Beyond Tourism

Why our strategy isn't working
and what we need to do to fix it

The Grenada Study

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Proven "next steps"
applicable to most countries
of less than 5 million people"

30 June 2010

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Issue

Since the 1970's Grenada has been struggling to address its most persistent challenge: how to chart a sustainable path to economic prosperity. Put another way, *how do we go about improving our standard of living without selling ourselves down the tube?* Many small countries have not produced clear solutions to this dilemma.

Trinity

In the late 1970s three things were drummed into our heads that have become an almost sacrosanct strategic Trinity:

- Commandment # 1: Foreign Direct Investment (FDI) is "God",
- Commandment # 2: Tourism Sector Development will be our Savior and
- Commandment # 3: More education: skill capacity "salvation" will surely follow

Early adopters (Bahamas, Barbados, Bermuda) have leveraged this strategy well. But, for the latecomers (Grenada, St Vincent and others), Tourism FDI and more education have not produced the expected economic miracle. In particular, Tourism FDI is no longer the "best value" option for them to pursue. Here's why:

Tourism FDI is good for you

By the mid 1980s we had accepted the Gospel according to the World Bank, USAID and others and started attending "Development Church". Those who advised us (mostly foreigners) and those who bought into their pre-packaged models and rationale (including me), assumed that unless we secured large amounts of FDI our formula would be incomplete and we would fail.

So, like good disciples, we invested over US$500 million in lots of infrastructure: new roads, a big airport, and a new cruise ship port facility. We offered increasingly generous concessions to investors. From the 1990s onwards, we measured our progress by how many new (tourism) investments were "in the pipeline" or rumored to "soon start". The obsession with Tourism FDI is understandable: according to Grenada Industrial Development Corporation (GIDC)-sourced data, it was 55% of total investment inflows in 2005; 74% in 2006 and 100% of all FDI commitments in 2009.

But what has such blinkered commitment actually "brought" for us?

In the early years there was reasonably genuine investment in our first hotels and in some manufacturing businesses. More recently, what we got was lots of "cowboys" promoting grandiose concepts. We then learnt that they could not raise most of the capital they claimed to have access to. We got our share of cashless speculators – those bent on "flipping" property before they had even paid for it - inclusive of transferable concessions to their buyers as well as tax exemptions on the windfalls they expected on instant sales.

Even so, no one dared challenge our home-grown "Cocoa Cola" prayer: Foreign Investment in Tourism is ***it***! If you did you would be summarily dismissed as narrow-minded; misinformed; a theoretical radical – or all of the above.

Golden Fleece or Illusion?

What the eyes see (mega cruise ships and condominium billboard ads) the mind believes. But has Tourism FDI actually produced payback so significant that it is worth the costs?

In Grenada, there is limited commercial verification that Tourism FDI has been overwhelmingly good for us. Statistical evidence suggests that we are yet to realize substantial benefits. Our average annual income, at US$6,000 is among the lowest in the region. Grenada's hotel and restaurant sector's contribution to GDP, in net terms, is less than that of the contributions from other growth sectors such as off-shore medical education and construction. Further, the direct impact on employment has been modest. The US State Department's 2010 Investment Climate Statement on Grenada, which references GIDC-sourced data, shows that a total of 715 permanent jobs were created by FDI inflows between 2005 and 2009, averaging 143 new jobs annually. That 5-year total is equivalent to 1½% of our 48,000-strong labour force.

Exogenous factors such as economic downturns, hurricanes, new competitors in other hemispheres and scale limitations have eroded local hotel profitability. Many are now concession-dependant, needing never-ending tax and duty free exemptions – just to stay cash-positive.

Regionally, when we compare our performance with that of the leading OECS countries, our indicators are less than half of their levels. In 2009, according to the Caribbean Tourism Organisation (CTO), Grenada registered 113,000 stay-over visitors while St. Lucia had 278,000 and Antigua, 234,000. In terms of cruise ship passengers, Grenada received 340,000, St. Lucia 699,000 and Antigua 713,000 in that year.

A predictive response to these comparisons is to argue for increased FDI. But three pivotal questions need to be answered first.

- How attractive are we to FDI and how successful have we been at attracting it?
- What is it costing us to attract FDI and can we afford those costs? and
- If the costs are excessive, is there another option that we should look at instead of this standard FDI model?

So how well is Grenada actually doing on the attractiveness front? The findings of a 2004 FIAS FDI-environment benchmarking study of 201 companies at various stages of investment in five Caribbean countries (Grenada, Barbados, Trinidad and Tobago, Dominican Republic and Jamaica) are instructive. Grenada scored the highest of the group in terms of personal safety (low crime) and second in terms of infrastructure and quality of life. But we came in dead last on receptivity to foreign investment, air transport, and labour issues. There are shortages of trained professionals, limited skilled personnel, low productivity, a militant negotiating environment and inflexible labour laws. Professional fees per hour in Grenada were twice as high as Barbados, the second ranked highest-cost provider in the group. Our unskilled labor costs were also in the group of highest-cost countries. Grenada's average import tariff was at least three times higher than the other four. Overall ranking of Grenada was around 4 out of 5 where 1 is the highest and 5 is the lowest comparative score.

How successful have we been at attracting FDI? When compared with St. Kitts & Nevis, the top-ranked OECS investment location, both countries were registering around US$20 million/year in FDI in 2000-2001. According to FDI.net, by 2006, Grenada's FDI was $120 million/year while St. Kitts & Nevis had reached US$200 million. The gap is much wider on a per capita basis: By 2006 FDI in St. Kitts and Nevis was four times that of Grenada's since the former's population is less than half that of the latter's. St. Kitts had secured a 400-room Marriott hotel over the same period while Grenada's last major hotel (La Source) was built about 15 years ago.

What about FDI attraction costs? Over 40 years ago, when we got into the business of luring foreign investment, we offered a basic package: a 10-year tax holiday and duty free imports of raw materials, fixtures and fittings. Today, investors are demanding and getting much more than that. In the last five

years, what we have conceded to them is now resulting in considerable losses of tax revenue which we badly need for essential maintenance and replacement of infrastructure.

A 2005 IMF Working Paper estimates that concessions cost Eastern Caribbean Currency Union (ECCU) countries between 10 to 16% of GDP in foregone revenue annually. Grenada's Minister of Finance, in his 2010 Budget Speech, put that number at EC$60 million (about 5% of GDP). Such tax breaks – in effect, implicit subsidies – are indicative of our unwavering adherence to Commandments #1 and 2.

So what are we actually giving up for what we are getting in? Since FDI was estimated at US$95 million in 2009, giving up EC$60 million a year in taxes means that our effective annual cost of attracting FDI, at least going forward for the next five years, is around 23%. But if we used the IMF estimate of at least 9% of GDP or an ECLAC average for ECCU countries of 10% of GDP then foregone annual tax revenue would be closer to US$64 million or EC$172 million – based on 2008 GDP of US$638 million.

What does it cost us in terms of our income stream? Another IMF Working Paper, "What Attracts Tourists to Paradise", estimates that tourism-related taxes account for 58% of total tax revenue. Assuming that <u>all</u> services are tourism-derived, and using Grenada's 2010 tax revenue estimate of EC$520 million, we are giving up EC$60 million to get $302 million. This is equivalent to a business offering a sales discount of around 20% to its customers.

But the tax revenue contribution of the tourism sector itself is much smaller. For St. Lucia it is around 25%; for Grenada the number is probably closer to 30%. Using this more direct estimate, then the discount i.e. the tax concessions of EC$60 million would actually be closer to 38% of related tax revenue. Clearly, the cost of attracting tourism-related FDI has become astronomical.

Regardless of the number you choose to use, if this were a business it would be losing money "like rain". It would have to shut up shop because it simply could not sustain such operations if it had to continually offer such large discounts to its customers.

Empirical evidence supports my own basic observations: The 2004 benchmarking study referenced earlier points out that for foreign firms in the Caribbean, tax concessions did not rank among the most important factors for investment decisions. Instead, the availability of telecommunications services, power supply, political stability, a favorable attitude toward FDI, business climate, and labor productivity played a more important role and are therefore much stronger influencing factors. In particular, keeping abreast of world-class ICT capacity and quality is much more important than other infrastructure to foreign investors.

The IMF 2005 ECCU-specific Working Paper suggests that taxes have played a limited role in attracting FDI and that the benefits of incentives, in terms of increased FDI, are far outweighed by the tax revenues forgone. A 2008 IMF study "The Caribbean: Enhancing Economic Integration" and other reports such as "Fiscal Policy and Tax Reform in the Caribbean" concur with this position.

Blind Belief

So why have we continued to place all bets on FDI-driven tourism? One reason is that desperation often blinds "in-your-face evidence" to the contrary. For instance, why is our tourism product, with a few exceptions, so unimaginative and does not stand out as unique in the region or on the world stage? And how come the relative contribution to our total annual income i.e. GDP, from hotels has stayed so flat (around 10 - 12%) over the last 10 years? Furthermore, why is it that our 25-year old "international" airport has not opened the foreign investor floodgates into the sector - as was anticipated by consecutive governments over the same period? In April 2010, there were less than 10 international flights per week to/from Grenada.

We have nurtured Tourism FDI with awareness campaigns, tax payers financing of marketing costs, and EC$4 million in subventions to international airlines to bring in larger aircraft, sometimes with unfilled seats in 2009. Despite all this, we still don't have critical mass. Almost all our hotels and guest houses are small scale i.e. less than 200 rooms. Most struggle to maintain even average room capacity in the off-season. The smaller ones have significant cash flow problems and have difficulty paying bills and servicing loans. Barring a few boom years, I am sure that many of them would agree that this has been the case since 1990.

Aging clichés are warning signs of outdated strategies (*we don't want mass tourism; our strategy is to be an exclusive location etc*). That way of thinking was perhaps pertinent before 2000 but not realistic today.

One reason our product is struggling is that we have not yet accepted that you <u>do</u> have to be "all things to all men" to compete more effectively. Jamaica's extensive product mix is an excellent example of this. Large hotels (400 rooms plus) can improve country visibility and improve airlift because of strong global brand awareness. Also, in economic downturns they have the capacity to keep their hotel beds warm. This is the case in St. Kitts, where one hotel alone, Marriott, bring in 50,000 guests each year – on their own. In theory, smaller players could piggy-back on the bigger operators' marketing effectiveness.

Interestingly, Cuba and Jamaica were the only two Caribbean destinations to register modest positive growth in stay-over visitors in 2009 – primarily because they are Branded Volume-Driven (BVD) destinations.

But attracting big hotels also exposes the smaller ones to severe competition because the larger operators can sell their products at much lower prices and can offer consistently dependable services. In the case of St. Kitts almost none of the boutique hotels are likely to survive the Marriott *hurricane*. Many have already converted sections to offshore medical student residences and are unlikely to be in the hotel business by 2020.

Forebodingly, the World Bank's 2005 report, "A Time to Choose", and an April 2010 ECLAC report on Tourism both suggest that the OECS product is at the mature stage of its life cycle and that sector competitiveness is slipping, especially when compared with highly energised and newer global destinations.

Still, a word of caution is necessary at this point: we should not generalize that FDI is "bad for us"; to the contrary, it is still an extremely important catalyst of economic prosperity. However, the challenge we face is how to change the composition of our FDI so that we 1) get our fair share and 2) reduce the cost of attracting it.

Hotel California

Now let's move on to the third commandment, education and skills development. Despite unquestionable national commitment, so far, our emphasis on education has turned out to be a zero-sum game. As fast as we train them, our talented young people migrate to more lucrative shores. In her book, the Story of Grenada's People, Beverly Steele estimates that 30,000 people left Grenada between 1984 and 2000. So for the last 30 years or more, we have remained perpetually skills-deficient.

Undaunted, we increase our funding and commitment to HRD in national education budgets. In contrast, private sector training levels are much lower than they could be. A 2007 World Bank study "Training the [OECS] work force" found that 85% of the large firms in the Dominican Republic provide training to their workers; the Latin American average is 75% while Grenada's is 48%.

We also train skilled workers more than we do unskilled ones: 8 out of 10 large firms offer training to skilled workers while only 3 of 10 offer training to unskilled employees. Furthermore, OECS Governments do not foster development of private sector-run part-time training services. The combination of low training levels and our incessant brain drain means that we keep starting over – training the young and re-training those would don't or can't leave.

But negative outflow can also produce positive inflow. The IFAD report "Sending Money Home" points out that remittances by Grenada's 50,000 Diaspora, at US$162 million in 2006, was equivalent to 31% of GDP. This is the highest share of GDP of Caribbean countries. Comparatively, remittances eclipse the net foreign exchange from other mediums such as tourism or product exports.

Forest from trees

Each time I present my perspectives to Believers they counter with examples of "success stories" or potential winners that are "just around the corner". This is understandable because Disbelief is anathema to converts and difficult for even agnostics to visualize and then digest.

The thing is, I agree with the Believers about success stories. There have been admirable achievements at business and individual levels. But a few blooming trees is not a conclusive indicator that the forest is healthy – nor can sustainability be assured by throwing lots of fertilizer on it when you are repeatedly confronted with visible signs of ill health.

A different view

From where I sit, the evidence strongly favors a complete "re-think' of our priorities.

It will take considerable self-confidence to change course. Recently, a Grenada Government decision not to proceed with a multi-million dollar investment in a private project was not well-received in some circles because of the absence of a cohesive stimulus package to boost economic activity. Nonetheless, our governments should not be committing substantial sums to ventures that cannot access most of their investment capital from commercial sources. Typically, such projects call for exemptions that most of Grenada's home-grown entrepreneurs could not even dream of getting. In many countries this approach is being promoted as Public-Private Partnerships (PPPs) – which is neither the intent nor core purpose of this mechanism.

Equally important, when any industry becomes volume driven (for example, sugar, rice, bananas) your survival becomes brand and cost- rather than "price-premium dependent". The Caribbean is now competing in the (tourism) volume business: net returns are tapering off and we are dependent on *highly robust global economic performance in source countries* to stay afloat. This would suggest that we need to look at Tourism through new strategic lens e.g. as a transitioning feeder-system for other growth sectors that have, for the last 10 years, exceeded the net performance of the stay-over visitor industry.

Anyone doing a "quick and dirty" value-for-money assessment would notice that the following (newer) sectors stand out in terms of income and wealth creation in Grenada:

1. Offshore Education
2. Yachting and Marina Services
3. Entertainment and Sporting Events
4. Expatriate homes and services

Up until the recent global financial crisis, all four sectors were growing faster than 10% a year in various parts of the Caribbean. For instance, in Curacao, the marina industry was growing at 30%

annually. Some sectors, like offshore education in St. Kitts, have increased revenues by 10 – 12% in 2009 and 2010, the two worst economic years in recent history. Yet, when you look at relative support provided by OECS Governments, the strategy is upside down: standard tourism is supported by multi-million dollar budgets in the form of a full Ministry, a marketing board, and investment promotion/publicity.

Offshore education, which is Grenada's No.1 industry by far, is largely left to its own devices. Also, yachting and marina services do not get nearly the level of support as Tourism does, and entertainment and sporting events are in a similar minority "boat".

If Tourism was a real business and not being subsidized or exempted from otherwise normal product costs such as import duties, the owners would have fired management "long time" . . . or shut down the business . . . or it would be on the verge of insolvency - which is about where we are right now with our excessive national debt.

Alternatively, both owners and management would have 1) taken a closer look at the "business" they were in and 2) set out redefining the business they s*hould* be in.

The business that Grenada is actually in

Whether we see eye-to-eye on my next point or not, this is what I think we are "selling" in the economic growth sector/human capital arena:

- Investor giveaways, including considerable amounts of forgone tax revenue
- Primary development of human capital that more developed nations then get for free
- Limited access to our domestic market and immigration policies that exclude non-citizens from participating in health care, training and education services etc.

The business that others are in

In contrast, most successful countries are doing the exact opposite thing to us: the US, Canada, UK, and even smaller ones like Singapore, Cayman, and St. Maarten.

The larger countries encourage their investors to go abroad to earn tax free income on their investments in our countries. Those companies *must pay taxes on that income in their home countries* – if they are operating under resident-based tax systems. The smaller countries expand their domestic market size at exponential rates by increasing the inflow of mostly skilled persons.

Many large nations or regions advertise extensively for Skills (Canada and Australia) or open up their markets to attract trained people (the European Union). They offer all sorts of incentives to encourage highly talented immigrants who study there to stay on and contribute value-added knowledge after they graduate. They actively discourage the best foreign graduates from returning home because they, the host countries, place such a high premium on Human Capital.

Why we are in The Matrix

In the movie, The Matrix, freedom was a three step process: 1) accepting that the Matrix actually existed; 2) understanding how it was created; 3) finding its Achilles Heel and then eliminating its psychological stranglehold of society. Likewise, we first have to understand ***how*** we got into the maze we are in before we can spell out ***what*** we should do to get out of it. We are in a recurring spell of excessive debt singular dependency on FDI and deficient levels of Human Capital (skills competency) because:

- Our primary growth platform, namely, our population base, is too small and its growth rate inadequate for creating a robust consumption and investment environment. Our resulting tax revenue base of 48,000 people is too small and incomes too low to sustain genuine and unavoidable costs of maintaining essential infrastructure such as schools, hospitals, roads, ports etc. These are the two underlying reasons why we exist in a recurring algorithm of unsustainable debt > deteriorating infrastructure > debt reduction > infrastructure replacement > unsustainable debt.

- We get "stuck-into" increasing our support to things we were told were good for us and grew up with. We are unable to see that they are ageing, no longer cutting-edge, or that they have been supplanted by other more vibrant opportunities and challenges. We got stuck-into Sugar and Bananas and are now doing the same thing with conventional tourism.

- We simply don't have enough "idea power" on the island to generate the entrepreneurial ***energy*** we need to turbo-charge our economy.

Grenada's population, since 1990, has been growing at about ½ of 1% a year. This translates into an increase of 500 persons annually. It does not take a complicated analysis to conclude that the resulting growth in consumption is insignificant in term of increased sales, taxes and new business opportunity. How much "new sales" can you achieve as a country when all you have to "share" or tap-into is 500 new clients annually?

Our relatively static consumption base leaves Government with little choice but to continually raise taxes to meet increasing public sector operating costs. The introduction of VAT, new methods of computing property taxes and special "tax levies" are extracting what little is left of disposable discretionary income from businesses and consumers. According to a July 2009 Commonwealth Secretariat presentation on Sustaining Development in Small States, Grenada's tax burden in 2003, at 28% of GDP, was the third highest in the region. Overall, our small economies are so close to their maximum tax potential that recent new taxes will have regressive impacts on current and near term GDP growth.

Further, because local market size is not increasing, the private sector has only two options to ensure continued profitability: 1) limit its wage bill and 2) pass on all product cost increases to consumers. The result: suppressed wages, lower discretionary disposal income and therefore less (new) business investment opportunities for existing businesses and new SME entrants.

I have already touched on the issue of our over-dependence on Tourism FDI. Symptoms include erasure of our endangered Dove, costly Ministry-level support to the sector, the loss of considerable tax revenue due to tax holidays and duty-free concessions, subsides that we commit to airlines. These are clear signs that staying on course may not be the best option. Similar commitments to prop up Bananas as a niche industry, including over Euro 200 million made available by the European Union, failed to ensure that sector's survival.

The lack of robust "idea power" is also axiomatic. Although we talk about the importance of the private sector being "the engine of growth" the evidence across the OECS is that it had been Government spending, not private sector investment, that has been the driving force of economic growth. The World Bank, in "A Time to Choose" points out that, since 2000, public sector investment has been outstripping that of our business communities. Also, private investment has actually been on a downward trajectory relative to that of the public sector.

There are multiple explanations for this phenomenon. One is that the private sector lacks the technical knowledge associated with aggressive entrepreneurial thinking and performance. Many critics point

out that local businesses are "margin gatherers" and not true investors. That view is only part of the picture. Local business thinking is also quite logical and pragmatic: why invest in new things when the consumption base is so static; when total disposal income is not increasing, and when there such a miniscule number of additional consumers to sell to?

If you are still reading this paper, it is possible that you are beginning to question whether the course we are pursuing will ever get us out of the quagmire that we are in. My overall conclusion is that, thirty years on, the FDI-Tourism recipe has lost most of its effectiveness. If we continue on this path we will be digging ourselves deeper into a resource-deficit hole by not adopting a value-for-money approach to economic growth.

Holy Grail

At this stage it is important that I open the window on the universal secret behind sustainable development, at least in the Western World. I have already alluded to it: for the last 150 years the world's most successful countries, regardless of size, have anchored everything that they do to one core strategy - the deliberate acquisition of skilled human capital. I call this the Holy Grail.

Some examples and evidence[1]:

- The largest single exodus in the world in the last two centuries occurred between 1800 and 1950 when 60 million people migrated, mostly from Europe, to the United States. America continues to owe it economic prowess today to that same strategy: in 1950 the USA's population was 161 million; in 2010 it will be 310 million.

- Australia advertised for 190,000 skilled persons to immigrate to Australia in 2009: 97,000 new migrants entered Australia between January and March that year. It is one of four key reasons why that country had been able to buffer the recent economic crisis more effectively than other emerging economies and larger more developed nations.

- Singapore's main economic strategy is based on being home to a highly skilled workforce. Besides investing heavily in ICT and human capital to meet global competition, it is focusing on becoming the "skills talent capital" of the world[2]. Consequently, since 2000, its new-resident growth rate has been four times as high as that of its citizen-growth rate.

- Almost all Caribbean countries that have increased their populations exponentially in the last 20 years (Cayman, Turks and Caicos, Bahamas, and St. Maarten) have out-performed those whose populations have been static since 1990 (Grenada, St. Vincent, St. Kitts & Nevis, Dominica). St. Maarten's population grew from 45,000 to over 85,000 in the last 20 years and 72 different nationalities now live there.

- More densely populated islands (Barbados, Bermuda, and St. Maarten) have higher average incomes than the low-density ones. Bermuda's average is US$80,000 per year – the highest in the world - and its poverty line is US$40,000. Our average income is US$6,000/year which is about 15% of someone at the poverty line in Bermuda.

There are two reasons why Grenada and others have not looked for the Grail yet.

[1] An excellent source of evidence and perspectives: http://www.migrationinformation.org
[2] For more information go to: http://www.migrationinformation.org/Profiles/display.cfm?ID=570

The first is that we don't want to find it. Xenophobia (fear of foreigners) is abnormally high. We deliberately limit the participation of wealthy or highly skilled persons in our domestic markets, mainly to protect local businesses from competition. Protection is almost absolute in areas such as education, law, medicine and health care. But excessive xenophobia is just a manifestation of lack of confidence in our ability to be good as or better than outsiders in our own space – and a lack of motivation to do so. Both schisms are illogical since Grenadians easily rise to the top of their game after they migrate to more competitive environments. That begs the question: why are we so insecure about doing the same thing at home?

The second reason is that the Grail ***is*** *an unspoken trade secret*. No sane nation is going to pass on their methods to others because, by nature, successful countries, like well-run businesses, don't parade trade secrets in public.

In my 25 years as a consultant I have never come across any Development literature which suggests that small countries should adopt aggressive human capital (skills) acquisition strategies. Instead, it is suggested that we encourage our talent to stay home or come back (the "brain drain" solution); to go after our Diaspora (play the nostalgia card); and to continue to emphasize "more training" (the elusive answer to getting better at what you do). But, despite our efforts, none of those initiatives has led to any real gains in "idea power". Furthermore, while recent regional integration policies aimed at liberalising intra-Caricom migration will help they will not be enough to fill the gaping hole in Caribbean human capital and entrepreneurial capacity.

Over the last three decades, the Caribbean has seen hundreds of ideas on what we should do. In my view, the endless proffering of "what to do" recommendations all suffer from one glaring omission: **who** is going to do all these things, given our brain drain and the chronic shortfalls in our human and institutional capacity? So far, neither our governments nor our benefactors seem inclined to face the "who issue" head-on.

The Rebirthing Principle

In successful countries (big and small), growth is a factor of the symbiotic relationship between Investment and Consumption since they feed off each other. The most effective way for us to increase consumption is to increase the organic growth rate of the domestic population ***faster*** than our current net increase of around ½% a year. Since many Grenadians are poor, encouraging them to have more children is not an option. So the other way to do this is to re-birth, i.e. "import people".

Perpetual rebirthing is ***the*** essential prerequisite for above-average organic growth to occur. The development principle is the same as the biological one: it is the process of deliberating replacing lost or depleted human capital with "new blood". This recharging leads both to new internal- and export-oriented investment, more employment and considerable new consumption. Positive performance is attained from constant spawning or "growing-out" your population base at relatively fast rates since the trickle down benefit of FDI alone is not enough to assure prosperity. This is amply demonstrated in the November 1997 Business Week commentary article, "Britain: Colonized and Loving It".

At this point, you might well ask: "in terms of value-for- money" options, is a strategy of aggressive human capital acquisition, more beneficial than continued tourism sector development?

Why human capital acquisition is better value-for-money than Tourism FDI

My own research indicates that human capital acquisition is a far more valuable option that all-out tourism sector development. In spending terms, <u>one</u> new highly skilled resident spends as much in 12 months as <u>25</u> stay-over tourists. The average middle or upper income resident spends US$1,500 per

month on living costs (not including rent or mortgage payments) while one tourist spends around US$700 locally (not including hotel accommodation costs).

Put another way, 4,000 new residents are equivalent to 100,000 new stay-over tourists – in terms of consumption expenditure and more tax revenue. (New) residents spend consistently, *all year round*; creating a sustainable services platform that is mostly supplied by local firms and service providers.

Who benefits? Almost everyone. Just as an example, if we required all new residents to buy their vehicles locally (duty free or at a low rate of duty) then 4,000 residents, over a period of 10 years of inward migration, would spend around EC$200 million in car purchases alone. More people with the capacity to generate new income means more employment, more services, more restaurants, more effective use of local agricultural products, more construction of new homes, more work for repair shops etc. This would happen without having to forego anywhere near the amount of tax revenue we are giving up through FDI concessions. And, more than anything else, we need higher consumption expenditure to bring our day-to-day economic activity to levels that make business and job opportunities worthwhile to all. Highly skilled immigrants also increase airlift demand, would transfer knowledge and expertise to us and could provide access to business networks that we are unlikely to link into on our own.

Also, the impact on our environment would be more controllable since we would not have another 100,000 tourists descending on cultural and heritage sites over intensive six-month periods each year.

Two other factors suggest that we focus on attracting highly skilled migrants rather than continue to put all our eggs into the Tourism FDI basket.

One factor, as noted earlier, is that Tourism is now volume-driven. Discount and Brand players dominate that leisure lifestyle business. These include large operators like RIU hotels in Jamaica and Dominican Republic and branded chains like Sandals, Breezes, Carnival Cruise Lines and Royal Caribbean[3]. For us to compete in this league we would need 400-room hotel investors, like Marriott or Holiday Inn - whose FDI concession demands will be at the upper end of the tax exemption spectrum.

For the latecomers, conventional tourism expansion is now a bridge too far. If we were to set Antigua or St. Lucia tourism metrics as our targets we would need to reach 250,000 stay-over visitors and 700,000 cruise ship passengers over the next 5 – 10 years. We would have to double the total number of cruise ship visitor arrivals add another 1,000 rooms to get to their current performance levels. This would require at least US$1 billion in new Tourism FDI given that we are now attracting 113,000 stay-over tourists and 339,000 cruise ship passengers.

Where would such investors and funds come from, given our poor relative ranking, in terms of comparative FDI attractiveness? In the last ten years of global economic prosperity we were averaging no more than US$40 million in FDI inflows annually. Going forward, the prospects are not nearly as positive given the expected prolonged return to healthy growth in high net-worth Western economies.

The other factor is that even if we were to achieve such relatively stratospheric levels of investment without having to subsidise FDI, the newer larger scale operators could inflict fatal wounds on the smaller ones. A real risk is that the latter could follow the path of smaller facilities on St. Kitts, in terms of lower average occupancy *after* Marriott arrived. For local hotels this will mean even worse financial prospects in the future as a result of the price-quality presence of larger "major brand" players. So brand name hotels will raise our visibility internationally, but we will have to be prepared to expose our existing stay-over business to extreme competition in the process.

[3] Royal Caribbean's Oasis of the Seas, the world's longest cruise liner (1,187 feet), cost US$1.4 billion and can carry 8,690 passengers. In contrast, Grenada has 54 stay-over properties totalling 1,500 rooms or about 30 rooms per property.

So what should Grenada and other small economies do?

The first thing we should do is to replace our sun-setting commandments with fertile ones:

- New Commandment # 1: We shall always protect the main sector(s) that are driving economic growth now (offshore education) and provide more support to those already on strong growth paths (marina services and yachting, entertainment/sports and expatriate home-related services). Everything else gets residual support.

- New Commandment # 2: Skills acquisition and assimilation into our national life shall be our Development Savior. Beyond the next 5 – 10 years, our future "priority sectors" should be left to the ideas and initiatives of those people[4].

- New Commandment #3: Government policy shall give clear "first priority" to supporting all investors who make Grenada their home-base and are prepared to make long term contributions to our development as "fellow Grenadians". Everyone else should "come with **all** their resources.

Given our current fiscal position, high debt levels and the need to maintain essential infrastructure, *if we are to support private ventures at all, we can only afford to support sound projects, not anemic cash-deficient ones.*

The second thing we need to do is to translate this generic doctrine into reality:

Putting "*what we should do"* into practice

1. ***Listen*** *to the four new growth sectors to find out how we can help to strengthen their competitiveness.* In the case of Grenada - SGU, Marinas, Entertainers, Sports, the expat community's service providers. Then assign people and budgets to specific actions aimed at addressing the changes/improvements they recommend so that they can compete for more business more effectively. This will lead to much higher returns on our economic investments than new risky projects. That is what Singapore did at the start of the recent global financial crisis.

2. *Develop a sensitization PR campaign to explain to Grenadians why we should deliberately invite foreigners in, and the positive effects on our economy.* Many Grenadians will, without thinking, immediately reject an aggressive human capital/skills acquisition strategy because unemployment is so high. The business community will probably lobby against it because they don't want competition either! But both groups should be more receptive when the knock-on benefits are explained to them (more diverse employment opportunities, better property rentals and sales, increased retail sales of construction, utility and consumer goods).

3. *Develop a migration policy and lay out a well-articulated campaign to attract skilled people to live/operate from here*. We should not re-invent the wheel but should "copy" relevant strategies that successful countries have used. Changes to policies, laws and regulations will be required to put this plan into action. For instance, we should lower our corporate tax rate to around 15% to entice relocation of departments, branch operations or headquarters of regional and international service firms to Grenada. Example: Ireland has done this with remarkable success. We should also apply a low tax rate to export earnings by the service sector. Example: Barbados applies a tax of no more than 2.5% on foreign income earned by international business companies (IBCs).

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[4] 80% of the people in North America have tertiary–level education. In Europe, the number is 70&. In the Caribbean, the average is less than 15%.

4. *Instead of borrowing or securing investment funds to support resource-deficient tourism sector developers lets create a relatively modest $10 million Human Capital Attraction Fund* to help facilitate rapid inward migration of highly skilled people. This option is a much stronger value-for-money proposition than committing substantial resources to anemic, unproven tourism project(s).

5. *Put an assertive "Grenadianisation" programme in place*. This will give first priority to all investors who make Grenada their home-base. To be more specific, we should modify our citizenship and residence eligibility requirements to encourage those who go to St. Georges University; expat residents, yacht owners, sports operators, entertainers, international consultants and others using Grenada as a base, to contribute their ideas and time to local issues. Example: the USA has Priority Worker immigrant visas for persons with extraordinary ability in the sciences, arts, education, business or athletics and for outstanding researchers that companies can use to keep top talent in that country[5].

6. *Change our property laws and taxes to reward those who opt-into our Grenadianization programme and to encourage permanent residence and discourage land speculation*. Example: In Guernsey (the island), resident status comes with an obligation to contribute significantly to the island through payment of local taxes. Another example: higher property taxes are applied in Barbados in some residential areas if you do not build within a stipulated time frame.

7. *Adopt international standards rather than CVQs if we are going to be really serious about increasing the linkages between local services and new high growth sectors*. The future of Grenada's export services will be driven by the extent to which we can provide international-quality services not regionally accepted ones. Because the CVQ initiative is CSME-driven it does not possess higher-level international standards required to compete in the global market place.

As you would have observed, the core of this paper is about focusing our development strategy on a different kind of FDI: rapid human capital acquisition. The strategy comes with its own challenges, caveats and risks, all of which are political.

The main challenge is to overcome the "we like it so" mentality by building the attitudinal commitment of citizens, private sector and government to the strategy. One caveat is that efficacy will be linked to simultaneous success in other areas e.g. labour reform; changing tax, residence and citizenship laws; investing more in culture etc. There will be more business and employment competition. When this starts, there will be calls to restrict inward migration. Also, expanding our population base will require creative approaches to optimising our educational, utility and civic infrastructural capacity.

My recommendations are not exhaustive and I appreciate that others have put forward highly valuable suggestions on addressing our development challenges. But at the end of the day, it is up us to decide whether we prefer to stay in The Matrix or to get out of it. I remain hopeful that Grenadians would be at least prepared to seriously consider my proposal - that we start now to pursue the Holy Grail.

The strategy I am proposing is applicable to most countries with populations of less than 5 million people. If we choose to live by these new "laws" it is possible that many of our countries will, within the next decade, start to achieve the prosperity and success that has eluded us for the last 30 – 40 years ▪

[5] For more information see: http://travel.state.gov/visa/immigrants/types/types_1323.html

End Notes

I am not a great fan of listing ”references” because Idea Legitimacy resides more in Thought Alignment than it does in evidence-based research. Besides, the process of accessing information and acquiring new knowledge has become increasingly parametric and unstructured: you are always on a journey of discovery and spontaneous crossroads - as it should be.

As a compromise, here are broader references that have influenced my thinking on this paper:

1. *From Third World to First*, by Lee Kuan Yew (Singapore’s rags to riches story)

2. *Tribes*, by Joel Kotkin (how race, religion and identity determine success in the new global economy)

3. *A Thousand Years of Non-Linear History* by Manuel de Landa (a post-modernism discourse on energy-matter systems as the driving forces of world development)

4. *Everything Bad is Good for You* by Steven Johnson (how counterintuitive outside-the-box pop culture is actually making us smarter)

5. *America’s Real Dream Team*, by Thomas Friedman (a newspaper article that zeros-in on the secret engine that sustains First World competitiveness today)

6. *The Blind Watchmaker,* by Richard Dawkins, the avowed Darwinist (or why predictive programming in life, which is the approach taken by most of the developing world, is wishful thinking at best),

   and . . . . .

7. *The reports quoted in this paper (*or, if you need more convincing or want to second-guess me – you can do the Googling to find the information on the web yourself)

. . . . . Keep the change!

Profile

Michael Julien is a financial economist. He has spent the last 25 years as an international consultant working on development issues in the Caribbean, Central and South America, East and Southern Africa, Eastern Europe and the Middle East.

Michael provides advice on challenges to economic growth: improving the business environment; competitive strategy; private sector development, and export-led growth. He does most of his work for the European Union. He has addressed similar issues for others: USAID, the British Government, the Canadians, the UN and the Inter-American Development Bank.

He holds a Masters Degree in Economic Development from the Arthur D. Little School of Management (first place, distinction) and was trained in Grenada, London, Montreal and Boston.

Michael is also the author of ”Why Banks Don’t Lend for Industrial Projects (1986), ”Time to Stop Investment Concessions?” (1994) and ”A Memetic Approach to Development Strategy” (2009).