Vulnerability and Resilience in the Investment Context in the Age of COVID-19: A Caribbean Perspective

By:

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The novel coronavirus disease 2019 (COVID-19) pandemic has reinvigorated discussions on the twin issues of vulnerability and resilience. In a previous contribution to the Afronomics Law Blog, my then co-authors and I demonstrated how the current pandemic has further confirmed the necessity of our on-going work here at the Shridath Ramphal Centre of The University of the West Indies, Cave Hill in Barbados on a Trade Vulnerability Index.

That index, which is presently at the conceptual stage, contemplates using a vulnerability index as a more equitable, scientific and effective methodology for determining World Trade Organization (WTO) Members' eligibility for special and differential treatment under the WTO agreements than the extant self-selection approach or the income-based approach mooted by the United States (US) as one of its four 'objective' criteria.

While investment is not *per se* a current focus of our TVI, this present article discusses vulnerability concerns in an investment context utilising Caribbean Community (CARICOM) Member States as the point of departure. It concludes by discussing the ways these countries have sought and could seek to build resilience.

The Importance of FDI to Caribbean Economies

CARICOM Member States generally have a very open orientation towards foreign direct investment (FDI), recognizing it as a more stable source of external private capital inflows than portfolio investment, with the added potential benefits of employment generation; knowledge, skills and technology transfer; and access to new markets.

A 2018 study by the Economic Commission for Latin America and the Caribbean (ECLAC) not only found FDI inflows to be the most important external private capital flows for the region, but that Caribbean countries' FDI receipts were high relative to their economic size. Caribbean countries are net FDI-importers, that is, countries where FDI inflows exceed outflows. The UNCTAD Stat database of the United Nations Conference on Trade and Development (UNCTAD) shows, for example, that in 2018 Caribbean countries received US$1,248 million in FDI inflows, compared to being the source of just US$168 million in outflows.

Although debate remains in the empirical literature regarding the extent of international investment agreements (IIAs)'s impact on countries' investment attractiveness, all CARICOM Member States have signed at least one treaty containing provisions meant to reciprocally protect, promote and liberalise the flow of investments between themselves and their treaty partner(s) with the aim of enticing investors to their shores. According to UNCTAD's International Investment Agreements Navigator, CARICOM Member States have signed a total of 83 BITs, of which 56 BITs are currently in force. The majority of these BITs were signed in the 1980s -1990s and early 2000s, with the most recent being the Guyana-Brazil and Suriname-Brazil BITs signed in 2018 but not yet in force.

FDI and Vulnerability

Many of the proxy indicators of vulnerability we use in a trade context for our TVI are applicable in an investment context:

Small Size: While several empirical studies have found small size to be insignificant to a country's ability to attract FDI inflows, what is not debatable is that it contributes to the asymmetric bargaining power between the State and foreign investors when negotiating state-investor contracts, particularly incentives packages. Small States also face resource constraints when seeking to defend themselves against an investor claim. Small size also relegates small States to largely being 'rule-takers' when negotiating IIAs with more powerful capital-exporting States.

Concentration and lack of diversification: FDI inflows to the Caribbean remain largely undiversified in terms of sector and origin, making them vulnerable to sector and origin-related shocks. An ECLAC (2014) report on FDI trends in the Caribbean found that FDI flows to the region were largely to the tourism, natural resources (commodity-dependent economies) and to a lesser extent, the export-oriented (offshore education and banking) sectors. The same study found the United States (US)to be the predominant source of FDI in the region, although Canada and China are also important sources.

Dependence on external finance: The 2018 ECLAC study found that "in most Caribbean economies, inward FDI as a share of GDP in the period 2008-2016 exceeded 6%, making them sensitive to variations in these inflows." Another sustainability problem ECLAC had raised in its 2015 annual report on FDI in the LAC Region was that "on average, the repatriation of profits derived from foreign direct investment is equivalent to more than three-quarters of the FDI inflows into the Caribbean". This is even more alarming considering that Caribbean governments, due to bargaining power asymmetries, often offer generous fiscal incentives (income tax and customs duties) exemptions to investors, resulting in foregone tax revenue.

Susceptibility to shocks: FDI flows, which are much more stable than portfolio investment, can still be negatively impacted by financial, weather-related and other shocks. Barbados, for example, saw a precipitous drop in real estate FDI inflows from the United Kingdom (UK) into its second home market after the Brexit referendum result in 2016 caused the significant devaluation of the UK pound sterling relative to the US dollar. In the aftermath of Hurricane Maria's devastation of Dominica in 2017, a major offshore medical university which had been domiciled there for many years relocated to another Caribbean country. As with the trade context, the COVID-19 pandemic has further revealed the extent of Caribbean small States' vulnerability in an investment context. For example, UNCTAD in its World Investment Report 2020 not only forecasts a 40% reduction in global FDI flows, but predicts a halving of FDI to the Latin America and Caribbean (LAC) region. Some investment projects which were in the pipeline have been put on hold as investors adopt a 'wait and see' approach.

Legal exposure to ISDS claims: While this is not a proxy we used in our TVI, it is worth noting that the vast majority of CARICOM countries' IIAs are older generation BITs which lack many of the development-friendly language and best practices of newer vintage IIAs and include investor-State dispute settlement (ISDS) as an option, increasing these countries' legal exposure to investor claims. Although most Caribbean countries' experience thus far with investor claims have been contract-based and not treaty-based, the threat of treaty-based claims looms larger now in the midst of the novel coronavirus (COVID-19) pandemic. This is because Caribbean governments, like those governments around the world, have had to implement stringent measures to contain and mitigate the spread of the virus, and may face claims from aggrieved foreign investors seeking legal protection under these BITs.

Building Resilience to Vulnerability

As outlined previously, small States, such as those in the Caribbean, possess several features which make them vulnerable in an investment context. However, there are concrete policy steps that they could take, and in some cases are already taking, to build their resilience, that is, their ability to withstand and recover from shocks. Below are a few:

First, Caribbean countries should accelerate their efforts to create a single investment space to mitigate the constraints of small geographic and population size. One of the initiatives under the CARICOM Single Market Economy (CSME) for some time has been the draft CARICOM Investment Code, which aims to transform the CSME Member States into a single investment space, boosting the sub-region's attractiveness to market-seeking FDI and also in theory strengthening the region's bargaining power vis-à-vis investors and in IIA negotiations with third States. Concomitantly, Caribbean countries also need to reduce the still high administrative barriers which make doing business across the region less seamless than it could be, such as the lack of a single registry for company incorporation or intellectual property registration.

Second, Caribbean countries must continue to diversify their sources of FDI to reduce their vulnerability to origin-related shocks. Some Caribbean countries have already begun actively targeting non-traditional markets, such as in Africa and Middle East, including by establishing a diplomatic presence there. Diversification of source not only includes the geographic origin, but also the type of investor targeted. With some four million people of Caribbean descent living outside of the region according to United Nations Populations Division (UNPD) data, the Caribbean diaspora remains one of the region's largest and most under-tapped sources for foreign investment. Research by the World Bank has found that relative to other global Diaspora groups, "the Caribbean Diaspora is large, educated, and professional and, more importantly, highly engaged, with a profound sense of loyalty as well as a sense of obligation to give back". Diaspora investment is not automatic, however, and Caribbean governments' investment promotion agencies (IPAs) should more actively target and 'court' the Caribbean diaspora as a source of FDI, which would require greater market research on the diaspora communities.

Third, as ease of doing business is an important factor in an investor's decision on where to invest, CARICOM countries should accelerate their business facilitation reforms to improve their FDI attractiveness. Even though Jamaica, for example, tops the English-speaking Caribbean in its ease of doing business rankings thanks to aggressive business reforms, no anglophone Caribbean country currently ranks within the top fifty countries on the World Bank Doing Business Index or World Economic Forum Global Competitiveness Index. This shows there is much work still be done in the region to boost the competitiveness and attractiveness of our business environments.

Fourth, Caribbean countries should also diversify the sectors in which they seek to attract FDI, ensuring they are areas of (potential) sustainable development importance to the country. The Government of Barbados, for example, has earmarked high technology manufacturing, fintech, medical tourism and education and alternative/renewable energy among its priority sectors for FDI attraction. This diversification would help mitigate their vulnerability to sector-related shocks, and also attract FDI in sectors in which investors may be more motivated to reinvest profits than simply repatriate them back home.

Fifth, CARICOM countries should also engage in a comprehensive review of their existing IIAs to determine whether they are fit for the purpose of attracting sustainable FDI and to reduce their current legal exposure to frivolous investor claims. Several countries worldwide have re-examined and/or overhauled their BITs to either limit the scope of applicability of Investor-State Dispute Settlement (ISDS) or eliminated it altogether. The Government of India in 2017 terminated 58 BITs, including the India-Trinidad & Tobago BIT, and has since formulated another model BIT used as the template for subsequent BITs. While a similar exercise, however, has not been done in any CARICOM country, it is sorely needed.

Current economic exigencies may make a comprehensive evaluation of their BITs low on the policy priority list for Caribbean countries. However, Caribbean governments should proactively protect themselves from ISDS claims arising from COVID-19 measures, such as deciding with their treaty partners to issue a joint interpretive statement for some of the most used (and abused) provisions by foreign investors like the fair and equitable treatment clause. Alternatively, they could mutually agree to exclude from ISDS applicability claims arising from their COVID-19 measures. At the bare minimum, Caribbean governments should support calls, like those made by the International Institute for Sustainable Development (IISD) in a recent paper, for a multilateral solution to prevent a possible barrage of investor claims emanating from governments' COVID-19 measures.

Sixth, CARICOM governments have largely taken a backseat on multilateral investment rule-making reform initiatives and should, therefore, consider adopting a more active posture in these on-going discussions given the importance of FDI to our development. Only four CARICOM Member States have so far signed on to the WTO's Joint Statement Initiative on Investment Facilitation for Development. Caribbean countries should also consider formally participating in The United Nations Commission on International Trade Law

(UNCITRAL) Working Group III on ISDS Reform. At its 50th Session in July 2017, the Commission, UNCITRAL's governing body, mandated a deliberation process on the reform of Investor-State Dispute Settlement (ISDS) to take place under Working Group III (WG III). Three phases were delineated: (1) identify and consider concerns regarding ISDS, (2) consider whether reform is desirable and, if so, (3) develop any relevant solutions to be recommended to the Commission. Several countries and non-State actors have actively participated in these meetings. Seeing that Caribbean countries have already had negative experiences with ISDS, it is in the region's interest to take a seat at the table of these discussions which have already moved on to the third phase, and to not simply relegate themselves to the position of 'rule-takers' instead of 'rule-makers'.

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