since early 1994 interest rates in industrial countries rose and the strengthening of the recovery resulted in some moderation of capital flows to developing countries. However, domestic factors such as macro-economic stability and the sustainability of external imbalances are likely to be the key determinants of the sustainability of capital flows. The globalisation of production that seeks efficiency in allocation of financial and managerial resources will further facilitate these flows. These flows will be reinforced and complimented with advances in telecommunications, information and financial liberalisation.

The subsiding of the contagion or "Tequila" effect arising from the Mexican peso crisis on investor expectations has facilitated the resurgence in capital flows to developing countries in general and to emerging markets in particular. The search for higher yields in recent times has been due to lower interest rates in Japan and Germany and the compression of corporate bond yields in the US. Prospects for increased flows will be based on the the need for portfolio diversification in mature markets, the immunisation of risks in emerging markets through financial innovations and the ongoing financial and capital account liberalisation in developing countries.

The slow down in growth in Asia, the increase in sovereign risk arising from large current account deficits and the concerns about banking and financial sector soundness has resulted in a shift in FDI and other flows to Latin America and the Caribbean. Preliminary estimates by the IMF and World Bank suggest that the largest component of total private capital flows in 1996 and 1997 was FDI. The doubling in portfolio flows arose due to the revisions on returns on emerging market equity, earnings price ratios and growth. The ECCB region is expected to maintain its share of FDI flows to Latin America and Caribbean region because of financial and economic stability arising from the nature of the monetary arangement.

Some Policy Issues

Data on the composition of capital flows can also provide useful information about the causes of the inflows, however, it is often difficult to distinguish between foreign direct investment flows and portfolio investment flows, especially in the short term. In general an increase in money demand is likely to attract a relatively large proportion of short term flows, whereas other changes , such as an increase in the domestic productivity of capital will tend to attract a relatively large proportion of foreign direct investment.

Effort must be made to improve the coverage and quality of data on direct investment inflows. Ways to track and record data must be found, particularly in light of the removal of exchange controls which will result in the loss of valuable data sources. With financial innovation it is becoming more difficult to track some of the FDI flows. Data sources should be continuosly reviewed and systems must be reviewed so that comprehensive coverage of transactions can take place. Policy makers should ensure that Statistical offices are properly staffed and the necessary resources, support and legal powers for data collection are provided. Compilers should also forge links and contacts with contractors. Ministries responsible for direct investment registration, compilers in other countries and international organisations which can assist with exchange of information, providing or cross checking the information reported, subject to confidentiality considerations. Direct enquiries can be made to parent companies or their affiliates and collaborate with other countries for exchange of data. Agencies that approve FDI initiatives need to record sectoral distribution and country of origin of FDI approvals.

The governments can encourage joint venture operations particularly with state enterprises that are not performing. State enterprises are considered more attractive than private business because of their relatively larger size, established links with decision makers, access to land and services.

The benefits of privatisation are financial, improvement in efficiency, distributional and political. However, a proper regulatory framework needs to be established to ensure that social and economic welfare is maintained by these natural monopolies. With increased financial deepening and liberalisation opportunities will arise for also joint ventures among enterprises in the ECCB region. This would help entrepreneurs to diversify into business ventures abroad.

Finally there will need to establish a body responsible for evaluating and approving all investment projects, and responding to an investment proposal within a certain number of days.
Investors should be treated in a non-discriminatory manner except in the case of land ownership.

VI. Conclusions

The ECCB area continues to attract long term capital inflows that have averaged as much as 9.0 per cent of GDP. These inflows tend to be variable and lumpy as they are linked primarily to the financing of new hotel development in the tourism sector. However, FDI inflows have also been linked to the privatisation of sate-owned enterprises and investment in manufacturing activity.

The subregion accounts for a respectable share of inflows into the Caribbean due to political, financial and economic stability engendered by the type of governance and quasi-currency board nature of the monetary arrangement. The low inflation climate and liberalised capital account will continue to facilitate sustained flows into the monetary union especially in light of the shift in investor focus from Asia to the Latin American region.

FDI was found to positively impact on investment, savings and imports. However, the impact on imports was sensitive to the period of estimation. Although FDI was found to impact on exports of goods and services the estimated coefficient was not of expected sign. The FDI growth nexus appears to be through gross capital formation and in particular private investment. This result was invariant to the period of estimation. In authorities appear to have created the necessary incentive framework that has encouraged sustained flow of these resources into the monetary union. Efforts to simplify the investment procedures and the provision for the settlement of disputes are expected to further facilitate these capital flows.

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Table 1

FOREIGN DIRECT INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN
(US$ millions)

COUNTRY	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Central America	1186.1	2961	2561.8	3411.3	2921.8	5106.9	4901.5	4988	11793.1	10293.1	7933.5
Guatemala	68.8	150.2	329.7	76.2	47.6	90.7	94.1	142.5	65.2	75.2	76.9
Nicaragua	0	0	0	0	0	15.0	38.8	40.0	70.4	85.0	
El Salvador	24.1	18.3	17	14.4	1.9	25.2	15.3	16.4	38	38	
Costa Rica	61	80.3	122.3	95.2	106.4	172.8	221.6	244.4	292.9	390	
Panama	-490.8	-533.8	-501.2	51.5	131.9	41.2	138.7	155.7	353.6	178.9	237.6
Mexico	1523.0	3246.0	2594.0	3174.0	2634.0	4762.0	4393.0	4389.0	10973.0	9526.0	7619.0
South America	1604.5	2016.3	4484.9	3542.4	3445.4	5215.5	7812.7	4965.5	11039.5	14001	15679.9
Argentina	574.0	-19.0	1147.0	1028.0	1836.0	2439.0	4052.0	2555.0	2941.0	4026.0	4080.0
Chile	116.0	230.0	141.0	1279.0	582.0	400.0	321.0	375.0	847.0	971.0	3011.0
Colombia	1016.0	642.0	293.0	547.0	484.0	433.0	679.0	719.0	1515.0	2033.0	3254.0
Brazil	177.0	1087.0	2794.0	608.0	324.0	89.0	1924.0	801.0	2035.0	3475.0	
Bolivia	10	10	10	-25.4	26.1	50	91.1	147.2	147.2	390.6	
Peru	22	32	26	59	41	-7	136	670	3084	2083	3571
Paraguay	1	5.3	8.4	12.8	76.3	83.5	136.6	110.8	179.8	179.8	
Uruguay	32.5	45	44.5	0	0	0	0	101.5	154.5	156.6	168.9
Venezuela	-344	-16	21	34	76	1728	473	-514	136	686	1595
Caribbean	67.3	243.1	248.2	245.8	668.9	896.4	630.9	931.5	1148.8	1219.5	741.8
Belize	4.6	6.9	14	18.7	17.2	13.6	15.6	9.2	15.4	21.1	
Anguilla					10.8	6.3	15.5	6.7	11.5	17.9	29.8
Antigua	22.6	38.6	32.9	43.1	60.5	54.6	20.0	15.0	25.2	33.3	22.0
Aruba	0	0	0	0	130.5	187.1	-37	-17.9	-73.2	-5.5	84.5
Bahamas	-13.2	10.8	36.7	25	-17.3	-1.3	1	27.1	23.4	106.8	87.1
Barbados	5	4.6	11.5	5.4	9.7	7.4	14.4	9.3	12.9	11.7	
Dominica	5.2	13.5	11.9	17.1	12.9	15.3	20.6	13.3	22.6	54.8	
Dom. Republic	50.0	89.0	106.1	110.0	132.8	145.0	179.7	224.5	360.2	404.4	394.1
Grenada	4.5	11.2	15.0	10.5	13.1	16.5	23.8	21.5	21.3	23.4	19.8
Guyana	-	-	-	-	-	-	-	25			
Haiti	4.8	4.7	10.1	9.4	8.2	-1.8	-2.2	-2.8	0	7.4	4.1
Jamaica	-4.6	53.4	-12	57.1	137.9	133.2	142.4	77.9	116.8	166.7	
Neth Antilles	1.0	2.2	6.7	17.4	8.1	33.4	40.1	11	21.5	9.8	
Montserrat	4.7	11.2	9.5	4.9	9.6	8.0	4.6	4.8	7.4	3.3	0.4
St. Kitts	9.2	16.7	13.1	40.8	48.7	23.0	12.5	13.9	16.6	23.1	37.6
St. Lucia	14.5	15.0	16.4	26.6	45.8	59.3	41.4	35.8	33.8	32.9	25.6
St. Vincent	7.4	5.0	9.1	10.6	7.7	8.9	14.8	31.4	47.3	30.6	18.3
Suriname	-33.8	-72.6	-95.8	-299.7	-76.8	18.5	-54.3	46.6	-30.2	-21.3	
Trinidad and Tobago	-14.5	33.1	62.9	148.9	109.4	169.2	177.9	379.2	516.2	298.9	
Latin America	2790.6	4977.3	7046.7	6953.7	6367.2	10322.4	12714.2	9953.5	22832.6	24294.1	23613.4
Latin America and Caribbean	2857.9	5220.4	7294.9	7199.5	7036.1	11218.8	13345.1	10885.0	23981.4	25513.5	24355.2
ECCB	68.0	111.0	108.0	153.6	209.2	192.1	153.3	142.4	185.8	219.4	172.0
Other Caribbean	-0.7	132.1	140.2	92.2	459.7	704.3	477.6	789.1	963.0	1000.0	569.8

Table 2

COUNTRY FOREIGN DIRECT INVESTMENT SHARES
(Per Cent ECCB Flows)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
ECCB	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Anguilla	0.0	0.0	0.0	0.0	5.2	3.3	10.1	4.7	6.2	8.2	17.3
Antigua and Barbuda	33.2	34.7	30.5	28.1	28.9	28.5	13.0	10.5	13.6	15.2	12.8
Dominica	7.6	12.2	11.0	11.2	6.2	8.0	13.4	9.4	12.2	25.0	10.8
Grenada	6.6	10.1	13.9	6.8	6.3	8.6	15.5	15.1	11.5	10.7	11.5
Montserrat	6.9	10.1	8.8	3.2	4.6	4.2	3.0	3.4	4.0	1.5	0.2
St.Kitts	13.5	15.0	12.2	26.6	23.3	12.0	8.2	9.7	8.9	10.5	21.9
St.Lucia	21.3	13.5	15.2	17.3	21.9	30.9	27.0	25.1	18.2	15.0	14.9
St. Vincent and The Grenadines	10.8	4.5	8.4	6.9	3.7	4.6	9.7	22.0	25.5	13.9	10.6

ECCB AND COUNTRY FOREIGN DIRECT INVESTMENT SHARES
(per cent Caribbean Flows)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
ECCB	100.0	45.7	43.5	62.5	31.3	21.4	24.3	15.3	16.2	18.0	23.2
Anguilla	0	0	0	0	1.6	0.7	2.5	0.7	1.0	1.5	4.0
Antigua and Barbuda	33.5	15.9	13.3	17.5	9.0	6.1	3.2	1.6	2.2	2.7	3.0
Dominica	7.7	5.6	4.8	7.0	1.9	1.7	3.3	1.4	2.0	4.5	2.5
Grenada	6.7	4.6	6.0	4.3	2.0	1.8	3.8	2.3	1.9	1.9	2.7
Montserrat	7.0	4.6	3.8	2.0	1.4	0.9	0.7	0.5	0.6	0.3	0.1
St.Kitts	13.7	6.8	5.3	16.6	7.3	2.6	2.0	1.5	1.4	1.9	5.1
St.Lucia	21.5	6.2	6.6	10.8	6.9	6.6	6.6	3.8	2.9	2.7	3.5
St. Vincent and The Grenadines	10.9	2.0	3.7	4.3	1.1	1.0	2.3	3.4	4.1	2.5	2.5

ECCB and COUNTRY FOREIGN DIRECT INVESTMENT SHARES
(per cent Latin America and Caribbean Flows)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
ECCB	2.4	2.1	1.5	2.1	3.0	1.7	1.1	1.3	0.8	0.9	0.7
Anguilla	0.0	0.0	0.0	0.0	0.2	0.1	0.1	0.1	0.0	0.1	0.1
Antigua and Barbuda	0.8	0.7	0.5	0.6	0.9	0.5	0.1	0.1	0.1	0.1	0.1
Dominica	0.2	0.3	0.2	0.2	0.2	0.1	0.2	0.1	0.1	0.2	0.1
Grenada	0.2	0.2	0.2	0.1	0.2	0.1	0.2	0.2	0.1	0.1	0.1
Montserra	0.2	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
St.Kitts	0.3	0.3	0.2	0.6	0.7	0.2	0.1	0.1	0.1	0.1	0.2
St.Lucia	0.5	0.3	0.2	0.4	0.7	0.5	0.3	0.3	0.1	0.1	0.1
St. Vincent and The Grenadines	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.2	0.1	0.1

Table 3 FOREIGN DIRECT INVEST AS A RATIO TO GDP MARKET PRICES

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	Mean
ECCB	6.43	9.26	7.81	9.94	12.51	10.87	8.09	7.25	8.88	10.12	7.52	8.97
Anguilla	0.00	0.00	0.00	0.00	19.87	11.27	25.56	10.05	15.48	23.90	37.67	13.07
Antigua and Barbuda	9.19	13.47	9.73	11.55	15.47	13.33	4.72	3.29	5.04	6.76	4.05	8.78
Dominica	4.63	10.70	8.29	11.18	7.75	8.50	10.74	6.70	10.55	24.65	7.97	10.15
Grenada	3.11	6.69	8.13	4.92	5.95	6.85	9.51	8.61	8.14	8.49	6.70	7.01
Montserrat	11.85	26.12	19.60	8.91	14.29	14.41	7.88	7.83	11.64	5.54	0.80	11.72
St.Kitts	9.80	15.42	10.38	28.51	30.64	14.00	6.89	7.00	7.50	9.97	15.18	14.12
St.Lucia	5.37	5.07	4.88	6.98	11.04	13.27	8.35	7.22	6.56	6.01	4.52	7.21
St. Vincent and The Grenadines	5.76	3.49	5.54	5.97	3.87	4.19	6.39	13.18	19.58	11.67	6.66	7.85

Table 4. Government and Investor Equity in the Divestment of State Owned Enterprises[1]

Company and Country	Government Equity (Per Cent)	Private Equity (Per Cent)	Major Investor
SKANTEL (St. Kitts-Nevis)	18.0	65.0	Cable and Wireless
DOMLEC (Dominica)	0.0	71.9	CDC
GRENLEC (Grenada)	51.0	51.0	WRB
ANGLEC (Anguilla)	68.0	32.0	CDC
GRENTEL (Grenada)	30.0	70.0	Cable and Wireless
LUCILEC (St. Lucia)	12.0	43.0	CDC
Cable and Wireless (Dominica)	0.0	100.0	Cable and Wireless
Cable and Wireless (St.Lucia)	0.0	100.0	Cable and Wireless
Cable and Wireless (St. Vincent)	0.0	100.0	Cable and Wireless

1 All companies ending with suffix "LEC" are electricity companies those with "TEL" are telephone companies. CDC denotes Commonwealth Development Corporation. Cable and Wireless is a Multinational telecommunications provider operating in 70 countries with over 70 million subscribers.

Table 1. Results of System of Equations Full Sample[1]

Variable	Investment	Savings	Imports	Exports	Growth[2]
Constant	0.07 (3.02)	0.04 (2.34)	0.01 (0.20)	0.08 (2.74)	0.24 (3.79)
DFI_t	0.40 (3.80)	0.21 (1.62)	0.03 (0.17)	-0.22 (1.79)	-0.003 (0.49)
DCR_t	0.11 (1.39)	-	-	-	-
RER_t	-0.13 (1.98)	-	-0.23 (2.08)	0.05 (0.61)	-
GRW_t	0.40 (2.73)	0.06 (0.31)	-	-	-
$IY_{(t-1)}$	0.54 (7.25)	-	-	-	-
$SNY_{(t-1)}$	-	0.59 (7.66)	-	-	-
IY_t	-	-	-0.10 (0.74)	-	0.06 (3.91)
$OCAP_t$	-	-	-0.07 (0.53)	-	-
EXP_t	-	-	0.12 (2.01)	-	0.16 (7.66)
$IMP_{(t-1)}$	-	-	0.81 (11.2)	-	-
$EXP_{(t-1)}$	-	-	-	0.89 (20.8)	-
$GRW_{(t-1)}$	-	-	-	-	-0.001 (0.02)
$INGRW_t$	-	-	-	-	0.55 (2.60)
Adj. R^2	0.54	0.48	0.59	0.81	0.42

1. Numbers in parentheses are t-statistics
2. Variables in this equation are in real growth rates.

Table 1. Results of System of Equations 1980-89[1]

Variable	Investment	Savings	Imports	Exports	Growth[2]
Constant	0.28 (2.53)	0.02 (0.79)	-0.01 (0.15)	-0.002 (0.001)	0.04 (5.46)
DFI_t	0.56 (3.66)	0.52 (2.63)	0.14 (2.01)	-0.29 (1.49)	-0.002 (0.20)
$DFI_{(t-1)}$	-	-	-0.11 (1.56)	-	-
DCR_t	0.08 (0.81)	-	-	-	-
RER_t	-0.19 (1.91)	-	0.04 (1.01)	0.12 (0.89)	-
GRW_t	0.27 (1.24)	0.29 (1.19)	-	-	-
$IY_{(t-1)}$	0.49 (4.39)	-	-	-	-
$SNY_{(t-1)}$	-	0.41 (3.75)	-	-	-
IY_t	-	-	0.03 (0.61)	-	0.07 (3.65)
$OCAP_t$	-	-	0.05 (1.40)	-	-
EXP_t	-	-	0.09 (4.51)	-	0.13 (5.62)
$IMP_{(t-1)}$	-	-	0.55 (9.57)	-	-
$EXP_{(t-1)}$	-	-	-	0.84 (12.9)	-
$GRW_{(t-1)}$	-	-	-	-	-0.14 (1.52)
$INGRW_{(t-1)}$	-	-	-	-	0.53 (2.20)
Adj. R^2	0.48	0.41	0.78	0.75	0.40

1. Numbers in parentheses are t-statistics
2. Variables in this equation are in real growth rates.

Table 1. Results of System of Equations 1990-95[1]

Variable	Investment	Savings	Imports	Exports	Growth[2]
Constant	0.39 (3.17)	0.02 (0.64)	-0.03 (0.77)	-0.08 (0.58)	0.03 (3.37)
DFI_t	0.82 (4.01)	0.19 (0.75)	0.06 (0.61)	-0.07 (0.25)	-0.001 (0.16)
DCR_t	0.07 (0.76)	-	-	-	-
RER_t	-0.25 (2.15)	-	0.06 (1.49)	0.19 (1.27)	-
GRW_t	0.24 (0.84)	0.85 (3.06)	-	-	-
$IY_{(t-1)}$	0.29 (2.15)	-	-	-	-
$SNY_{(t-1)}$	-	0.53 (3.96)	-	-	-
IY_t	-	-	0.04 (0.68)	-	0.06 (3.26)
$OCAP_t$	-	-	0.01 (0.35)	-	-
EXP_t	-	-	0.09 (3.32)	-	0.11 (4.06)
$IMP_{(t-1)}$	-	-	0.57 (7.92)	-	-
$EXP_{(t-1)}$	-	-	-	0.83 (10.5)	-
$GRW_{(t-1)}$	-	-	-	-	0.02 (0.17)
$INGRW_t$	-	-	-	-	0.37 (1.56)
Adj. R^2	0.44	0.42	0.76	0.78	0.25

1. Numbers in parentheses are t-statistics
2. Variables in this equation are in real growth rates.