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Incentives and Impediments to U.S. Foreign Direct Investment in the Caribbean: Case Studies of the Dominican Republic and Jamaica

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A Synthesis Report

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I **Overview**

Susan Kramer's empirical study of the incentives and impediments facing U.S. investors overseas fills a significant gap of knowledge about how investors react to foreign country disincentives and how promoters of such investment can reduce these obstacles.

Based on seventeen interviews with U.S. investors in the Dominican Republic and Jamaica, Kramer has compiled a list of approaches used to avoid investment constraints and possible solutions to remove such limitations. The businesses interviewed identified a series of investment obstacles that can be grouped into five categories: **1) logistical bottlenecks, 2) political economy issues, 3) macroeconomic, 4) labor-related, and 5) legislative.**

Logistical Bottlenecks

Some of the constraints to U.S. investors overseas involve simple logistical bottlenecks that are not usually found in the United States. In the cases of the Dominican Republic and Jamaica, these consisted of erratic electricity supply, unreliable garbage collection, insufficient water pressure or purity, inadequate telephone service, and the frequent unavailability of replacement parts. Most businesses coped with these problems by simply paying more: by purchasing these services privately, by paying the proper authorities more to ensure service delivery, or by buying their own infrastructure (water tank or auxiliary generator).

Political Economy Issues

The most frustrating and entrenched obstacles that investors encountered were the different political, socio-economic, and cultural norms at work in developing countries. This primarily involved difficulty in dealing with unaccountable and poorly structured government bureaucracies as well as customs officials who were susceptible to bribes. Excessive documentation, poor inter-agency cooperation within the host country, inconsistent enforcement of regulations, and the overriding influence of political personalities in the business world also reduced the effectiveness of investors. Investors reacted with patience or by finding a sympathetic ear within in the bureaucracy.

Macroeconomic Issues

Certain macroeconomic policies also constrained investors. Typically these involved exchange rate controls and exchange rate policies. Inflation, repatriation of profits, and labor-related policies were also concerns. Investors related to these problems through normal business channels.

Labor-Related Issues

Insufficient skilled labor, inadequate supplies of unskilled rural labor, low productivity, high rates of absenteeism, and poor worker motivation represented some of the labor-related problems businesses faced. Firms resolved these issues through private and public sector training programs as well as by providing certain extra services to its employees, such as private bus services to reduce absenteeism.

Legislative Issues

Finally, investors complained of inconsistent application and adherence to policies in the U.S. (especially the CBI) and in the host country, particularly in regard to fiscal incentives.

II **Descriptions of Constraints and Possible Solutions**

A. Logistical Bottlenecks

Constraints	Possible Solutions
1) Erratic Electricity Supply (higher cost)	- use auxiliary generator - arrange advance notification of supply problems with host-country utility (especially for computer-based industries) - access main power lines directly - World Bank financing to deal with institutional problem
2) Irregular garbage collection	- buy own truck to handle refuse - contract out service privately - pay regular service additional fee to ensure regular service
3) Insufficient water pressure or water purity	- purchase own water tank and supply privately
4) Slow telephone hook up	- empower promotional agencies
5) Unavailability of replacement parts	- import at higher cost - find locals who can fix or advise as to others who can
6) Prevalence of drug smuggling	- hire private security service

	- develop special trust with certain employees - more customs security - revise U.S. "zero tolerance" policy - ship to smaller U.S. port where there is less chance of unnecessary stripping of containers

B. **Political Economy Issues**

Constraints	Possible Solutions
1) Excessive customs delays	- standardize regulations - depoliticize customs service by creating permanent civil service position - reduce documentation - streamline operations and reduce agencies involved, including export licensing - modernize and computerize equipment - greater flexibility needed among customs officials (why reject forms because of typos?) - more specialization among customs officials (so they know that one computer arrives in two boxes and is only charged once) - one of firm's employees specializes on customs matters only - use a customs broker (costly)
2) Unaccountable, disjointed, and politicized bureaucracy	- depoliticize bureaucracy, strengthen civil service, and reduce number of authorizing signatures - empower investment and export agencies to better assist investors in dealing with the bureaucracy <u>after</u> initial investment - consolidate promotional agencies (a true one-stop investment shop) - explain opportunity costs of lost investment because of poor public service to host-country authorities based on empirical information, such as interviews

Constraints	Possible Solutions
3) Highly personal/political and unpredictable business environment	- greater standardization and specificity of regulations - improve contacts within the government in certain agencies

C. **Macroeconomic Issues**

Constraints	Possible Solutions
1) Inflation	- fiscal policy reform
2) Foreign exchange policies	- exchange rate policy reforms - streamline foreign exchange approval and disbursement process by central banks - make foreign exchange more accessible to businesses - reduce cash flow disincentives, such as local currency reserve requirements
3) High local interest rates	- monetary policy reform - lower interest rates

D. **Labor-related Issues**

Constraints	Possible Solutions
1) Lack of administrative and semi-skilled labor	- increased vocational training with a focus on a business environment, basic business skills, and modern business machines (PCs) - increased cooperation between public and private sector (on-the job training) - pay more skilled workers more competitive wages - in-housing training of best staff
2) Low worker motivation	
3) High levels of absenteeism	- find out why and solve (provide private transportation to ensure their arrival) - create more specific rules on allowed absences
4) Language barriers	- teach more English in and private sector vocational training

5) Unreliability of rural labor	- hire more women who have proved more reliable in rural areas

E. **Legislative Issues**

Constraints	Possible Solutions
1) CBI incentive changes, influence of U.S. producers	- lobby for consistent CBI (no changes in ethanol legislation) - lobby for CBI-II and push for fewer exclusions
2) Repatriation of profit controls	- liberalize restrictions
3) Levels of foreign ownership permitted	- make more flexible in certain sectors
4) Lack of specific criteria for obtaining foreign exchange	- establish more specific rules

III Conclusions

The Kramer study begins a process of examining how businesses cope with the disincentives and impediments that they face as foreign investors. The study provides many concrete examples of the problems and solutions chosen to overcome these obstacles. However, the findings are limited, and surely the coping mechanisms discussed are not complete or necessarily the best. Yet they are specific and provide insight as to which areas investors will continue to need assistance and perhaps the ways that both A.I.D. and host country institutions can provide such assistance.

Three general observations from the information generated in the interviews come to mind. First, many businesses cope simply by paying more for the services they seek. On the one hand, this is a very practical and expected approach, one that is sure to be continued. On the other hand, it points to some of the implicit investment issues that need to be made explicit to host countries. Namely, that the real cost of investment is higher than it may appear in some countries, and that informed investors will make investment decisions accordingly.

A second general observation is that one of the clearest policy recommendations coming from the Kramer report is the need to empower promotional agencies to provide them better leverage in the overall bureaucracy <u>after</u> the initial investment is made. Successful promotion, whether in assembly manufacturing or tourism, is only truly successful if there is long-term satisfaction and reinvestment among investors. It appeared that many of the logistical bottlenecks facing investors could have been expedited or remedied with a sympathetic and powerful ear within the bureaucracy, which could be found in a agency with more leverage.

A final observation is that the Kramer study is largely descriptive and academic. The study, however, points to the need for more research in this area, works that are both descriptive and empirical but also analytical in their framework. Building on the Kramer study, future examinations should continue to detail the types of constraints and impediments facing investors but should link these constraints more directly to programmatic and policy reforms.