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Disclaimer

I want to indicate at the outset of my presentation that the opinions that I express are personal opinions and do not reflect the position of the Jamaica Stock Exchange.

Building a Caribbean Investment Culture

It is said that nothing focuses the mind as forcefully as the knowledge that at dawn the next morning you will die. If not a sentence of death, something closely akin to that might have recently been pronounced in the case of Pear Tree Bottom. This ought to bring into clearer focus the need for us in the Caribbean to build an investment culture that is consistent with our needs, yet responsive to international investment flows and in that order of precedence.

Standing here today, you must forgive me if I feel strongly that the last thing we need in the Caribbean is more talk. You certainly do not need another so-called expert to tell you what to do. Least of all, somebody from Jamaica. We, like the West Indies Cricket Team, have developed a scientific approach to the art of snatching defeat from the jaws of victory. Pear Tree Bottom testifies to this. For those who have not read about this significant watershed in the history of Jamaican investment activities, I will resist the urge to sing about "pipers piping, maids a milking and a partridge in a pear tree", because this is a serious issue.

Justice Sykes, in the Supreme Court of Jamaica in a judicial review, has quashed the decision by the relevant authorities to grant a permit for the building of a 1,918 room hotel at Pear Tree Bottom. This large hotel is being built on approximately 80 acres of land along the northern coastline of Jamaica, nestled by the sea, just outside of Runaway Bay. It is rich in bio-diversity. Local residents and environmentalists have for years lauded and enjoyed its picturesque grandeur. It teems with wildlife ranging from potoos and patoos to yellow snakes and yellow-billed parrots. It is agreed that it is a very sensitive area from an ecological standpoint, yet in the process of consulting with the public and the production of the necessary Environmental Impact Assessment, the judge found such significant short comings that he ordered the NRCA to reconsider its decision to grant a permit. The investors had spent US$62M and the hotel is 80% complete.

The implications and the consequences of this decision on investments in the Caribbean? Severe and far reaching. The judge said, "In these circumstances, I must give greater primacy to obedience to the law than to hardship to third parties and detriment to good administration." The reactions of the head of JAMPRO, the Government investment promotion agency was one of acute disappointment. She said, "It is clear that we are not ready to welcome foreign investment." She suggested that there was a love/hate relationship. I would suggest that this extends beyond Jamaica to the entire region when it comes to non-domestic investment. So we have to make up our minds. Governments in the Caribbean are known to give more favourable terms to investors from outside the region and from other territories than their own nationals. Is this necessary, desirable or sustainable? Nationals have a “necessary evil” view of non-domestic investment. Is this healthy for a country? To the same extent that Jamaica is viewed as “taking over” the service sector in some Caribbean islands, Barbados and Trinidad are viewed as taking over the financial and manufacturing sectors in Jamaica while foreign investment is viewed as biting the ripest cherries in our economies. The need to define and build our investment culture is critical. Pear Tree Bottom raises a significant question. When an investment will have a major impact on the economic future of the people, at what stage in the negotiations will government invite the participation of the people?

It is quite clear that the bureaucracy which ought to protect the public interest was so committed to advancing the project that the people had to go to court to protect their interest. They claimed that they had been agitating for their issues to be addressed for 10 years without being paid the necessary attention. While the investors no doubt have done what is required of them, they will now be as distrustful of the process as the people have long been

Professor C.Y. Thomas in a lecture recently stated: “Given the critical juncture at which the region finds itself, it is not altogether surprising that harsh comments and severe doubts have been expressed in many quarters about the **readiness, fitness, seriousness** and even **purposefulness** of the contemporary leadership elites in moving the Caribbean forward."

He went on to say, "We also face enormous pressures as the forces of globalization and liberalization transform the global economy and change the institutional architecture under which we undertake international transactions. These direct economic effects have been multi-dimensional in character impacting on production, technology, cross-border flows of people and financial resources, management and enterprise. "

In the process, the Caribbean faces both increased opportunities for engagement in the international economy, as well as increased exposure to economic insecurity. For example, he points to the dramatic expansion of the number and range of inter- governmental conventions and agreements to which the region is bound. These pressures have created international "best practice", norms and standards in the form of "state of the art benchmarks" which are expected to guide the region. To what extent have we adjusted and geared ourselves to properly implement these standards I would like to ask.

Further, the speeding up of communications, the intensifying of relations between countries and the bringing together of cultures into closer contact with each other have impacted immeasurably on the region's capacity to build national identity and therefore "investment" culture.

The truth is, every year we attend the Caribbean and Latin America Conference in Miami and are reminded that our investment and economic culture is defined for us in terms of **size, skill, bureaucracy** and

corruption. Let us not forget Pear Tree Bottom. It was the attempt to break the mold, accelerate the project and demonstrate that red tape can be dispensed with that ran afoul of the Rule of Law.

<u>Small Sizes of Caribbean Firms</u>

One of the limitations of Caribbean owned businesses is their relative small size. It should be understood that this is not a function of the size of the market they serve but the limiting constraint borne of the thinking of the owners. While we are still going through the transition phase where owner/managers are giving way to professional management, the issue of control is still deeply embedded in the psyche of the owners. As a consequence there appears a reluctance to grow companies to a size which outstrips the capability of the owners to manage.

Secondly, there is a decided preference among business owners to finance their operations with bank loans rather than equity. The constraint here, of course is that bankers need collateral and the company can only raise finance to the extent of its ability to produce collateral. The reasons advanced for the pre-occupation with debt financing are varied -

1. Ease of access – they can call their bank manager and arrange a loan quickly
2. They can retain control – and are not answerable to a large body of shareholders.
3. They do not have to disclose information that competitors might gain access to and put them at a disadvantage.

When we recognize that it is firms, not countries or regions that carry out trade and investment we begin to understand the Caribbean dilemma. Ambassador Dr. Richard Bernal, Director General of the Caribbean Regional Negotiating Machinery points out. ***"The issue of differences in size and small size has two dimensions"-***

a. Differences in size among countries
b. The differences in size among firms

He points out that larger firms have better prospects for international competitiveness and the enhancement of the international competitiveness of the CARICOM national economies must involve the enlargement of CARICOM firms. The various international agreements now in force have increased the exposure of CARICOM firms to international competition. ***"The biggest CARICOM firm Grace Kennedy of Jamaica,"*** he reminds, ***"had revenue of US$412 million compared to George Weston of Canada with US$22billion, B.P. Oil and Gas in Europe with US$174 billion and Wal-Mart in the US with US$224 billion. Grace Kennedy's revenue was 0.17% of Wal-Mart's revenue. The largest national CARICOM firm (in assets), NCB in 2003 had 4.4% of the assets of Petrobas of Brazil and 0.002% of the assets of Citibank of the US".***

My contention is that the investment culture in the Caribbean has led to such small enterprises that we are at a competitive disadvantage. The advent of the CSME is intended to impact on that culture to reorient companies to recognize the disadvantage of their size and seek capital to expand to take advantage of greater opportunities or lose out in the competitive struggle.

The issue of skills has been brought home forcible by the experience of Carib Cement in Jamaica. The company released faulty cement on the market and brought the construction sector to a grinding halt. The entire episode has been so poorly handled that the first quarter performance of a number of companies and indeed the entire economy has been affected. A report has now been produced that indicates that both the Bureau of Standards and the company did not have the proper monitoring and quality control mechanisms in place. The fact that Carib Cement is majority owned by Trinidad Cement is likely to have a "chilling effect" on cross border investments. Host countries in the region will need to more carefully examine whether they have the skills to monitor the investors coming to their shores

Industrialization by Invitation

Having said all of this, I will indicate where we have been in building an investment culture and suggest where we ought to go. The Caribbean has been inspired by the strategy of "**industrialization by invitation"** formulated by Nobel Laureate, Sir Arthur Lewis. The strategy consisted of attracting foreign capital through a series of incentives. I must press into service the views of Senor Esteban Perez who suggested that from the time of independence, the **"industrialization by invitation"** strategy has shaped the development path adopted by Caribbean economies and remains a fundamental pillar of our economies. The expansion of foreign direct investment however, has been accompanied by a stagnation of domestic investment, and I would like to suggest that that has been the defining feature of our investment climate.

Lewis' model for attracting investment was based on the need to acquire managerial, entrepreneurial and administrative skills - ceteris paribus. The problem with economic models is that ceteris never remains paribus. The attraction of foreign investment was a means of acquiring capital and entrepreneurial skills as Caribbean entrepreneurs would "learn by doing" and so start their own domestic firms.

With Lewis' guidance, Caribbean countries as they became independent, passed laws establishing fiscal incentives. It is remarkable that when the investment climate in the Caribbean is being assessed, it is the package of trade and investment incentives that is usually given prominence. So mention will be made of profit tax holidays, tariff exemptions, export allowances for extra-regional exports, dividend payments, loss carry forward and depreciation allowances. Attempts have been made to harmonize incentives across the region, but while the legal framework was conceived at the regional level, incentives were implemented at the national level and often there was a disconnect as national interest vary.

It is interesting to contrast the approach taken by Puerto Rico where government intervention by significant capital expenditures in education, transportation, housing, communications and irrigation provided a basis for the development of private enterprise. A policy of tax incentives was deliberately aimed at encouraging domestic investment.

The conclusion we can arrive at as we review these policies is that governments tend to have a preoccupation with large scale projects. Those are the most visible and from which most political mileage is derived. But it is the small businesses that drive development. We focus on the incentives that must be given to attract large capital intensive projects, and we have neglected the infrastructure to provide small businesses with startup capital. We are interested in groups that can develop 2,000 room hotels, but we do not ask how appropriate, in the long run, such a sized project will be for our environment and our economic development. Large investors are more committed to a speedy return on their investment to reduce their capital at risk. How the region's long term interests are factored in should be uppermost in our minds.

There is a fundamental difference between the economist's concept of investment and that of the financial manager. The economist considers investment to be the productive employment of capital for the production of goods and services. The financial manager is interested in the employment of funds to earn a return. In reality, it is the financial manager, who through the capital market, makes the funds or capital available through various instruments for the purchase of durable equipment, new construction and business inventories that make the economist comfortable when he talks about capital formation. How has the development of these activities progressed in the Caribbean and why are we today preoccupied with defining and building a culture, an environment, a model that is both reflective of our peculiar circumstances and appropriate to our needs?

The Enterprise Research Institute prepared a report for the Inter-American Development Bank in 2005 authored by Paul and Sarah Holden. This report assessed the Jamaican private sector and came up with some useful insights.

Some of these might be useful for our consideration. The report points to the low growth of the economy (which is probably true of nearly all our Caribbean economies except Trinidad) and the vulnerability to external shocks. The authors point to low productivity, low growth and private sector stagnation. "Private sector activity" they report "has stagnated in spite of relatively high levels of investment, implying that the marginal efficiency of investment is very low." The reason is not difficult to determine. They argue that "structural developments in the economy give grounds for concern."

It appears that the economy has evolved in three directions: the traditional manufacturing and agricultural sector which has been stagnating; dynamic, more modern services sector characterized by tourism and the increasingly large informal sector dominated by trading and low productivity services." They estimated the informal sector to amount to 40% of GDP and growing in size.

The conclusion is that misdirected policy has so skewed the investment climate that while we have attracted significant foreign investment, we have not been able to structure the economy to interface with those investments and therefore derive maximum benefit. On the other hand, our policies have driven our people into the informal economy. While we have an investment promotion agency that works with large projects to bring them to the table, the small indigenous investor has to "*fight the good fight*" with the bureaucracy and ends up in the informal sector, small and unproductive.

On the matter of investment incentives, they reported that “a recent study estimated that there are over 200,000 different incentives”, but is it really not possible to identify all of them accurately. The incentive policy was targeted at sectors of the economy that the investment promotions agency and others saw as having the greatest potential. That of course meant that those sectors that grew would benefit from tax holidays – quite a contradiction.

The authors’ conclusion and recommendation could assist us as we endeavour to build a climate in which investment can thrive.

1. Transaction costs are too high. *(We ask why do real estate transactions attract such high fees and taxes and take such a long time to conclude. If regulation is a public good, why do investors have to pay such high regulatory fees?)*

2. Resource allocation is distorted by incentives. *(If a project has to be given so many incentives, it probably should not be given such high policy priority.)*

3. The financial system does not intermediate effectively to fund investment and entrepreneurships. Smaller companies and sole proprietorships are left behind. *(How easy is it to obtain a second mortgage to free up the equity in your property*?)

4. The legal system is outdated. *(How easy is it to get a matter heard and resolved? How up-to-date are the laws of bankruptcy?)*

5. The modern mechanisms of businesses are available only to a small portion of the population forcing the development of a large informal sector.

6. The marginal efficiency of investment is low.

7. Overwhelming bureaucracy decreases the efficiency of the public sector and increases costs.

Against this background, the reality revealed in World Bank Data is as follows;

1. Net official flows of aid has decreased between 1990 and 2000 from 59% to 6%. *(The region is receiving less aid.)*

2. Foreign Direct Investment has substituted for official flows leading to demands for incentives. *(With greater foreign direct investment, governments collect less taxes because of the incentive regime.)*

3. Debt flows have become more significant. *(We are borrowing more.)*

4. Private flows increased from 26% to 94.5%(*This leads to more active repatriation of profits.)*

5. Large increases in foreign direct investment did not translate into or trigger corresponding increases in domestic investment.

6. Foreign direct investment has gone into those economies that had the highest levels of domestic investment.

7. Domestic investment as a percentage of GDP has remained unchanged at the regional level and for some countries has decreased.

Gross Domestic Invest. As a % of GDP Regional Average (World Bank)

Year	1981-90	1991-2000	2000
Percentage	25.96	25.69	25.61

Gross Domestic Investment as a % of GDP Selected Countries

Country	%	%	%
Jamaica	23.1	28.1	26.8
Barbados	18.6	15.2	18.1
Trinidad	20.3	20.7	19.1
St. Kitts	37.7	42.6	45.0

It is quite clear that there is a greater preference for foreign over domestic investment. In the paper presented to the Jamaican private sector the Holdens argue that the deteriorating export performance of most of the CARICOM economies makes them forever dependent on foreign capital. “The pressing need for foreign exchange has shaped and geared most of their internal policies to the capture of foreign exchange rather than to goals linked to domestic economic development.”

This is what motivates me to ask the question and make the suggestion, ***Should we not build a Caribbean Investment culture in which we clearly educate our people to understand the concept of risk and return as it relates to economic development?***

My considered view is that having embarked on a policy of industrialization by invitation, which has focused more on the provision of incentives to attract foreign investment and by foreign, we usually mean “extra regional”. We have neglected the need to inculcate within our own people the principle of risk and return and develop their entrepreneurial potential so that domestic investment can play the important role it must in our economic development.

It is only in recent times that Trinidad and to some extent Barbados has been making investments across the region and the absence of a “Caribbean”. view of investment has resulted in national newspapers continuing to present editorials that speak of “Bajan-owned” or “Trinidadian-owned”, suggesting that the company is not Jamaican-owned and therefore ought to be viewed as foreign-owned and not operating in the national interest. I remember being present at the entry of a Trinidadian company into Jamaica and the Chairman recounted the concern of Trinidadian shareholders when they were advised that the company was going to invest in Jamaica. They, like all other extra-regional investors, demanded significant concessions to compensate for the perceived “higher risk’. Suffice it to say that investment has turned out so well that the Jamaican part of their operations is contributing a major part of the profits.

Clearly, if we are to grow as a region, investors must have better information on the companies that are operating throughout the region so that they can invest with more confidence.

No doubt while governments of the region would like to trumpet their openness to investment from across the region, they are still more favourable to extra regional investments, and will often provide more facilitation. At the same time, the wider public has not been sufficiently sensitized to the need for regional investment, and we maintain a skepticism, if not a resistance, to being taken over by Trinidadian capital. Please do not forget that it is not many years ago that there was the same fear of Jamaican dominance. What is obviously needed is an approach to investment in the region that will enable the populace to identify with the companies operating in their economic space such that the company's success is their success.

Some of our companies that operate across the Region have begun to pursue this path by cross-listing their securities. The intent is to enable people across the Caribbean to identify with them by providing the opportunity from them to share ownership.

Recommendations

To build a culture of investment beneficial to both the users of capital and the providers of capital is to ensure that the objective conditions exist which will encourage investors to commit their resources into the hands of entrepreneurs and managers who can be depended on to fulfill promises made and provide a return for investors. From all that we have discussed so far the following recommendations seems a natural outflow:

1. Our educational institutions have to begin to seriously modify their curriculum to include the development of entrepreneurs. I went to the UWI where I did management studies. I received no entrepreneurial

training. I graduated intent on seeking employment rather than seeking opportunities to create employment.

2. The public sector, which presently dominates regional economies, crowding out the private sector and creating a high cost inefficient business environment, has to be radically restructured. For example, while we claim that capital is scarce in the region, our nationals hold significant resources in the banking sector. Jamaicans at the end of January held US$ 2.03BN in foreign accounts while the Bank of Jamaica held US$2.02 in reserves. This does not include the public holdings of Government of Jamaica US dollar debt.

   The Government of Jamaica has over the last 6 years raised J$518B locally and J$206B externally, a total of J$724 B. Compared to J$4.9B raised by the private sector in the Jamaican equities market. The situation is no doubt similar throughout the region. In Jamaica, it is estimated that the public sector accounts for 39% of GDP.

3. We must develop the financial markets in the region to enable the effective financing of investment and entrepreneurship. This requires that we both give attention to the development of our regional stock markets as well as financial intermediaries that provide long term development capital. To reiterate, while there is a preoccupation with foreign direct investments to fund large projects, we have not focused on the supporting framework of smaller projects which will enhance the benefits of those large projects to the region. The development of

our equities markets to provide long term risk capital to fund these necessary projects is an immediate priority.

4. Investment incentives must be simplified and rationalized so that rather than favouring the larger projects and forcing the majority of our indigenous entrepreneurs into the informal sector, the incentives can in fact lower the cost of doing business and encourage more of our people to invest in the region.

5. We must encourage more of our indigenous companies to share the risks and rewards of their operations by coming to the public market and raise equity capital to grow either by expansion or by acquisition.

6. Governments in the region need to map out a clear path for foreign direct investment to become public companies. There is the tendency for most of these ventures, especially in critical areas of our economies to proceed without public participation. Most of the hotels built in the Caribbean are privately held. While some are owned by Caribbean nationals, is there not a case to be made for more public ownership through listings on the various exchanges?

   I would suggest that whereas the government bureaucracy often does not have the capacity for effective monitoring when companies are publicly held, the exchanges, the media and analysts bring to bear greater and more effective pressure for disclosure and accountability and in our experience, listed companies tend to be better corporate citizens and pay more taxes.

Regional Stock Market

The Caribbean is not achieving its full potential because to a large measure, we end up competing among ourselves rather than cooperating for the benefit of all. The Stock Exchanges in the region is an issue in point. Some years ago the major exchanges under the auspices of the Inter-American Development Bank embarked on a harmonization project. As a result, the BSE, TTSE and JSE shared the same operating platform. Along comes the Eastern Caribbean Region and they determined that they needed to develop their own exchange and their own platform, even though the same platform could be linked to serve their needs. Their strategy was to build what they say is the most efficient system and then market it throughout the region. Their solution – close down the other viable, profitable exchanges in the region and use their Exchange as a regional exchange. The response of the other Exchanges is predictable.

The ECSE has an excellent advocate in the respected and articulate Governor of the Central Bank, Sir Dwight Venner. However, even his erudition cannot successfully contend with the logic of business. What we have is the experience of other regional emerging markets to guide us. Often the regional facilities are put in place and there is only limited use, not enough to justify the significant investment made. Our current experience with cross border listings is also instructive. We find that investors have the propensity to trade in the stocks from their domestic exchanges and there is limited trading on host exchanges.

The reality is that a compromise has to be struck. It is very unlikely that a company in Jamaica that paid J$50M for a seat on the Jamaica Stock Exchange will be prepared to agree to closing down the JSE. Another reality is that since 1996 when the JSE lost its tax exempt status, we have paid millions in taxes to the government of Jamaica and millions to our regulator the Financial Services Commission. Our government is unlikely to be thrilled at the prospect of a recommendation to close the Exchange

However in recognition of the need to advance the agenda and bring a regional market to fruition, the major exchanges have embarked on a program that will link their trading platforms to give brokers and investors access to all the stocks listed on the three exchanges. That is Phase One of the project. In the second phase, all the exchanges, including the ECSE, can be linked. This will remove the need for companies to be cross-listed and solve the over arching regulatory issues that are likely to emerge and take time to resolve should we immediately go to the concept of one regional Exchange.

Conclusion

What we cannot and must not fail to do is to motivate our people to recognize that the past is gone. The future will not be lost, if we take steps in the present to secure the future by developing a different attitude to investment in our region. We cannot refuse to lift up our eyes and see the opportunities which exist. We should not seek security by over zealous risk avoidance strategies. Otherwise, we will lose our entrepreneurial energy and sit on the sidelines expecting foreign investment to be our salvation. And while we no doubt will attract some enterprising investors, we will be left on the sidelines while the game is vigorously played out on the field before our eyes and to the visitors will be the spoils and our children and the generation to come will marvel at our lack of vision. At University, I had a classmate who told us her father was offered significant amounts of land on Beverly Hills, a hill range that overlooks the city of Kingston. Her father refused the land saying only goats occupy those rocks. Today some of the most expensive houses are perched on these hills, affording their wealthy owners a sweeping view of the city and the sea below.

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