

# Chinese Rise in the Caribbean

## What Does It Mean for Caribbean Stakeholders?

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Group

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## **Abstract**

Chinese and Caribbean economic relations have deepened over the past decade and a half. The paper analyzes the impetus for China's foreign economic policy to reach out to developing regions such as the Caribbean, as well as highlights recent trends in merchandise trade and foreign direct investments, in particular between the Caribbean and China. Furthermore it indicates areas of potential benefits and risks, identifies some of the implications of these new South-South cooperation ties, and concludes with recommendations based on game theory insights to further deepen and more fully assure mutual benefit from the relationship going forward.

**JEL classification:** C78, F00, O01

**Keywords:** China, Caribbean, bilateral trade flows, foreign direct investments, bargaining theory, economic cooperation, Chinese economic foreign policy

## **From the China Sea to the Caribbean Sea**

The Caribbean states have long had very strong economic ties with North Atlantic states—Western Europe, Canada, and the United States. However, in recent years, economic ties with the People’s Republic of China, hereafter referred to as China,<sup>1</sup> have multiplied and deepened. Trade flows between the Caribbean and its traditional partners continue to be quite significant but flows of Chinese capital, credit, and foreign assistance have risen dramatically from a small base. This shift in economic relations carries a number of implications and represents both new opportunities and challenges in assuring mutually beneficial exchange.<sup>2</sup> This paper analyzes the impetus for China’s foreign economic policy and some of the implications of these new South-South cooperation ties, and concludes with some recommendations to further deepen and more fully assure mutual benefit from the relation going forward.

### **Reasons for the Boom in Chinese Foreign Investments and Financing**

In 1999, China adopted the Going-Out Policy of actively encouraging Chinese firms to invest overseas.<sup>3</sup> Most nations, especially developing ones, actively seek to attract inward flows of foreign investment and support outward-bound foreign investment only passively. China, starting in 1980—the beginning of its liberalization period—aimed to attract inward investments and was successful in creating an export-oriented manufacturing sector using inexpensive labor<sup>4</sup>.

The main goals of the policy of new outward promotion were threefold:

1. Gain access to needed natural resources
2. Promote the export of Chinese-produced goods
3. Assist in the development and brand recognition of Chinese multinational corporations, and by using mergers and acquisitions, obtain advanced technology and know-how.

The motivation that led to this policy shift stemmed from a combination of factors. First, China’s immense trade surpluses translated into growing foreign reserves (US\$3.69 trillion as of June 2015; average was \$767 billion over the period January 1980–June 2015). The size of surplus provided an impetus to search for alternative investment opportunities and not just be

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<sup>1</sup> The “other” China, Republic of China (ROC) will be referred to as Taiwan in the article.

<sup>2</sup> For an early discussion of the topic, see Richard L. Bernal’s book *Dragon in the Caribbean: China’s Global Re-Dimensioning Challenges and Opportunities for the Caribbean*.

<sup>3</sup> <http://www.uscc.gov/sites/default/files/Research/GoingOut.pdf>

<sup>4</sup> At the start of the liberalization period, China was a very low income country and had limited domestic purchasing power so a domestic consumption led model of development was not deemed a feasible avenue to achieve rapid growth. In 1980, the GDP per capita income was US\$193.00. By 2013, the figure had risen to US\$6,807.

content with investments in low yielding government securities. China, thus, emerged as the world's largest global creditor. Second, not only does China have a massive population, it also has a political-social contract between the ruling party and the populace to generate sufficient employment to reduce poverty rates quickly and enlarge the middle class. Third, China, with its double-digit growth rate, was encountering domestic resource constraints and mounting environmental degradation and had to look abroad.

Outward foreign direct investment is often facilitated by financing from state-owned banks—China Development Bank and China EX-IM Bank. The terms of the Chinese financial institutions are commercial, but the transaction costs are lower and the turnaround time for processing a loan is much more attractive than in Western-controlled development finance organizations (Gallagher, Amos, & Koleski, 2012).<sup>5</sup>

### **How Does the Caribbean Fit in the Picture of Chinese Economic Expansion?**

#### *Trade*

Since China emerged in 2009 as the world's largest exporter of goods and the fourth largest export of services, the percentage of total imports sourced from China has increased dramatically. Low-cost Chinese manufacturers have penetrated almost all markets. Import of Chinese products in the Caribbean region has mushroomed and many countries report China as one of its top five sources of imports. On the flip side, to fuel its rapid industrialization, China has increased imports of raw materials and emerged as a significant export destination for commodity producers in Latin America, but to a much lesser extent the Caribbean. (See Figure 1 with 2010 data for a glimpse of country-level trade structure). In rank order to 2010 data, Cuba, Dominican Republic, Guyana, Dominica, Barbados, Haiti, Suriname, Trinidad and Tobago, and Jamaica were exporting to China albeit at low percentages of total exports. Over time, the trade balance between the region and China has tended to deteriorate, with China selling or exporting more to the Caribbean than buying or importing from the region (see Figure 2 with data from 2000 to 2013). This indicates that the Caribbean region has much to do to promote exports to China. During the period covered, the Caribbean region has had a positive balance in only two of the years.

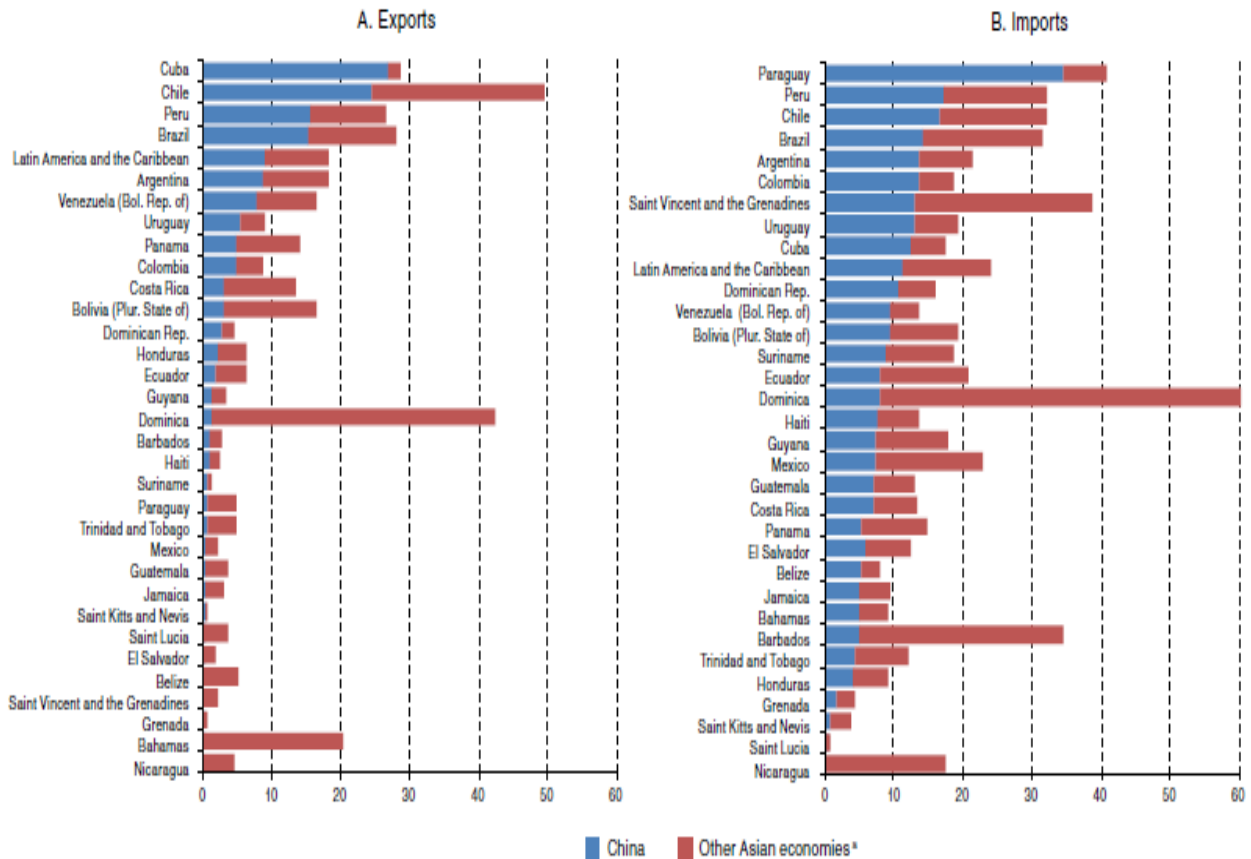
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<sup>5</sup> Note that many of the investments realized today are bilateral government deals. These transactions seem to feature softer or more concessional financing terms. Note, however, complete, detailed, and exhaustive information on each transaction is not available.

**Figure 1. Latin America and the Caribbean: Share of Asia-Pacific and China in Trade, 2010**

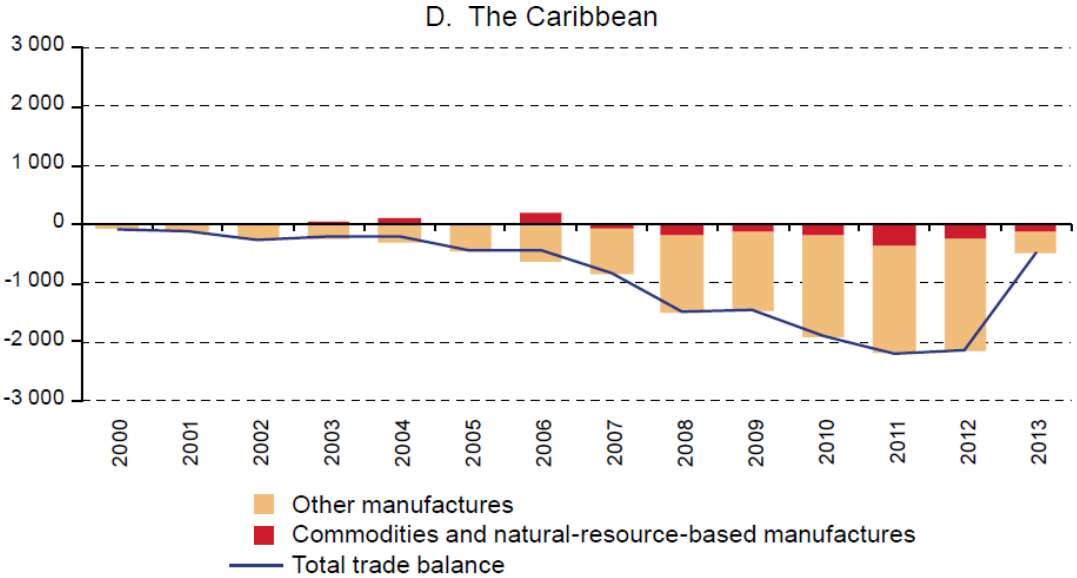
**Latin America and the Caribbean: share of Asia-Pacific and China in trade, 2010**

*(Percentages of total exports and imports of each country)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Commodity Trade Data Base (COMTRADE) for 2000 and official country data for 2010.  
 \*Other Asia includes Hong Kong SAR. China refers only to the People's Republic of China. Data for the Caribbean countries (except for Dominican Republic) are from the International Monetary Fund (IMF), Direction of Trade Statistics.

**Figure 2. Latin America and the Caribbean: Subregion’s Balance of Trade with China, 2000–14 (Millions of US dollars)**



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the United Nations Commodity Trade Database (COMTRADE).

The Caribbean countries that have benefited from the increased demand for primary goods are Cuba (metalliferous ores and metal scrap), Jamaica (aluminum oxide), Trinidad and Tobago (oil and gas), Suriname (minerals, timber), and Guyana (minerals, timber). The four leading products exported to China from the Caribbean states with available data are alumina (65 percent), timber (9 percent), nonferrous metal waste (7 percent), and crude minerals (4 percent) for the period 2006–08 (Economic Commission for Latin America and the Caribbean; United Nations Commodity Trade Database.)<sup>6</sup> The rest of the Caribbean is dependent on services—tourism, financial services, and call and data processing centers—which have not seen such a dramatic uptick in their exports. In general, merchandise imports from China have exceeded merchandise exports to China, creating a regional trade deficit with China.

*Investments and Financing Flows*

Compared with other parts of the world, the Caribbean has not been as favored in attracting Chinese foreign direct investments in absolute terms because the majority of its economies are small, tourism-dependent markets and not resource rich, but some have done better in relative

<sup>6</sup> The countries with available data include Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, St. Kitts and Nevis, St. Vincent and the Grenadines, St. Lucia, Suriname, and Trinidad and Tobago.



terms.<sup>7</sup> Most of China's outflows of investments and granting of loans have been concentrated in resource-rich developing countries. Over the past 8 years, China has lent US\$100 billion in total to Latin American and Caribbean governments and companies, but half of the loans went to Venezuela, followed by Argentina, Brazil, and Ecuador in rank order.

China extends financing principally through the China Development Bank and the Chinese Export Import Bank. By 2010, the two Chinese banks had loaned more money to Latin America and the Caribbean than the World Bank, the Inter-American Development Bank, and the US Ex-Im Bank combined. Most of the Chinese funding, however, was concentrated in a few countries and did not displace these historically dominant financial institutions on per country basis, except in the cases of Venezuela and Argentina.

In general, China has also shown a marked tolerance for risk by investing heavily in countries such as Afghanistan, Angola, Argentina, Myanmar, North Korea, Venezuela, and Yemen, which many business investors and commercial bankers consider to be either speculative risk investment opportunities or not creditworthy for loans as a result of deteriorating macroeconomic economic conditions, a history of previous debt defaults, or mounting political instability.

Similarly, in terms of outbound foreign direct investments, China's net outbound flow of foreign direct investments grew from US\$5.5 billion in 2004 to US\$90 billion in 2013. According to a recent study on China's Outward Foreign Direct Investment, 52 percent of investments by large Chinese firms were in the mining sector—with Australia and South Africa being the most important target countries—whereas 64 percent of medium- and small-sized Chinese investments were in the manufacturing sector, with Vietnam and the United States being the top two destinations in 2013 (Marukawa, Ito, & Zhang, 2014). Click on the following link to see map of investments between 2005 and 2013: <http://nyti.ms/1VEqhAR>.

As can be seen for data between 1998 and 2013 (see Table 1), the amount of Chinese foreign direct investment inflows into the Caribbean was concentrated in two offshore banking centers—the British Virgin Islands and the Cayman Islands. If you exclude these financial investments—which are liquid financial assets parked for tax advantage reasons (normally within special-purpose vehicles) and can quickly flow to other jurisdictions where the monies are actually invested in medium- to long-term construction, industrial, or mining projects—the flows to the Caribbean are miniscule compared with the larger Latin American states.

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<sup>7</sup> Nonetheless, a few Caribbean countries (Dominica, St. Vincent and the Grenadines, Grenada, Guyana, and Suriname) however, have received relatively more Chinese FDI stock as a share of GDP in 2011 compared to larger resource rich countries or countries that have stronger trading relationships such as Thailand, South Africa, Brazil, and Venezuela.

Excluding the BVI and the Caymans, the leading Caribbean destinations for the time period covered, in rank order, were Cuba, Guyana, Trinidad and Tobago, Suriname, and Jamaica. The other Caribbean states garnered less than US\$10 million. In more recent times, the largest Chinese investment has been the Baha Mar Resort in The Bahamas via a US\$2.4 billion loan from the China Export-Import Bank (Hotel News Now 2011). The developer of the project filed for bankruptcy protection on June 29, 2015 (Gleason & Fitzgerald, 2015). This motion was dismissed and the project is currently in receivership under the jurisdiction of the local Supreme Court. China State Construction and Engineering Company, the Baha Mar's contractor and the largest contractor in China, holds preferential shares in the amount of US\$150 million in the same project. China Harbor Engineering Company made a US\$50 million injection to assist in receivership fees, which brings China's total exposure to US\$2.6 billion (Gleason & Fitzgerald, 2015). Other investors are reportedly interested in taking over ownership and management of the stalled resort. In 2014, in Antigua and Barbuda, the Yida International Investment Group announced plans to invest US\$1 billion in a mega-resort in the twin island state of Singuliri (eTN Global Travel Industry News, 2014).

**Table 1. Outbound Chinese Foreign Direct Investments in the Caribbean Region, 1998–2013**

*US\$ millions*

Year	Antigua and Barbuda	Bahamas	Barbados	Belize	British Virgin Islands	Cayman	Cuba	Dominican Republic	French Guyana	Grenada	Guyana	Jamaica	Suriname	Trinidad and Tobago	Latin America and the Caribbean Region
1998					1	1									2
1999							1								1
2000	1														2
2001															0
2002															11
2003					2	3	1								12
2004					4	4									16
2005					8	9						1			44
2006		1			7	6	2								52
2007					14	8		1			2	1			57
2008				1	19	7				1		1			74
2009					35	5	10				2	1	1	2	130
2010					54	12	6				1		1	1	176
2011			1		86	12	3								207
2012	1	1		1	72	32	5				3			1	249
2013			1		39	10	5		1	1	2		2	1	322
<b>Total</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>412</b>	<b>138</b>	<b>33</b>	<b>1</b>	<b>1</b>	<b>2</b>	<b>10</b>	<b>4</b>	<b>4</b>	<b>5</b>	<b>1356</b>

Source. Marukawa et al. 2014.

Up until 2008, China pursued “Chequebook Diplomacy” in the Caribbean and with many other small, low-income states located in Central America, Oceania, and Sub-Saharan Africa, granting non reimbursable financial assistance to states as a way to encourage them to derecognize Taiwan (Republic of China). Recipient states would threaten to switch recognition between the two Chinas in order to extract more aid, thereby taking advantage of the rivalry between PRC and Taiwan. However, as relations between the two Chinas have improved, “Chequebook Diplomacy” came to an end.<sup>8</sup>

Currently, two Caribbean states, Dominican Republic and St. Kitts and Nevis, continue to maintain relationships with Taipei while the others have recognized Peoples Republic of China (Mainland China). These two tout the untiedness of Taiwanese aid as compared with Mainland Chinese aid. Much of the Mainland Chinese aid is for the construction of large public works and often is tied to the use of Chinese labor and materials.

### **Potential Benefits for the Caribbean States**

The rise of China undoubtedly represents significant positive opportunities for the independent states of the Caribbean.

First, China represents an attractive export destination (rising purchasing power, large market size), especially for commodity producers. The five commodity producers in the subregion—Belize, Cuba, Guyana, Suriname, Trinidad and Tobago—have already benefited handsomely from the commodity super cycle that China fueled up to 2011–12. The commodity boom is waning and commodity prices are expected to continue to decline over the medium term. Nonetheless, if Chinese authorities can manage to maintain growth rates between 5 and 7 percent and complete structural reforms while avoiding financial and environmental crises, China will continue to be a growth locomotive for its trading partners.

Second, China represents a new source market for tourists. In 2014, an estimated 117 million outbound Chinese tourists spent approximately US\$498 billion. Leading destinations were Hong Kong, Macau, the United States, and France (Plowright, 2015). The number of Chinese tourists is expected to double by 2020. Main constraints on Chinese tourism outside of Asia are the cost of long-haul travel and the limited amount of vacation time the typical Chinese worker earns in the year (Credit Lyonnais Securities Asia, 2014). To date, the typical Chinese tourist has tended to economize on food and accommodation and splurge on the purchase of

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<sup>8</sup> The two Chinas came to a tacit agreement not to openly compete for official diplomatic recognition in the rest of the world so as to not jeopardize their improving cross-strait relationships around 2008. One China Policy is now in effect and Taiwan is recognized by only 22 of the 187 countries in the world.

luxury goods. However, shifts in tastes and expenditure patterns are emerging. For the most recent data available, it seems that among the higher income Chinese households (>350,000 Rmb per year, equivalent to US\$56,402), they are spending more on entertainment and experiences (Credit Lyonnais Securities Asia, 2014). An opportunity clearly exists for Caribbean tourism- dependent economies to target this higher income bracket, those who may be seeking different experiences and opportunities to explore far-flung and exotic cultures. For the Caribbean to capture more of the Chinese market, many changes and investments would have to be made—streamlined or visa exemptions for Chinese nationals, more five star hotel properties, better personal and property security, more offering of Chinese cuisine, hiring of Mandarin and Cantonese speakers as staff and tour operators, sensitizing staff and tour operators to Chinese cultural proclivities and differences, developing marketing materials and signage in Mandarin language, offering more price-competitive shopping experiences<sup>9</sup>, and establishing more airlift connections.

Third, it represents an alternative and flexible source of loan finance and foreign direct investments. Already, state-owned development banks in China have surpassed the World Bank in lending, and outbound foreign direct investments from China to the rest of the world have multiplied. Chinese financing, however, tends to have strings attached. Loans from state-owned banks tend to support the penetration of Chinese multinational corporations abroad. See Box 1 for some of the notable projects financed by the Chinese in the Caribbean.

What distinguishes Chinese loan and grant capital is that it is not accompanied with “policy conditionality” as is the case sometimes with the more established international finance institutions such as the International Monetary Fund, the World Bank, and regional development banks as well as bilateral donor organizations. China is a pragmatic partner in foreign relations, willing to engage with a wide spectrum of regimes, irrespective of quality of governance, political conditions, financial conditions, or state of development. Most importantly, China is also open to accepting repayments in physical commodities, especially oil, which broadens access to

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<sup>9</sup> According to 2013 World Tourism Cities Federation report titled “Market Research Report on Chinese Outbound Tourist City Consumption,” Chinese tourists spend US\$128.7 billion abroad, with 58 percent of expenditures on goods as opposed to 13 percent on food and entertainment. Chinese concentrate on purchasing Western luxury goods. The implication being that Caribbean tourism stakeholders will have to work hard to provide price competitive duty-free shopping outlets if they want to attract Chinese tourists. At present, many duty-free luxury items such as electronics in Caribbean locales can be had at the same price in New York City before the administration of sales tax, so the competitive advantage is negligible. According to same report, 52.11 percent of Chinese tourists said that they would be attracted if they could enjoy more beneficial tax rates and discounts for purchasing foreign goods. Other attractive factors are beautiful vistas (73.56 percent), unique culture (68.64 percent), and long history and abundant museums (53.06 percent). Unfortunately, this report did not seem to capture data on the Caribbean destinations. However, from this study, it would seem that Caribbean has potential as a destination selling “unique historical/cultural experiences, beautiful beaches and scenery,” and possibly “luxury shopping.” Further and more in depth marketing research is needed to confirm and verify.

countries that may be illiquid or have a history of loan defaults and thus have no access to traditional capital markets.

### **Box 1. Chinese Construction Services: Tip of the Spear**

Chinese construction firms have been involved in number of large scale projects in the region that often combine largesse with Chinese labor requirements. Below is just a sample but by no means exhaustive.

#### Antigua

- Sport stadium (20,000 capacity)
- Singulari Tourist Resort

#### Bahamas

- Sport Stadium
- Baha Mar Hotel Resort (started in 2011, receivership 2015)

#### Barbados

- Renovation of Sam Lord Hotel

#### Dominican Republic

- Punta Perla resort

#### Dominica

- One Mile Agricultural Station and Agricultural Demonstration Centre
- Dominica State College
- Newton Primary School
- Upgrading and Maintenance of E.O. Leblanc Highway with Bus Shelters

#### Trinidad and Tobago

- Prime Minister's official residence
- Dry Dock
- Hospital
- National Academy for Performing Arts

#### Guyana

- Marriott Hotel
- Skeldon Sugar Processing Plant

#### Jamaica

- Montego Bay Convention Center
- Goat Island Transshipment Port
- Kingston Airport Road and Seawall Defense
- North South Highway
- National Complete Plant Import and Export (Sugar processing plant)

#### St. Kitts

- Hospital

#### Suriname

- Ministry of Foreign Affairs Building
- Roads
- Housing schemes

*Source:* Compilation from news periodicals.

## **Potential Challenges for Caribbean States**

Beneficiary countries need to ensure that they have clear strategic development goals, adequate negotiation capacity and robust institutional safeguards when considering financing and investment transactions from any bilateral source. In engaging China, Caribbean states clearly should seek to enhance bargaining positions but they must at the same time be aware of potential trade-offs. In bilateral bargaining, the burden is on each party to negotiate well, but differential institutional capacities and asymmetric information may weaken bargaining positions and impede optimal outcomes. Below are a few examples of how practical realities in the region today may constrain optimal negotiations and how Caribbean partners and stakeholders may be susceptible because they are likely to be the weaker party in the negotiations, a priori, the party desirous of an injection of financial capital, which is in scarce supply, but offering a resource or an opportunity for which there are many other substitutes or competitors.

First, Chinese multinational companies have been criticized in several countries for having “low local content,” that is, not hiring local labor, using only minimal amounts of locally-sourced materials in turnkey operations (e.g., building of roads, ports, stadiums, hotels, hospitals, dams) or failing to honor tax holiday contracts by incorporating value adding activities in extractive businesses. As a result, the development impact may be reduced especially in the case where the local unemployment rate is high and qualified local talent is displaced or underused. The argument used to defend low local content is that local firms in the Caribbean generally have low capacity to deliver complex and large-scale projects on time. The low-content proposition, however, reduces the spending multiplier effect and does little to build know-how or add value to local resources. Since China has significant over capacity in steel and cement industries and surplus labor, these “tied deals” would seem to serve Chinese interests. Thus, there is a tradeoff between rapid completion with a minimum of local input into the project; and slower implementation with higher local input. The former option has the downside of reducing, a priori, the multiplier effect of the investment.

Second, the institutional capacity of the host country should ideally be strong in monitoring and enforcing compliance with assorted labor, environmental, and consumer safety standards vis-à-vis any foreign investor, but less than perfect capacity is a fact of life and low capacity is a hallmark of underdevelopment. Therefore, host countries have to be extra cautious in engaging with companies that either come from home environments with nonuniform application of best standards or who are still on a learning curve and adjusting to internationally recognized best practices. Some Chinese firms have been accused of being more lax in

complying with environmental regulations, and given that the majority of Chinese investments are in environmentally sensitive sectors such as energy, mining, and dam and road construction in developing countries, this may pose a reason for concern and make the case for extra efforts to improve enforcement capacity on the part of the host country. Phillip Stalley found that home country environment governance and standards affect the behavior of multinationals abroad and China suffers from weak and nonuniform enforcement of domestic environmental regulations, making the ability to adhere to stricter environmental standards abroad more problematic.<sup>10</sup> Several Latin American media sources report allegations of less than satisfactory compliance with environment safeguards for example in construction projects and operations of mines and dams in Argentina, Ecuador, and Peru (Krauss & Bradsher 2015). Nonetheless, in 2013, the government of China, in an attempt to improve standards, issued new environmental guidelines for Chinese firms operating abroad calling upon them to abide by local regulations, develop integrated risk management and mitigation systems with reporting mechanisms, support community development, and communicate with stakeholders about sustainability issues (Wang, 2013). Information on implementation of these new guidelines is not readily available.

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<sup>10</sup> In a 2009 study, the Chinese Ministry of Environmental Protection reported that 15.5 percent of projects started without construction permits, 9.6 percent of enterprises that were closed for environmental reasons resumed production without permission, and that 25 percent of the main sources of pollutions were attributed to failure to adhere to proper operating processes and/ or improper use of machinery.



**Box 2. Comparative Analysis of Environmental Standards Applied: Comparison of Traditional Development Banks and China Development Bank**

<i>Specific Guidelines</i>	<i>World Bank</i>	<i>Inter-American Development Bank</i>	<i>China Development Bank</i>
Ex-ante environmental impact assessment	X	X	X
Industry specific social and environmental safeguards	X		
Ensure compliance with host country environmental laws	X	X	X*
International environmental laws and regulations	X		
Public consultations with affected communities	X	X	
Grievance mechanism	X	X	
Independent monitoring and review	X		
Ex-post Environmental Impact Assessments (EIAs) and Evaluations	X	X	X
Covenants linked to compliance	X	X	

Source: Gallagher et.al. 2013.

\* If host country standards are inadequate, firm can follow either Chinese standards or international best practice.

Third, transparency, accountability, and full appropriation of benefits are overarching goals in any bilateral relationship. When these elements are missing the distribution of benefits may be skewed or fail to be realized. When foreign partners are prone to nontransparency in business practices this may reinforce the power of corrupt local elites, especially in country settings with compromised procurement systems, weak systems of oversight and audits, inadequate enforcement of anti-corruption laws and a weak press that could serve as deterrents or countervailing sources of power in the host country. According to Transparency International, Chinese companies tend to publish little about country-to-country operations (revenue, taxes paid, capital expenditures), reveal little about organizational and signed contractual arrangements, such as corporate holdings, interlocking board memberships, political contributions, effective prices for goods and services rendered) and they tend not report on audits and internal anticorruption mechanisms.<sup>11</sup> Moreover, Chinese companies and banks

<sup>11</sup> Transparency International published a report in 2013, titled “Transparency in Corporate Reporting: Assessing Emerging Multinationals,” on the public reporting practices of 100 leading emerging market transnational companies (i.e., having operations in

have also shown flexibility in repayments. For example, in the case of Venezuela, much of that country's US\$20 billion outstanding debt to China is structured to be paid in oil (Hausmann, 2015). However, the terms, conditions, and effective costs are unknown to the Venezuelan public and international observers. Therefore, it is difficult to objectively assess money for value propositions or to conduct cost/benefit and other types of economic and financial analysis. The two leading Chinese financiers of development projects in developing countries tend not to publish or list on their websites Environmental Impact Assessments for their major projects in either Chinese or English (Gallagher et al. 2013). These proclivities and tendencies could pose another challenge for host countries with weak institutions and again point to the need to strengthen their capacity as quickly as possible and aspire for full transparency and accountability.

### **Game Theory Insight**

If China and the Caribbean can be likened to two agents engaged in a strategic game where a joint production function is being employed to produce some “good or service”, the benefits and risks of engagement can hypothetically be represented by the following pay off matrix with three dimensions (see Table 3). Both parties have to join together and collaborate in producing some “good or service” that will yield value or benefits to each based on demand for the good or service. Assuming constant demand and fixed prices for the end product or service to simplify matters, the quantity and quality of inputs will obviously matter. If we abstract away the importance of physical quantities by assuming a Leontief type fixed proportions production function, then we can focus on the latent or not easily observable characteristics such as management quality and effort. Furthermore we posit that these qualities can become important in determining the outcomes and distribution of benefits in a joint production or joint engagement setting.

To advance the argument that latent or unobservable variables matter, we assume that the critical dimensions of interaction are the following:

- 1) Vision: a planning horizon for engagement/investment that can be either short-term (less than 3–4 years approximate to one electoral cycle) or long-term(>5 years approximate to placing a value on national development goals);

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multiple countries) and 9 of the worse 11 performers were Chinese.  
[http://www.transparency.org/whatwedo/publication/transparency\\_in\\_corporate\\_reporting\\_assessing\\_emerging\\_market\\_multinational](http://www.transparency.org/whatwedo/publication/transparency_in_corporate_reporting_assessing_emerging_market_multinational)

- 2) Effectiveness: ability to appraise financial propositions, negotiate deals, execute signed agreements; properly supervise, monitor, and/or implement contracts; and
- 3) Appropriation: Whether the benefits derived from the “engagement” are appropriated or captured by a few in the form of “rents” or widely distributed or reinvested toward enhancing future productivity and growth.

To simplify matters, we further assume that China ranks more favorably in all three dimensions (higher scores being preferable) and this bestows an advantage in capturing returns in the joint production function and in shaping bargaining strategies and strengths. We assume that China has a long-term vision, that is, that China is willing to sustain losses in the short term, invest capital and wait patiently for a larger return in a distant future (lower discount rate) as opposed to expecting a positive return within a year or within an electoral cycle); that it has superior execution and implementation capacity; and that the returns or benefits of the investment/ transaction/ project are widely shared among its national stakeholders in the activity (e.g., managers, shareholders, national government, laborers, suppliers, shippers). On the other hand, we assume that the Caribbean counterparts have variable rankings that can be either high or low.

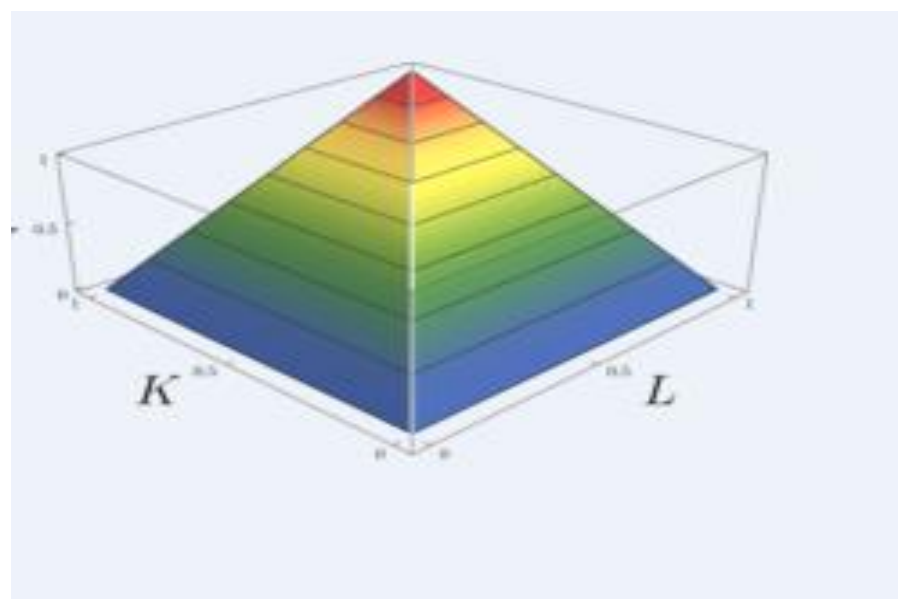
Formally, this can be represented as follows:

$$Q = \mu_{\text{Caribbean}} \cdot \beta_{\text{China}} \text{Min} ( z_1/a, z_2/b )$$

Where  $z_1$  and  $z_2$  are the input quantities utilized and  $a$  and  $b$  are technologically determined constants.

The introduction of  $\mu$  acts as a shifter that can be envisioned as a variable that captures the latent or unobservable qualities of vision, effectiveness, and appropriation. If  $\beta_{\text{China}}$  is assumed equal to 1, the upper bound, and if  $\mu_{\text{Caribbean}} < \beta_{\text{China}}$ , a mismatch of Caribbean and Chinese characteristics will lower the amount of total possible output. In Figure 3 below, instead of an output of 1, it could be a fraction of one.

**Figure 3. Example of Leontief Fix Proportion Production Function**



Source: © Luca Verginer.

Payoff values can be likened to a bilateral bargaining game and depend on the Caribbean counterpart values in relation to the three aforementioned key characteristics. A full array of characteristics of the setting of the host Caribbean country (e.g., nature of political culture, proximate time to a severe economic downturn or recency of a natural disaster shock, proximity to upcoming elections, macroeconomic conditions) will shape whether the strategy of engagement will be “accommodative and impatient” or demanding or “hard-nosed”. An accommodative position will result in a less favorable division of the value generated in the “engagement”—lesser payoff— and a less accommodating, more demanding and hard-nosed strategy should result in a more near equal distribution of the value generated in the “engagement”. For example, if the Caribbean agent is more interested in implementing the project quickly to gain political credit or to capture a return for narrow elite at the expense of the larger society, the strategy could be more likely accommodative rather than disciplined. If the Caribbean representative suffers from asymmetric information and inexperience in structuring a deal, the bargaining strategy adopted may be more accommodative or suboptimal from a societal perspective for the simple lack of information.

The matching responses for the two bargaining agents can then be summed and compared over two states, either a high capacity state or a low capacity state (see Table 2 which contains illustrative payoff values). If the Caribbean representative agent closely matches

the latent capacities of the Chinese counterpart, then the payoff will be equal to the Chinese counterpart and higher than in the case where the Caribbean representative has gross mismatches in time horizons, effort, and capabilities.

If the Caribbean representative agent has a short-term horizon, that is, a strong desire to complete the project quickly (high discount rate) so that credit can be claimed before the end of an electoral cycle regardless of cost, quality, or expected return considerations, the project with the larger return or the one that is more cost effective or of higher quality may be sacrificed, yielding a lower payoff. Alternatively, if the capacity to appraise, negotiate, and execute is low, poor terms and conditions may be agreed to or the benefit stream could be much lower than expected. Similarly, if capacity to implement and enforce contract conditions is low, the expected benefits may not be obtained. For example, “low local content deals,” costly implementation delays, or inability to generate a positive supply response to an export opportunity (i.e., the Caribbean cannot meet the volume and quality terms and conditions of the export contract) can singularly or jointly combine to reduce payoffs. Last, if the benefits of the “engagement” are largely concentrated in the hands of rent-seeking Caribbean elite or the proceeds are not reinvested in new productive activities to spur longer term growth, then again the payoff is low. One example of lack of appropriation can be failure to monitor or enforce the conditions of tax holidays or the granting of tax holidays that are overly generous in view of what other jurisdictions are granting (race to the bottom). The result is benefits being privatized and risks and costs being socialized. Those who capture the outsized tax breaks increase profit margins and the host country’s public treasury could continue to be short of revenues and unable to make important expenditures in public goods and services, which in turn reduces overall welfare, competitiveness, and growth prospects.

**Table 2. Illustrative Pay-Off Matrix for a Joint “Engagement” Function**

<b>Dimensions</b>	<b>China (fixed characteristics)</b>	<b>The Caribbean (variable characteristics)</b>	
<b><i>Vision:</i></b> Existence of a long-term vision of economic gain (low discount rate)	Long term 10	Long term 10	Short term 5
<b><i>Effectiveness:</i></b> Degree of capability or effectiveness: <ul style="list-style-type: none"> <li>• to gather and analyze information</li> <li>• to negotiate terms</li> <li>• to execute and deliver according to contract</li> </ul>	High 10	High 10	Low 5
<b><i>Appropriation:</i></b> Ability to appropriate rents/returns for the benefit of largest number of stakeholders	High 10	High 10	Low 0
<b>CUMULATIVE</b>	30	30	10

### **Summary and Recommendations**

In summary, the growing economic ties between the Peoples Republic of China and Caribbean states may appear to be symbiotic but deliberate precautions and steps have to been taken to ensure mutual benefit, otherwise benefits may be one-sided or limited.

The Chinese have a clear objective of pursuing the “Going Out Policy” in general and in raising its economic profile in the Caribbean subregion by securing access to markets and raw commodities, making profitable investments, and generating employment and procurement opportunities for its nationals and registered companies.<sup>12</sup> To date, it would appear that China has been fairly effective in achieving most of its stated goals.

As China’s growth rates moderate (growth between 5 and 7 percent as opposed to double digits), financial market frailties are confronted, and the country shifts to a more consumption-driven model as opposed to an investment-driven one, China will have less demand for commodities and less surpluses that can be recycled into foreign direct investments and foreign loans. In addition, some observers claim that China has engaged in aggressive expansion, thus increasing its risk exposure. That it may be in for an unpleasant awakening in the near future by repeating the errors of traditional development and Western commercial

<sup>12</sup> Current Chinese President Xi Jinping and Premier Li Keqiang are revamping the strategy, advocating a more focused approach centered on exporting higher value manufacturing goods and technology (high speed rail, electric power plants, autos, aircraft, electronics etc.), in short a “Going Out 2.0” predicated on industrial upgrading. [http://www.huffingtonpost.com/china-hands/china-going-out-20-dawn-o\\_b\\_7046790.html](http://www.huffingtonpost.com/china-hands/china-going-out-20-dawn-o_b_7046790.html)

banks in terms of lending too recklessly to certain countries with unsustainable macroeconomic conditions and even volatile and uncertain political settings (*Huffington Post*, 2015). These new developments may lessen Chinese interest in the Caribbean region, a trend which Caribbean policymakers need to take into account, revamp their own strategies of engagement with China based on short- and medium-term forecasts, and press for more impactful ties.

From China's perspective, the Caribbean is a minor subregion, a relatively resource-poor one with a relatively small market of 41 million people, compared with Sub-Saharan Africa, Latin America, and South Asia. China's total involvement and exposure in the Caribbean subregion is comparatively small when viewed in light of its engagement in other regions of the world, especially South Asia and South America, and therefore its risks profile is much lower.

From the Caribbean's perspective, China represents a new export destination, an alternative source of capital, and a new source of tourists. To tap into all the opportunities presented by China, however, Caribbean states will need to introduce policy changes and engage in several structural reforms to build competitiveness and become more dynamic and attractive, such as a manufacturing platform, a logistical hub, or a premier tourist destination for higher-income Chinese.

The evolution of the growing economic ties has been in three phases. The first stage consisted of just trying to win diplomatic allies in international fora by using aid and finance to persuade Caribbean states to derecognize Taiwan.<sup>13</sup> Simultaneous to this was the steady rise of Chinese exports as share in the total imports of merchandise goods. The second phase had been the growing presence of its construction firms working on public infrastructure projects and burgeoning direct investments in the extractive sectors (timber, gold, bauxite, oil, nickel) of the main commodity exporters in the subregion: Cuba, Guyana, Suriname, and Trinidad and Tobago. As commodity prices decline, it is likely that Chinese outbound foreign direct investments to these countries will also diminish. In the third and latest phase, Chinese investment is beginning to support tourist resort complexes (Antigua and Barbuda, The Bahamas, and Dominican Republic) and port and logistical facilities (The Bahamas, Jamaica, and Trinidad and Tobago), probably in light of tourism as the economic mainstay for much of region and the expected increase in shipping traffic associated with expansion of the Panama Canal. As Cuba opens up to the massive US tourist market and positions itself to catapult pass the Dominican Republic as the largest tourist destination in the Caribbean, Chinese construction companies could be well positioned to assist in a hotel construction boom and related tourist

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<sup>13</sup> See Richard Bernal's book, *Dragon in the Caribbean*, and Caitlan Campbell's report for more details on the rivalry for diplomatic recognition between the two Chinas that lasted until 2008.

infrastructure investments in Cuba given long-standing relations with the Cuban government already.

The most singular and noteworthy unexploited opportunity for the Chinese in the Caribbean subregion is to mount export-oriented businesses to take advantage of preferential trade arrangements between signatory Caribbean states and the United States and Canada. These investments may be slow in materializing because of low labor productivity, high transport cost, high energy costs, and other impediments to competitiveness that beset most of the Caribbean states and again underscore the need for policymakers to redouble efforts and address these particular weaknesses.

Still another unexploited Chinese opportunity may be in helping the subregion shift its energy matrix toward renewables. The existing foothold of Chinese construction firms in the subregion, mixed with China's dominant position as the one of the world's lowest cost manufacturers of photovoltaic cells, offers China another mutually beneficial opportunity to be exploited (Tofler, 2015).

A third area that can be exploited is the market for tropical, high-value specialty crops such as spices, peppers, coffee, and cacao; however, production levels of coffee, citrus, cacao, and bananas have been declining in the Caribbean outside of the Dominican Republic. The possibility for agricultural exports from Latin America and the Caribbean to China is high, but Latin American countries with better endowments of land and fresh water and lower labor costs are much better poised to take advantage of this opportunity. Caribbean agricultural producers will have to focus on branded specialty crops.

In general, publicly elected authorities and private sector representatives in the Caribbean express the desire for more access to financing, more direct investments, more tourist arrivals, and new export opportunities with China to spur growth. They generally see the rise of China as a positive development. Whereas the region's aspiration to engage with China is clear, it needs to strengthen its ability to execute deals and implement action plans which will lead to obtaining a greater level of benefits out of economic relations with China. Caribbean states must continue to improve their business climates; invest in human capital; enhance labor productivity; build competitiveness; control corruption; demand higher levels of local content; seek transfer of skills and know-how; assure that requirements for tax incentives are complied with as well as labor and environmental regulations; learn how to better structure and negotiate public-private partnerships; and learn how to appropriate returns, especially natural resource rents and channel them into pro-poor strategies.



Given that most Caribbean states are fiscally constrained and suffering from low growth cum ever mounting debt burdens, the revenues needed to make the aforementioned investments and structural reforms may be scarce and the time needed to complete the institutional reforms considerable. The opportunity to exploit near-term Chinese trade and investment deals could represent a means to spur growth and increase public sector revenues and thus a way to break the “chicken and egg” dilemma of which comes first, reform or growth. Thus, the bargaining theory dictum to be “well informed, protect your own interests, negotiate well, and execute well” becomes ever more salient to escape this vicious cycle and move to a virtuous path.

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