4 Transforming industries: Focus on nearshoring in the Dominican Republic

The United States has been for decades the principal economic partner of the Dominican Republic. Identifying mechanisms to make the most of traditional economic ties and diversifying those ties are the two key elements of a forward-looking strategy. The world economy now faces an unprecedented health and economic crisis that is augmenting the already high uncertainty on the future geography of production, trade, and investment. This chapter analyses the evolution of offshoring in the Dominican Republic, identifies risks and opportunities, and proposes policy approaches amid a highly uncertain future.

Introduction

This chapter, based on the outcomes of interviews with multiple stakeholders as well as a government-business roundtable on the future of nearshoring and global FDI during field missions, provides an assessment of the current strategy, identifies untapped opportunities and delivers recommendations for policy reforms. The process also involved peer-to-peer learning between the Dominican Republic and the Reshoring Institute in the United States.

The first part of this chapter presents a snapshot of global trends and update in light of the unpreceded social and economic crisis brought by the COVID-19 pandemic. The second clarifies the relevance of nearshoring in the Dominican Republic. The third part proposes policy reforms.

A world of uncertainty and hidden opportunities

Despite the political, economic, and public health challenges the world faces, FDI continues to represent an important development driver for economies worldwide. For an economy like the Dominican Republic in which foreign investors play an important role in the country's development, it is particularly important to pay attention to the evolving global trends to identify how the country can take advantage of them and meet its development goals and aspirations.

Attracting FDI has been historically an important component of the Dominican Republic's development strategy. Particularly, since the 1990s it became one of the most relevant drivers of the country's participation in global production networks. As presented in Chapter 1 of this report, tourism, mining, manufacturing and services in FTZs attract the largest share of FDI in the economy. The United States remains the main country of origin with 23% of total investment in 2017-19, 5% less than in 2010-14. Canada, Spain and Brazil follow as other main investors.

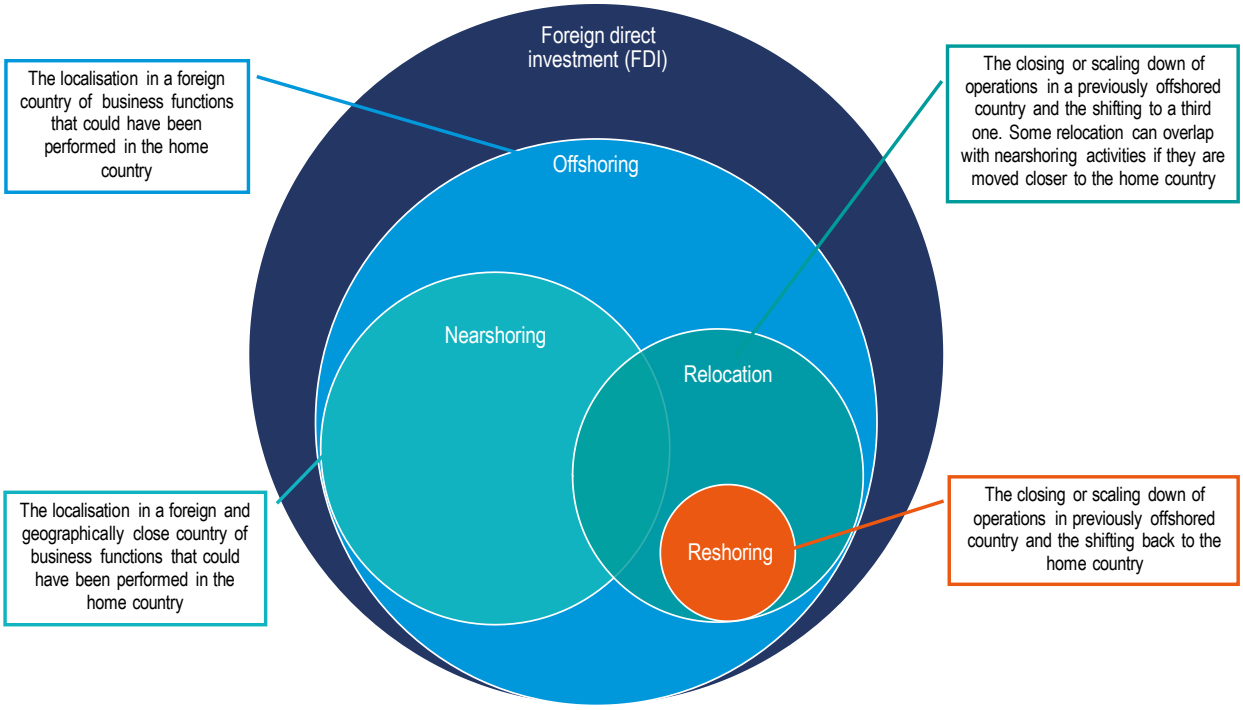
FDI remains a major cornerstone of the current strategy in the Dominican Republic. The current National Development Strategy as well as the National Competitiveness Agenda (as discussed in Chapter 2) stress the importance of increasing and diversifying FDI to ensure spillover into the local production and innovation systems. The current strategy has specifically targeted nearshoring from the United States to facilitate increased sophistication and industrial diversification.

In particular, three emerging global trends appear relevant for the Dominican Republic articulation of a renewed and updated FDI strategy:

Firms are rethinking their localisation strategies

The world is witnessing a reorientation of the geography of production, investment and trade, as companies explore new forms of organisation to adapt to changing policy landscapes, to meet new demands related to sustainability and to exploit the potential of digital technologies. Latin America is also part of the game. For example, in 2019 Seegene, a Korean biotechnology company invested USD 32 million in a Research and Development (R&D) facility in Belo Horizonte (Brazil). The aim is to develop new diagnostic products and molecular diagnostics systems for tropical viruses. Likewise, Heolios EnTG, a French-Japanese company is planning to build a renewable energy project in Aguascalientes (Mexico). The project aims to produce 721 MW from a mix of wind and solar power plant (Financial Times, 2020[1]). The universe of FDI comprises multiple sub-strategies and new emerging concepts (Figure 4.1).

Figure 4.1. Firms are implementing a variety of localisation strategies



Note: The figure is not meant to be representative of the real size of each phenomenon.
Source: Authors' elaboration.

Before the COVID-19 pandemic, offshoring was relatively stable as a share of global GDP. With an increase in absolute terms, from USD 1 400 billon in 2003-06 to USD 1 800 billion in 2016-19 offshoring accounted for 0.5% of world GDP in 2016-19, down from 0.8% in 2003-06. It has represented around 50% of total greenfield FDI since 2003. Manufacturing remains the main sector that absorbed 72% of total investment, 3 percentage points less with respect to 2003-06. In the same period, offshoring activities in R&D become the second main business activity. Total projects moved up from 2 800 in 2003-06 to 4 500 in 2016-19 and investment from USD 90 billion to USD 130 billion (Financial Times, 2020[1]).

Relocation is an emerging phenomenon, but still limited. The number of firms that closed or scaled-down operations abroad and relocated to a third economy has grown in the last decade. According to estimates available from FDi Markets, the number of relocation projects increased from 22 in 2013 to 160 in 2018. Globally, relocations accounted for only 1.3% of total FDI projects between 2013 and 2018. Half of these relocations involved the shifting of headquarters' operations (especially in software, information and communication technologies and financial services); almost 30% involved manufacturing activities and 6% sales, marketing supporting activities facilities (Financial Times, 2020[1]).

The majority of relocations happened from the United States (26%), China (12%) and the United Kingdom (10%) towards Mexico (the top recipient economy of globally relocated projects, accounting for 20% of relocations), the United States (14%) and China (7%). Most of relocations happened within the United States (12%) and from the United States to Mexico (11%), followed by China to Mexico (5%) and Germany to Poland (3%). A further breakdown shows that automotive components, industrial equipment and food are industries in which relocations predominate (Figure 4.2). Although several reasons drive relocation, the presence of specialised suppliers, a sizable market and the ability to quickly respond to markets are important factors that drive relocation strategies (Box 4.3). There are opportunities for economies ready to seize them, but benefits will not accrue automatically everywhere. Strategic partnerships and targeted policies will be needed to ensure positive outcomes.

Relocations are challenging for the recipient economy. This process engenders major economic and social implications with job losses in the short term and infrastructure depletion in the medium and long term. The socio-economic impacts are bigger than the direct employment and business turnover losses. Relocations trickle down rapidly to the local economy affecting the local supply chain, employment and in the long run they impact the quality of infrastructure and the offer of local services, unless targeted strategies are put in place. For example, in 2017 a manufacturer of medical infusion and transfusion equipment, discontinued manufacturing operations in the Dominican Republic and transferred production to Costa Rica, with a loss of 700 direct jobs (Financial Times, 2020[1]). Reconversions are possible but these processes need to be closely monitored to ensure positive transformations and revamping of previously industrialised areas (Reuters, 2019[2]). Over the years, reconversion have been conducted backed up by policy decisions both at the local and national level (Box 4.1). However, as much as this phenomenon has been on the rise and it represents a major concern for the reality where this happens, at the aggregate level this trend is not a major one.

Reshoring – the return of business operations to a country of orign – is not widespread and is mostly related to high-tech sectors. According to the European Manufacturing Survey (EMS 2015), in 2015 6% of all interviewed firms reshored while 17% have offshored. High-tech and science-based firms are more prone to backshore (24%) with respect to low-technology firms (15%). Flexible production and higher quality products are the main drivers for reshoring with 70% and 55% of surveyed firms, respectively. In addition, reshoring is highly related to firms engaged in industry 4.0 activities and firms with more than 1 000 employees (UNIDO, 2019[3]).

The current pandemic is putting global economies under strain; one dimension has been the disruption in global value chains. Suddenly, it has become very difficult to operate globally and to manage and control suppliers dispersed around the globe. The ultimate impact on firms' localisation strategies and on the prevailing geography of production, trade and investment in the post-COVID-19 landscape remains to be seen. Most analysts concur that the current pandemic will reinforce pre-existing relocation trends. With most economies under full or partial lockdown and with trade and investment contracting, the future of offshoring is more uncertain than in the pre-COVID-19 situation. The WTO predicts a trade fall between 13% and 32% and UNCTAD estimates an FDI contraction from 30% to 40% during 2020-21 (WTO, 2020[4]; UNCTAD, 2020[5]).

Box 4.1. Examples of relocations: Rationales and outcomes

Market size, quality and fast fulfilment are affecting relocation strategies.

Case 1: Water filtration equipment company

Issue: Redefinition of global manufacturing strategy

Headquartered in the United Kingdom, with a factory in China. Major growth was in the US market, so the company wanted to find a US location for a new factory to produce for US customers. It evaluated six potential US cities based on availability of manufacturing sites, tax rates, proximity to market, availability of labour, education levels, nearby universities teaching engineering and water biology, airport services, incentives and monetary grants offered by state and local governments. The location selected was Dallas, TX.

Case 2: Industrial fan manufacturer

Issue: Tight control over manufacturing quality

This company had been manufacturing its low-priced products in China for years, but found it was increasingly hard to control the quality of the products. The company worried that poor quality low-end products would affect their overall brand image on the more expensive, high-end industrial products. As a result, the company decided to relocate all production back to Kentucky, United States. The company had to redevelop its supplier base in the United States and tried to find suppliers close to the new manufacturing site. All products now carry the "Made in USA" label and are sold at premium prices.

Case 3: Custom-made men's shirts

Issue: Fast fulfilment

This company makes custom-tailored shirts in New Jersey, United States. Although they could produce the shirts at a much lower cost overseas, they choose to keep production in the United States so that they can offer faster order fulfilment times and extremely high-quality products. Custom shirts are only sold online and significantly more expensive than shirts sold in department stores.

Source: Rosemary Coates, Executive Director of the Reshoring Institute, United States. Presentation during the public-private roundtable "Leveraging on new business opportunities in the Dominican Republic", Santo Domingo, 12 December 2019.

Box 4.2. Reconversion can lead to new business opportunities

North Carolina, United States

In 2019, Cook Medical, a manufacturing company specialised in the production of technologies that eliminate the need for open surgery, completed an agreement with local authorities to acquire a facility Whitaker Park in Winston-Salem (North Carolina). The site formerly hosted one of the largest cigarette plants in the world, offers 80 000 square metres of space, and will employ 650 workers.

Its reconversion into a modern facility producing life-saving medical devices has been sustained financially by the local authorities. Moreover, the new production plant offers the possibility to rely on long-standing local production capabilities and readapt them to new industry and market requirement.

Bilbao, Spain

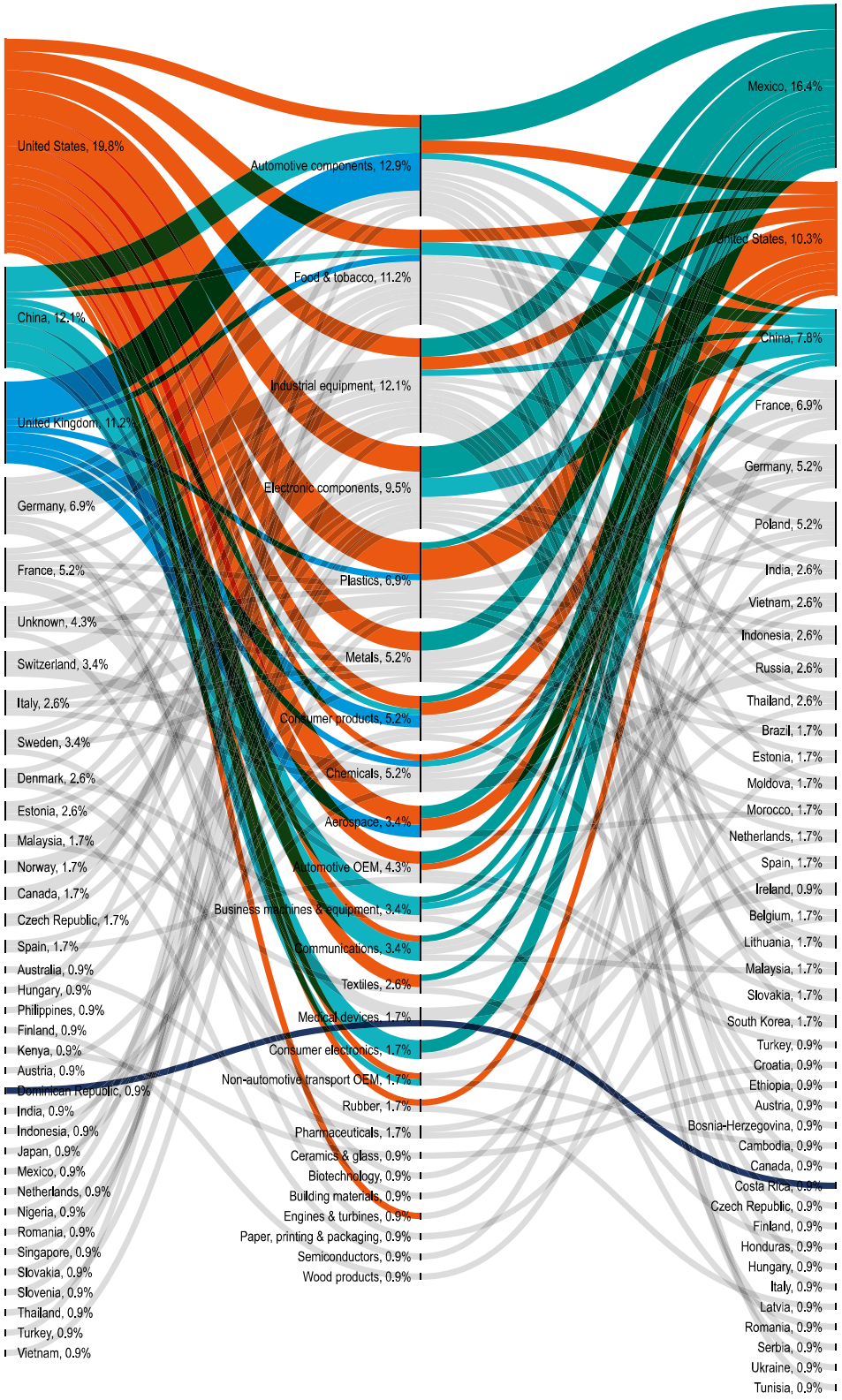
In 30 years Bilbao transformed itself from a polluted industrial brownfield into a flourishing innovation hub. Between 1850 and 1970, Bilbao became one of the largest industrial hubs in south-western Europe led by iron, steel and shipbuilding. The economic crisis of the 1970s and 1980s hit the city; between 1981 and 1991, unemployment rose to 26%, and Bilbao lost 15% of its population.

The reconfiguration process involved public and private stakeholders' backup with the support of the European regional structural funds. Local administration acquired and decontaminated industrial lands, created technological parks and investment in new public infrastructure. Without losing its industrial vocation, the city is now a central innovation hub in the Basque country, in which new investment in pharmaceutical, advanced manufacturing, and biotechnologies are coupled with flourishing tourist and cultural activities.

Source: Brian Daigle, United States International Trade Commission (USITC), Technology Onshoring in the United States: Local Government Successes and Challenges, presentation at the PTPR Peer Learning Group (PLG) of the Dominican Republic, Lima, 1 April 2019; (EU Parliament, 2019[6]), Reconversion of industrial areas in the framework of regional policy, Panel for the Future of Science and Technology (STOA), European Parliament.

Figure 4.2. Manufacturing is being relocated, but between few countries and in few sectors

Share of world relocation projects in manufacturing, 2013-18



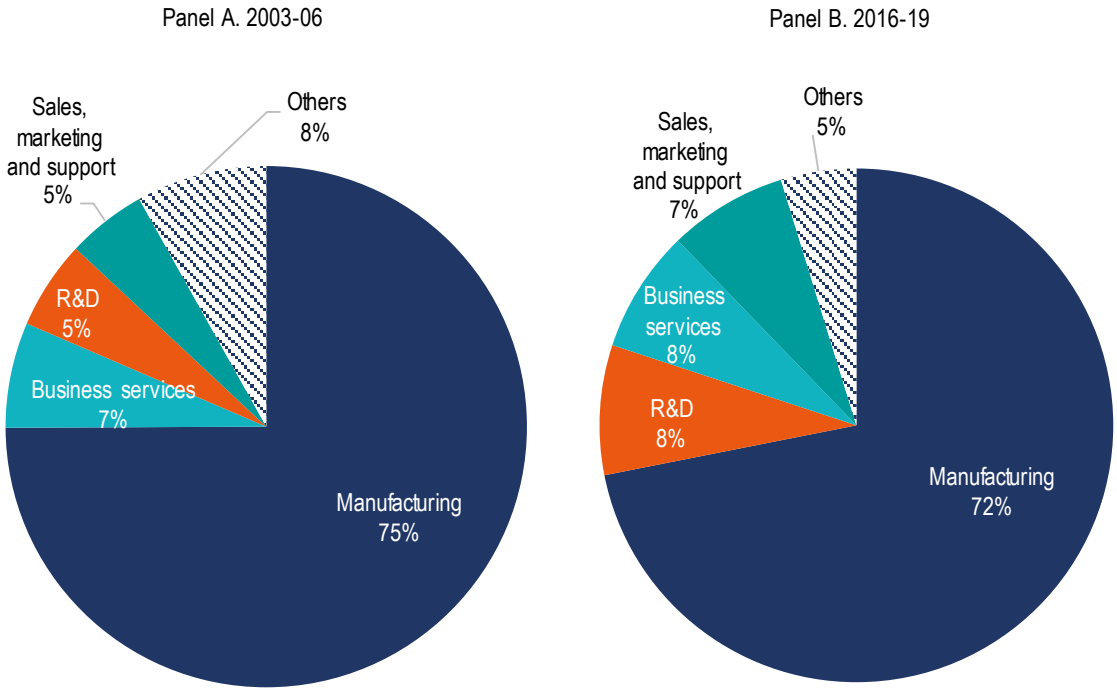
Note: The sector classification follows the North American Industry Classification System (NAICS) 2007.
Source: Authors' analysis based on Financial Times fDi Market Database, https://www.fdimarkets.com.

Manufacturing drives global offshoring activities

Manufacturing accounts for 72% of global capital investments for offshoring (Figure 4.3). The leading sectors in manufacturing are transport equipment, food and beverages, industrial equipment, electronics, and chemicals. Knowledge-intensive activities are also on the move. For example, the incidence of offshoring activities in R&D grew from 5% in 2003-06 to 8% in 2016-19. A more granular analysis shows that software and ICT, telecommunication, biotechnology and chemicals count for 50% of total offshoring activities in R&D.

Figure 4.3. Manufacturing continues to lead offshoring investments

Share of world total offshoring capital investment, 2003-06 and 2016-19



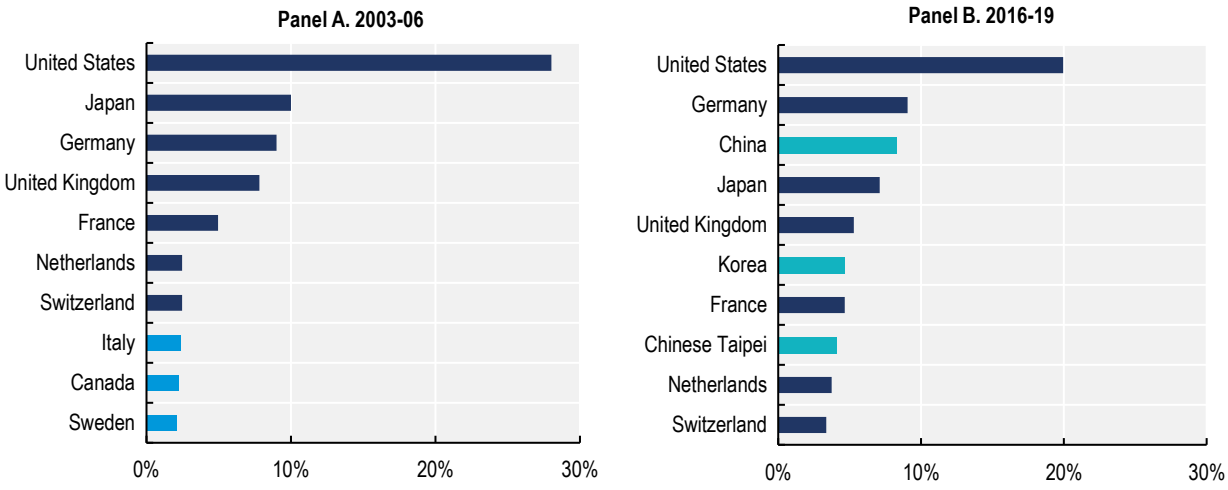
Source: Authors' elaboration based on Financial Times fDi market database, www.fdimarkets.com.

New investors are emerging

The geography of offshoring is changing. In 2016-19 the top five investors accounted for 50% of total investment, 5 percentage points less with respect to 2003-06. While the United States remains the world's leading offshoring economy, its role is shrinking, and new investors are emerging. The United States accounts for 20% of total capital investment in 2016-19, down from 28% in 2003-06. Germany is the second leading investor with 10% and China has become the third world-leading investors, accounting for 8.5% (Figure 4.4). Asia continues to be the global manufacturing hub, absorbing almost 40% of total offshored investment, slightly lower than the 45% reached in the early 2000s.

Figure 4.4. New investors are catching up

Share of total capital offshoring investment, 2003-06 and 2016-19



Source: Authors' elaboration based on Financial Times fDi market database, www.fdimarkets.com.

The Dominican Republic can benefit more from offshoring

This section highlights the role of the United States as the principal investor in the Dominican Republic. It shows how nearshoring has enabled the development of new activities in the economy and clarifies that proximity is not sufficient to attract investment and to ensure upgrading. The Dominican Republic could enrich its nearshoring focus by looking at North America and Latin America and the Caribbean.

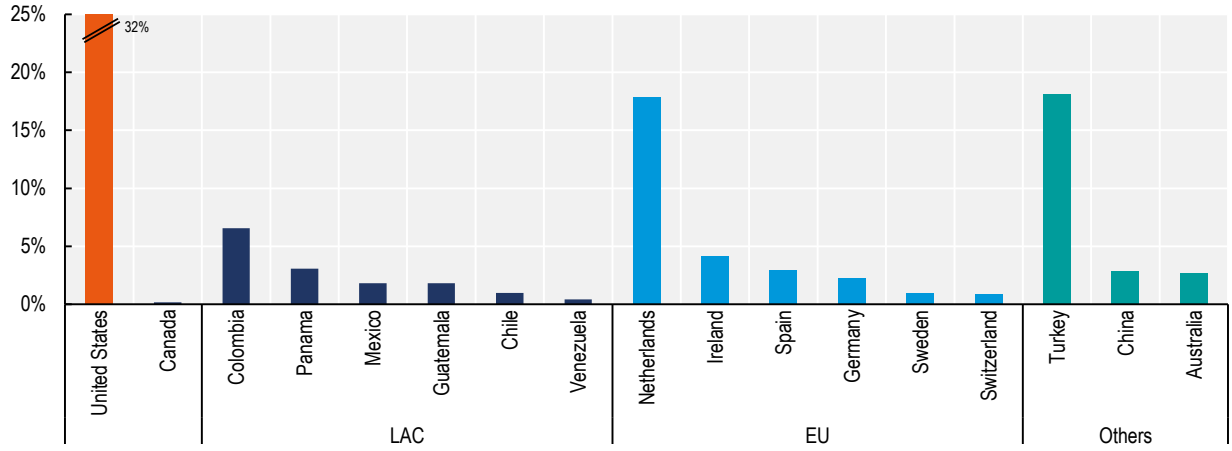
The United States is a strategic partner for the Dominican Republic

Offshoring is an important economic activity in the Dominican Republic, and the United States plays a major role even though new partners are emerging. The United States accounted in 2016-19 for 32% of capital investment and 48% of jobs created through offshoring activities in the Dominican Republic. This figure is lower than what it used to be in the early 2000s, when the United States accounted for almost 67% of capital investment and 58% jobs created (Financial Times, 2020[1]). Colombia, Panama and Mexico recently offshored in the country, in building materials and food and beverage products.

New overseas investors are emerging from the European Union and other regions. The Netherlands have invested in both business activity and manufacturing of paper products, Turkey in manufacturing of food and beverage and plastic, and China in footwear and metal manufacturing. Overall, manufacturing activities are the leading component, specifically in medical equipment, food and beverage, and packaging, followed by customer and market services that are emerging as new important activity. In addition manufacturing activities cover 22% of firms operating and to 16% of total employment in the FTZs (CNZFE, 2019[7]). These include in particular back-office functions and call centres that serve the east coast of the United States.

Figure 4.5. The United States is the main offshore investor in the Dominican Republic

Share of offshoring capital investment by country of origin, 2016-19



Note: The data reported are estimated figures.
Source: Authors' elaboration based on Financial Times fDi market database, www.fdimarkets.com.

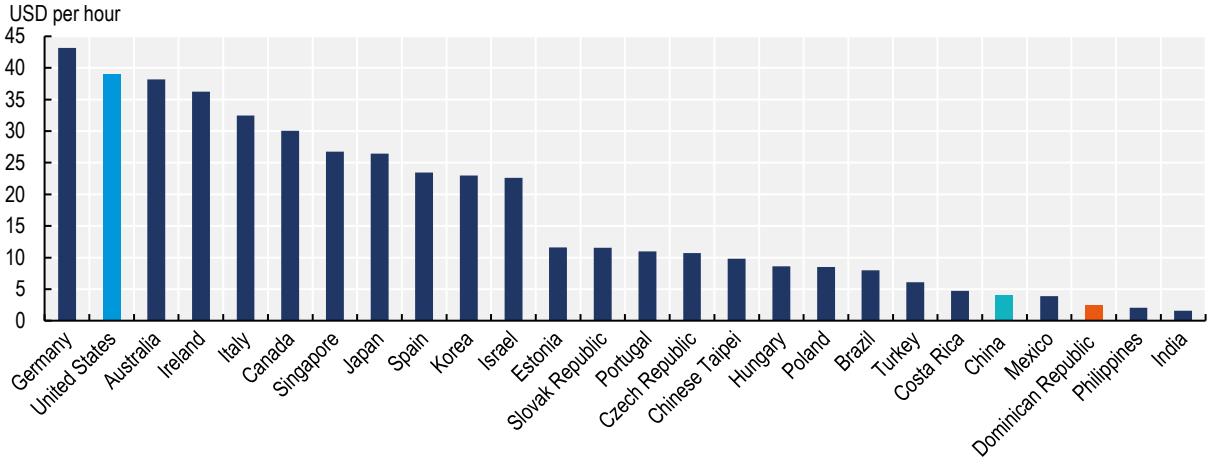
A targeted policy for nearshoring is an important component of the national development strategy. The United States invests primarily in manufacturing activities (medical equipment, plastic packaging) customer and marketing services (call centres) and business services (legal and banking services). However, the United States is a major investor in most of the countries in Central America and the Caribbean, urging all countries to constantly update and improve their value proposition, as they tend to compete for attracting similar activities.

Latin American neighbours mostly host manufacturing activities, which operations tend to be linked to labour-intensive and lower-knowledge intensive segments of manufacturing activities. Indeed, the competition for attracting nearshoring investment among countries in Central America is fierce, as they rely on similar competitive advantages, including proximity, capacity to align business operation similar to the time zones of the United States and low labour costs. The latter is playing an important role in the attractiveness of the Dominican Republic. For example, the hourly manufacturing labour cost in the country is USD 2.5, approximately half of Costa Rica or Mexico and only 6% than the United States (Figure 4.6).

The pattern of investment from the United States to the Dominican Republic is similar to the one of Mexico in terms of type of activities, with manufacturing accounting for 65% of total investment. This is above the average of 44% for the countries in CAFTA-DR (Central America Free Trade Agreement and the Dominican Republic) and above Costa Rica. Nevertheless, in absolute terms, Costa Rica absorbs as much as four times the nearshoring investment from the United States when compared with the Dominican Republic (Table 4.1).

Figure 4.6. Labour costs in the Dominican Republic are 6% of those in the United States

Hourly labour cost in manufacturing, the Dominican Republic and selected countries, 2018 or last available year



Note: Labour cost includes direct pay, social insurance expenditures, and labour-related taxes. Costa Rica (2018); Dominican Republic (2017); China (2013); India (2014); all other countries (2016).
Source: Authors' elaboration based on Conference Board International Comparisons of Hourly Compensation Costs in Manufacturing, https://www.conference-board.org/; Dominican Republic National Survey of Economic Activity (ENAE), https://www.one.gob.do/encuestas/enae; and Costa Rica National enterprises survey, http://www.inec.go.cr/.

Table 4.1. United States nearshoring activities, 2016-19

Nearshoring flow	Capital investment (USD million)	Main sector of investment
USA > CAN	19 308 (31.8%)	R&D (44%); ICT services (22%); manufacturing (20%)
USA > MEX	20 533 (33.8%)	Manufacturing (67%); ICT services (22%), customer and market services (6%)
USA > CAFTA-DR	2 707(4.4%)	Manufacturing (46%); customer and market services (11%); business services (11%)
USA> DOM	358 (0.6%)	Manufacturing (65%); customer and market services (20%); business services (10%)
USA > CRI	1 581 (2.5%)	Manufacturing (31%); customer and market services (15%); R&D (13%)

Note: The data reported are estimated figures.
Source: Authors' elaboration based on Financial Times fDi market database, www.fdimarkets.com and UNCTAD FDI database, https://unctadstat.unctad.org/EN/.

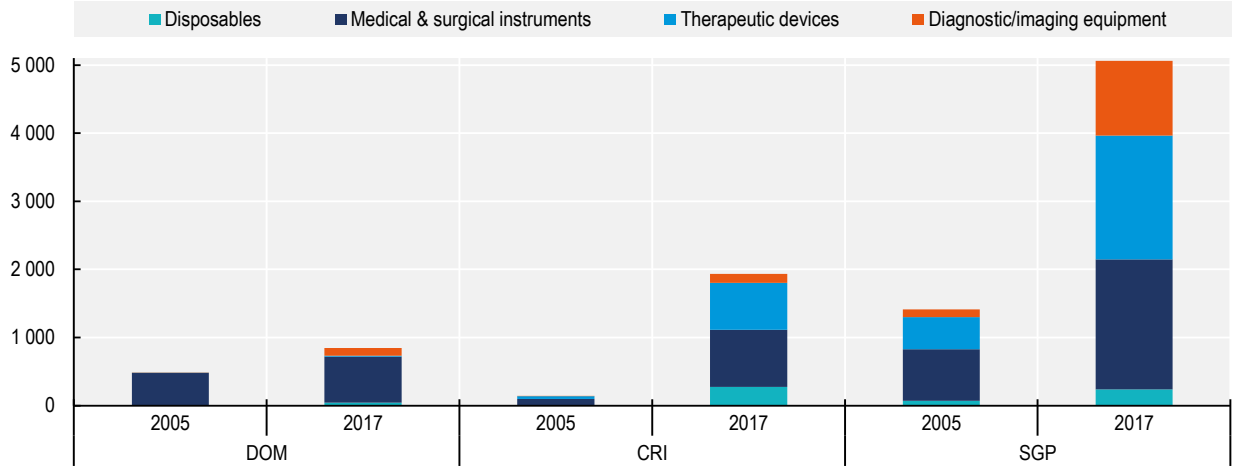
Nearshoring opened up new business opportunities

The fierce competition between the economies in the region to attract investment is contributing to economic modernisation and diversification. For example, the late 1990s and early 2000s witnessed an increase of both offshoring and nearshoring activities in the medical device industry. The choice between the two complementary strategies was driven by several factors: the final market of reference, the scalability of production as well as the total landed cost (TLC) which includes transportation fees (both inland and ocean), customs duties, taxes, tariffs, insurance and currency conversion. As a result, since the mid-1990s, United States-based original equipment manufacturing (OEMs) started to move considerable production segments to Central America and the Caribbean, particularly in Mexico, Costa Rica and also in the Dominican Republic (Pomager, 2015[8]). In 2018, the country had 33 firms operating in medical devices that contribute to 27% of total investment and 25% of total exports of FTZs (CNZFE, 2019[7]). As the industry emerged, exports almost doubled between 2005 and 2017. However, the manufacturing of

medical devices in the Dominican Republic is linked to the most labour-intensive and less technologically sophisticated activities. For example, therapeutic devices (e.g. pacemakers, implants, etc.) account for only 2% of total exports in the Dominican Republic, while they represent 36% in Costa Rica and Singapore's medical devices exports. Similarly, while the share of exports of diagnostic and imaging equipment increased from less than 1% in 2005 to 13% in 2017, it is still below Singapore's 22% (Figure 4.7).

Figure 4.7. Medical devices exports from the Dominican Republic, Costa Rica and Singapore, 2005 and 2017

USD million of exports by industrial category



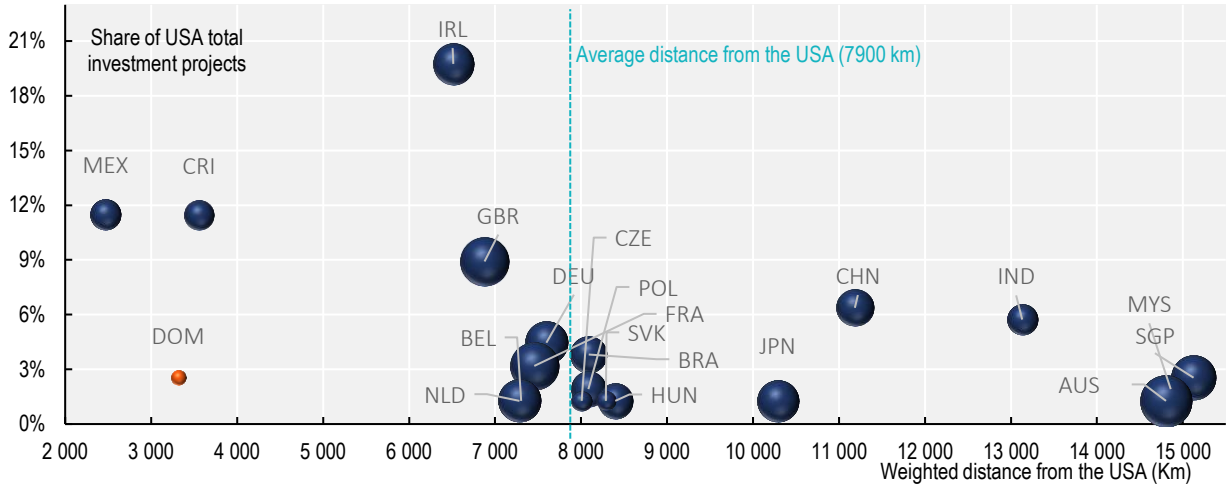
Note: The categories follow Bamber and Gereffi (2013) and go from least (disposables) to most sophisticated (diagnostic/imaging equipment). The figure includes non-FTZ exports, which amount to 2% of the total.
Source: Authors' elaboration on UN Comtrade, https://comtrade.un.org/.

Proximity does not guarantee upgrading

Proximity to offshoring countries does not guarantee more investment and localisation of activities that foster upgrading and spillovers. The countries that tend to benefit more from offshoring and FDI, in general, are the ones with targeted strategies and policies in place. The case of medical devices helps to illustrate this point. Figure 4.8 plots the recipients of FDI from the United States in medical devices according to their proximity, their share of total investment and their technological specialisation. The figure seems to suggest that while the United States offshores knowledge-intensive activities to Europe and Asia, investments in Mexico, Costa Rica and the Dominican Republic represent mostly low knowledge intensity manufacturing activities. Among the destinations in Latin America, the Dominican Republic is the one that receives the least knowledge-intensive activities.

Figure 4.8. Proximity is not enough for attracting investment and for upgrading

United States FDI outflows in medical devices, world locations by proximity and technological specialisation, 2016-19



Note: a) Bubbles size reflect the share of high technology exports of medical devices for each country between 2016-18 following the classification developed by Bamber and Gereffi (2013). b) The weighted distance takes into account bilateral free trade agreement, transport cost, languages.

Source: Authors' elaboration based on Financial Times fDi Market database, https://www.fdimarkets.com/; CEPII's GeoDist database, http://www.cepii.fr/cepii/en/bdd_modele/bdd.asp; and UN Comtrade, https://comtrade.un.org/.

Strengthened economic ties with Latin America and the Caribbean is an unexploited opportunity

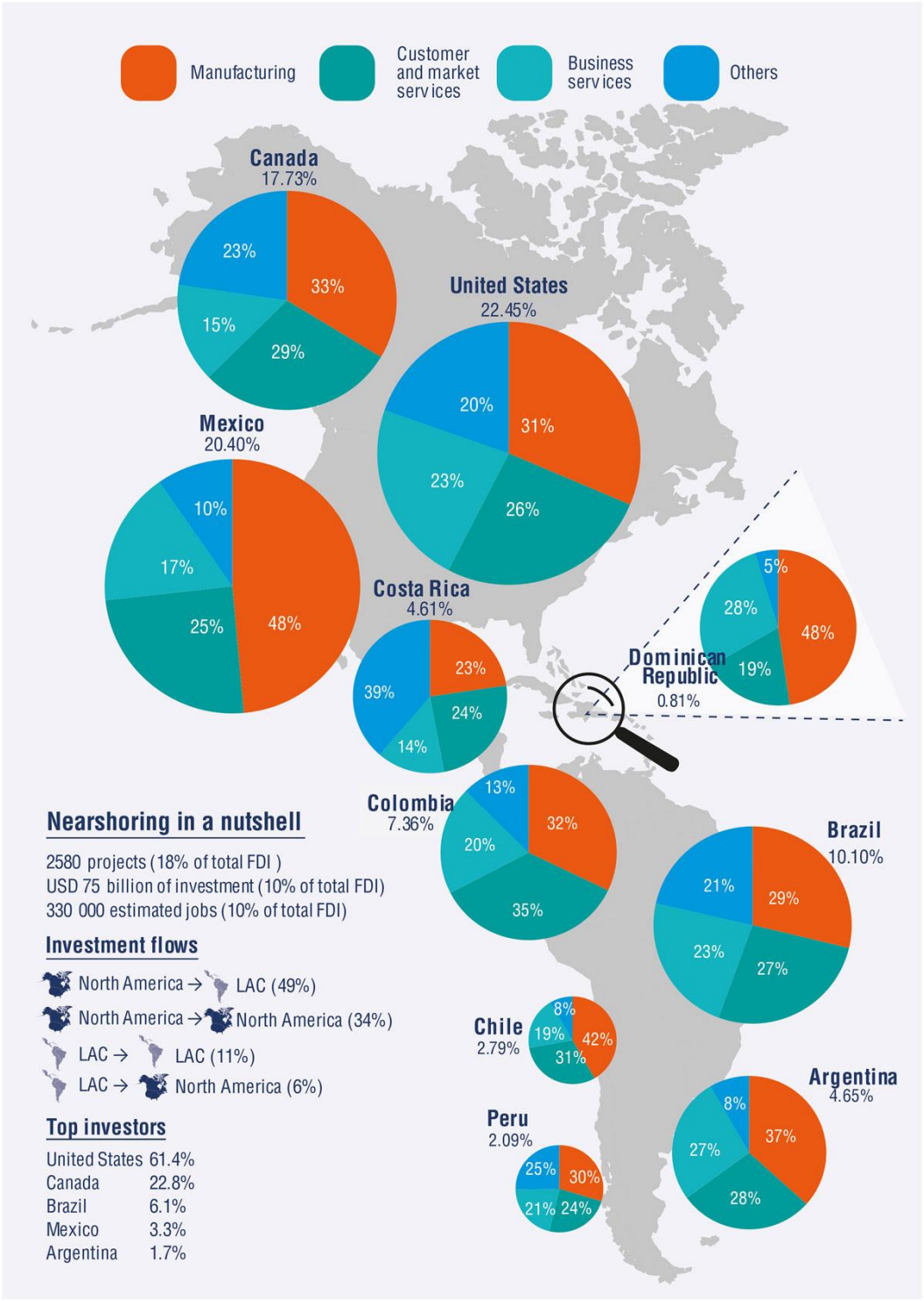
The Dominican Republic captures only 0.8% of the total investment flows within Latin America and the Caribbean and from the United States and Canada. Costa Rica, a neighbouring country with a similar export profile, accounts for 4.6% of these investments. The pattern of who invests in these two countries is very similar, where 70% of the intra-area investment comes from the United States, 14% from Colombia and 7% from Panama. In the case of Costa Rica, 75% of investment comes from the United States, 18% from Mexico and 3% from Colombia.

Nearshoring between the United States, Canada, and Latin America and the Caribbean has been on the rise. In 2016-19, intra-regional offshoring accounted for 18% of total FDI and as much as 10% of capital investment, up from 15% and 8% in 2003-06, respectively. The United States is the principal investor in the areas, accounting for close to 60% of total offshoring within the area (41% to Latin America and 18% to Canada). Offshoring within Latin America and the Caribbean has grown, representing 11% of total intra-area investment in 2016-19, up from 6% in 2003-06. Mexico, Brazil and Chile explain almost half of offshoring in the area.

Attracting nearshoring investment from the United States merits a targeted strategy. But improving the value proposition and visibility of the Dominican Republic to other countries within other Latin American and Caribbean economies, and Canada, is also an important approach.

Figure 4.9. Offshoring between the United States, Canada and Latin America and the Caribbean, 2016-20

Top 10 recipients' countries of nearshoring activities



Note: The data reported are estimated figures.
Source: Authors' elaboration based on Financial Times fDi Market database, www.fdimarkets.com and UNCTAD FDI database https://unctadstat.unctad.org/EN/.

Tapping into the dynamism of the creative industries

The new wave of knowledge-intensive investment is related to the creative industries. More recently, creative industries, i.e. those economic activities that are related to the generation or exploitation of knowledge, information and cultural assets (Nurse, 2018[9]), are also increasingly being organised along complex international value chains. There is significant growth in global production networks associated with the creative industries although it is not well developed in the offshoring or nearshoring literature (Coe 2015; Hudson and Tung 2010). Estimates show that in 2016-19, creative industries accounted for 4% for total offshoring activities, 3 percentage points more with respect to 2003-06. Internet publishing, software development, motion pictures, and gaming account for 60% of total offshoring activities in the creative industries (Financial Times, 2020[1]).

A critical area for investment expansion for the Dominican Republic is in on-location film shooting for the audio-visual sector. Since 2010, the Dominican Republic has a special tax regime to foster the development of the cinematographic industry. Similar to other special tax regimes (see Chapter 2) film producers may benefit from two specific incentives. The first is a transferable tax credit (CFT) equivalent to 25% of all expenses incurred in the Dominican Republic that are directly related to the pre-production, production and post-production stages of their films if the production expenses in the country exceed USD 500 000. This incentive is available for films, TV films, TV series, music videos, reality shows, soap operas, documentaries and other audio-visual works. Secondly, there is a VAT exemption, on all goods, services and/or leases directly related to the pre-production, production and post-production of cinematographic works; and temporary imports free of tariffs and taxes of equipment and consumable or non-consumable goods, necessary for filming.

The total special regime for 2019 amounted to USD 18 million and is granted by the inter-sectoral council for the promotion of cinematographic activity in the (CIPAC) (DIGEPRES, 2020[10]). The council has a board of ten representatives of public and private sector and is chaired by the Minister of Culture that oversees the work of the National Film Commission in attracting and developing the cinematographic projects. For example, the DGCINE supported the development of complementary instruments to attract investment and develop local capabilities. These include the creation of eight specialised film schools in co-operation with local universities and the development of three on-site location studios in co-operation with major world production such as the Pinewood Studios. In 2018, the country hosted over 86 audio-visual productions from all over the world that received over 40 international awards in numerous film festivals, such as Locarno, Toronto and Guadalajara (Murray, 2020[11]).

Policy reforms to preserve the gains from investment

The Dominican Republic has several institutions charged with attracting FDI. Formally, the Export and Investments Centre of the Dominican Republic (CEI-RD) is in charge of both attracting investments and promoting. It was created in 2003 by merging the former Export Promotion (CEDOPEX) and the Office of Promotion of Investments of the Dominican Republic (OPI-RD). Merging export promotion and investment attraction is an increasing trend both in the OECD and in Latin America. The CEI-RD is an autonomous agency under the Ministry of Industry, Commerce and MSMEs. In addition to a headquarters in Santo Domingo, it has three autonomous offices abroad (Miami, New York and Chicago) and operates via liaison officers in diplomatic embassies around the world. The executive director co-ordinates the activities of CEI-RD and reports to the board – chaired by the Ministry of Industry, Commerce and MSMEs and composed of 16 members from both public and private institutions – that oversees and steers the work of the agency. In 2020, the CEI-RD has a total budget of USD 8 million and 232 staff members. The current policy mix of the CEI-RD counts with USD 1.4 million of which 30% is dedicated to investment attraction via matchmaking events in the country and abroad. To facilitate investment and reduce red tape in 2012 the CEI-RD launched a one-stop shop investment (Ventanilla Única de Inversión, VUI). Moreover, other public

and private stakeholders in the country have a similar and to some extent overlapping role. This is the case of single ministries (i.e. the Ministry of Tourism, the Ministry of Agriculture and the Ministry of Energy and Mining), and other specialised agencies and regulatory authorities like the CNZFE. Similarly, the administrators and owners of private parks that host FTZs often seek for investment in autonomy.

The Dominican Republic offers fiscal incentives for foreign investors. Companies enjoy exemptions among others for VAT, corporate income tax, and imports duties, according to a series of different special regimes *(regímenes especiales*, for more information, see Chapter 2 of this report*).* Although special regimes had made possible attracting investments and spurring employment in both FTZs and in tourism and mining, the country still does not have a targeted strategy to attract FDI in more knowledge-intensive industries aligned with the national innovation and industrial policies. In going forward, the Dominican Republic would benefit from updating its strategy and identifying ways to take more advantage from FDI.

The country needs to address basic gaps that hamper its competitiveness. For example, on average it takes 9.4 days to clear exports through customs; this figure is above the Latin America and Caribbean average (7.8 days) and the OECD average (5 days) (World Bank, 2018[12]). Likewise, the country still lacks a resilient and reliable electric energy supply throughout the entire power grid. Although the country reduced the total electricity losses from 35% in 2011 to 24% in 2018, this figure is twice as the median of the region. Moreover, the electricity generation relies for 70% on imported fossil fuels (oil and gas) that pressure both national current account and environmental sustainability (Fitch, 2019[13]; World Bank, 2015[14]). The addition of 400 MW of solar and wind power generation in 2015-18 is an important step towards greater reliance on renewables (IRENA, 2018[15]).

Also, the development of digital infrastructure requires particular attention. In 2018, the average broadband connection speed was 25 Mbps, similar to Costa Rica but lower with respect to other countries in the region such as Mexico (34 Mbps) and Peru (50 Mbps) and six to seven times less with respect to frontier economies such as Korea and Singapore (ITU, 2020[16]). In addition, the Dominican Republic can benefit more from FDI by clarifying future opportunities and risks and by identifying new partnerships for development. Table 4.2 clarifies the outcomes of the consensus-building activity carried out in the framework of the PTPR.

Table 4.2. Benefiting more from nearshoring: opportunities, risks and partnerships

New opportunities	Risks and vulnerabilities
• Companies are implementing new localisation strategies • Cultural and creative industries • New demands for sustainability and inclusiveness could make traditional sectors willing to increase local linkages (e.g. tourism) • Tapping into local talent for start-up creation • Managing the recently established diplomatic relationship with China	• Global uncertainty • Readiness to operate in an Industry 4.0 landscape • New technologies are changing localisation drivers and could make labour costs less relevant in localisation decisions • Environmental and climate vulnerability • Uneven industrial infrastructure between FTZ and local economy • Managing relations with traditional and emerging trade and investment partners
Strategic partnerships	
• Leveraging the Dominican diaspora • Looking beyond Washington, DC to develop strategic relationship with the federal states • Forming a diplomatic and trade and investment relationship with China • Making the most of CAFTA-DR and co-operation with Latin America • Setting up targeted forms of technical co-operation with traditional partners	

Source: Government-Business Roundtable on “Making the most of nearshoring in the Dominican Republic” organised in the framework of the PTPR of the Dominican Republic on December 2019 in Santo Domingo, Dominican Republic.

To update its FDI strategy the Dominican Republic should focus on the four following areas:

- **Complementing the focus on nearshoring with an emphasis on global attractiveness.** While updating the strategy with respect to the United States is crucial, the country should not underestimate the future possibilities of investments that could originate from Canada and Latin America and the Caribbean countries as well as from new partners such as China.
- **Updating the local value proposition and country branding**. Currently, the Dominican Republic principally exploits its low-labour costs as a selling point (Table 4.3) which makes the country an effective location for labour-intensive activities. Updating the value proposition of investing in the Dominican Republic and attracting more quality FDI would require an upfront selective strategy.

Table 4.3. Labour costs are more competitive in the Dominican Republic than in China

Factors	Dominican Republic	China	Mexico
Labour costs	+++	++	++
Proximity	+++	+	+++
Skills and education	++	+++	++
Technology	+	+++	++
Infrastructure	++	+++	++
Density of production system	+	+++	++

Notes: +++ high competitive, ++ average competitive, + low competitive.
Source: Coates (2019), "Policies and instruments for (re)attracting new productive investments: lesson learned from the USA", Presentation during the Government-Business Roundtable on "Making the most of nearshoring in the Dominican Republic" organised in the framework of the PTPR of the Dominican Republic on December 2019 in Santo Domingo, Dominican Republic.

- **Deepening the gains of investment through local linkages and innovation**. Foreign firms operating in the FTZs in the Dominican Republic are rarely relying on local actors to develop new product and process solutions. These types of local linkages do not develop automatically; they are often the results of targeted policies that strengthen the local production base and improve the quality and timely supply capacity, and that make it simple and effective for foreign firms to rely on local suppliers. In Santo Domingo, the Cybernetic Park offers an example that could be scaled-up and replicated (Box 4.3).
- **Diversification away from traditional nearshoring activities.** The narrow focus on manufacturing must give way to more emphasis on new sectors like the creative and digital economy sectors. Some of the sectors that have benefited the most from the COVID-19 crisis are those that can deliver online and on-demand services. Platformisation and the distribution mechanisms for creative content are key drivers of the burgeoning digital economy. The Dominican Republic can utilise its investments in the audio-visual sector and in the Cybernetic Park to facilitate increased investment in the growth sectors like animation, gaming, and e-sports that have strong incentives for nearshoring activities.

Box 4.3. Nurturing local business talent: Cybernetic Park in Santo Domingo

Cybernetic Park of Santo Domingo (PCSD) was established in 2000 to spur industrial innovation and support the creation of innovative start-ups. PCSD is located in the centre of a major campus that includes:

- The Technological Institute of the Americas (ITLA) which provides certified training in several areas of technology such as Software Development, Information Networks, Multimedia, Mechatronics, Automated Manufacturing and Computer Security.
- A free trade zone where 16 companies with more than 200 employees operate.
- A business incubator (Emprende) to foster new start-up development.

The Cybernetic Park has both public and private participation. Over the years the PCSD developed joint partnerships also with international organisation. For example, in 2016 the IDB lab financed the development of autonomous drones capable of moving up to six pounds of medical supplies at 25 miles per hour and reaching remote areas of the country.

To achieve these goals the Dominican Republic needs to:

- **Modernising the policy approach**. The country should plan for attracting FDI within the overall national development strategy and should identify, *ex ante*, opportunities for local linkages and innovation. In addition, national policy could be modernised by shifting towards a more selective type of FDI attraction, for example by prioritising specific types of investment (e.g. more knowledge-intensive) and/or by adding in contracts specific provisions for local development (e.g. training and technology transfer provisions) (Box 4.4). Modernising the policy approach means also anticipating which sector and activities will drive the next wave of FDI. Most likely new investment in e-commerce, digital technology, cybersecurity, biotechnology, healthcare, mobility, and renewable energy will gain momentum in the near future due to the COVID-19 outbreak.

Box 4.4. Attracting FDI in Malaysia

FDI has been a key component in Malaysia's development strategy.

Tax incentive packages

Malaysia offers FDI incentives under the Promotion of Investments Act 1986 and the Income Tax Act 1967. The Malaysian Investment Development Authority (MIDA) is the autonomous agency under the Ministry of Industry (MITI), in charge of the promotion and co-ordination of industrial development in the country that also oversees and drives foreign investment in Malaysia.

It offers two main incentives packages: **Pioneer Status and the Investment Tax Allowance.**

- The Pioneer Status (PS) provides an income tax exemption of 70% of statutory income for 5 years. Unabsorbed capital allowances and accumulated losses incurred during the pioneer period can be carried forward and deducted from the post-pioneer status of the company.
- The Investment Tax Allowance (ITA) provides an allowance of 60% on qualifying capital expenditure (factory, plant, machinery or other equipment used for the approved project) incurred within 5 years from the date the first qualifying capital expenditure is incurred.

The exception and deduction for both PS and ITA can be extended up to 100% and to 10 years if the activity of the company is related to strategic activities defined by the government. Promoted strategic activities include automation of production, high-technology industries, provision of technical and vocational training, strengthening industrial linkages, value creation from oil palm biomass, in-house R&D, and green technology.

In addition, since 2015 Malaysia has introduced a principal hub (PH) package. The scheme provides a preferential corporate income tax at tiered rates (0%, 5%, or 10%) for a period of up to 10 years to foreign companies that uses Malaysia as a base for conducting regional and global businesses and operations through management, control, and support of key functions, such as management of risk, strategic decisions, finance, and human resources The PH scheme is subject to:

- A paid-up capital of USD 580 000;
- Serving and controlling a network of at least 10 to 15 of companies;
- At least 50% of the high-value jobs must be filled by Malaysians and must provide structured internship and training programmes approved by the Malaysian Talent Corporation.

Promoting linkages

The Industrial Linkage Programme (ILP), managed by the Small and Medium Enterprises Corporation (SMEs Corp) of the Ministry of Industry and MIDA, offers tax incentives to local SMEs and foreign affiliates to develop local SMEs capabilities. Local SMEs which are capable of achieving world-class standards of price, quality and capacity, are granted a tax exemption of 100% on statutory income for 5 years and Investment Tax Allowance of 60% on qualifying capital expenditure incurred within a period of 5 years. On the other hand, multinationals can claim tax deductions for costs involved in providing support to local suppliers, including training, product development and testing, and factory auditing to ensure local supplier quality.

Investing in skills

Malaysia facilitates access to foreign talent. Companies can hire expatriate personnel through two mechanisms: key post and time post. A key post is a high-level managerial post that can be held indefinitely by a foreigner that is essential for companies to safeguard their interests and investments. A term post is a post approved for up to 5 years that requires technical skills with professional qualifications and working experience in the related field. In the case of time post, Malaysians must be trained to eventually take over. The eligibility for expatriate posts is subject to a minimum paid-up capital as follows.

Time posts

- USD 60 000 for 100% Malaysian-owned company
- USD 80 000 for jointly owned firms by foreign and Malaysian
- USD 115 000 for 100% foreign-owned company

Key posts

The key posts are subject to the condition that the company must be incorporated in Malaysia and must deposit its capital of at least USD 250 000.

Source: (MIDA, 2019[17]), Investment in the Manufacturing Sector 2019: Policies, Investment and Facilities.

- **Streamlining and strengthening the institutions in charge of investment attraction.** The CEI-RD has improved synergies over the years with other institutions such as the CNZFE and other agencies under the MICM; for example by fostering supply chain development between local firms and FTZs, it developed matchmaking event organised in co-operation with the CNZFE. Moreover, along with the National Office for Industrial Property (ONAPI), the CEI-RD is currently drawing up a strategy for promoting country branding and image. Nevertheless, the level of engagement and overlapping in function and objectives among multiple institutions undermine the effectiveness of the current investment attraction strategy.

  The Dominican Republic would benefit from identifying a unique services agency for investment attraction. The CEI-RD could strengthen this function if backed with a stronger mandate for FDI attraction and improve the co-ordination and convening capacities with other relevant bodies. This change would allow more selectivity in investment attraction, would foster co-ordination with the overall national development strategy and would provide increased services to investors and parks administrators making the overall FDI management more effective. Reforms in the payroll system for staff involved in FDI management would help retain capabilities in the institutions, reducing turnover in those involved in working for FDI attraction (These talents often tend to leave for the private sector as remuneration gaps are huge). These reforms should be coupled with stronger aftermarket services, better evaluation and targeting specific investment that could favour innovation and upgrading like in Costa Rica (Box 4.5).

Box 4.5. Attracting FDI to Costa Rica: The role of CINDE

The Investment Promotion Agency (CINDE) is the agency in charge of FDI attraction in Costa Rica that was founded in 1982 as a private non-profit organisation and declared of public interest by the Costa Rican government in 1984.

CINDE is the key implementing agency for FDI attraction in Costa Rica and operates as a one-stop-shop service hub for investors. It actively scouts out potential investors, supports investors in setting-up operations and delivers aftercare services. Its private nature enables the agency to operate fast and understand the business dynamics, and its strong linkages with the Government enable the agency to operate as an effective broker between foreign investors and the national administration. Since the beginning of the decade of 2000, CINDE has adopted a selective approach prioritising the attraction of knowledge-intensive FDIs to increase the sophistication of the local production base and export specialisation. CINDE operates in strong synergy with the national Ministry for Foreign Trade (COMEX).

CINDE counts with 49 employees. As a private non-profit organisation, CINDE operates independently under the supervision of the director general that oversees the work of four departments: investment promotion, research, international affairs, and aftermarket. The director general reports to a board composed of 10 representatives from public and private institutions, which in turn reports to a general assembly. In 2019, it managed a budget of USD 4.9 million.

Source: Updated and expanded with official information (OECD, 2012[18]), Attracting Knowledge-Intensive FDI to Costa Rica: Challenges and Policy Options, . https://www.oecd.org/dev/americas/mdhcostarica.htm.

- **Complementing the incentive package with targeted tools to foster local industrial development.** When foreign firms set up operations in FTZs, they rarely develop local linkages over time if that was not envisaged in the first place. The experience from Asia, Latin America and more recently Africa, shows that it is possible to develop local linkages and to require that big companies source locally. But this happens through a process which often requires government support to bridge several gaps:
  a *The operational gap,* as the foreign firm normally has an already established network of suppliers and might not even be aware of local possibilities;
  b *The information gap*, as the foreign firm does not know rules and forms of operation in the local economy;
  c *The trust gap*: starting to work with new suppliers requires developing mutual understanding and trust, which requires time that often businesses are not ready to invest.

When FDI has led to effective local linkages these have happened through the implementation of targeted programmes like in the case of Singapore (Box 4.6).

Box 4.6. Fostering local linkages in Singapore from LIUP to PACT

In 1986, Singapore's Economic Development Board (EDB) launched the Local Industry Upgrading Programme (LIUP) to strengthen procurement linkages between outside investors and local companies. Under the LIUP, investors involve local SMEs in their value chain and seek to improve them, first in terms of general organisational efficiency (Phase I), later by transferring products and processes to SMEs (Phase II), and at the last stage, by jointly developing research (Phase III).

The cornerstone of LIUP was the secondment programme in which staff from the investing companies were working directly and along with local suppliers. Seconded salaries were covered by the EDB. By 1999, 11 large local organisations, 30 MNEs and over 670 local suppliers participated in the programme, some of which became world-class first-tier suppliers, such as Advanced Systems Automation and Manufacturing Integrated Technology.

Based on the success of LIUP in 2010 the government rolled out the Partnership for Capability Transformation (PACT), which is jointly administered by the EDB and SPRING Singapore. PACT promotes partnerships between original equipment manufacturers, either local or foreign, and local SMEs suppliers beyond pure purchasing activities.

Nature of the project

Capability development

- Supplier/partner development: A Lead Enterprise helps existing/new suppliers upgrade their technology capabilities to improve the quality of the supply chain.
- Co-innovation: A Lead Enterprise helps to co-develop and test an innovative product from its smaller supplier.
- Knowledge transfer: A Lead Enterprise develops a coaching programme to help its smaller distributors improve their cashflow management skills.

Business development

- Alliances or consortiums: A Lead Enterprise forms an alliance with smaller firms to jointly pursue new international projects. The smaller firms in the alliance benefit through having new customers/contracts.

- Shared resources: A Lead Enterprise pools common resources with smaller firms to achieve economies of scale and/or engage in shared marketing efforts.

Conditionalities

PACT projects must include a majority of Singapore enterprises, even though foreign companies can be involved in the collaboration. Support for SMEs covers up to 70% of the qualifying costs.

- The Lead Enterprise should have clear capabilities above those of the other participating companies in the project. It takes responsibility for the implementation and successful delivery of the project.
- The Lead Enterprise should help the participating companies in a manner that is beyond its normal commercial interests. For example, the Lead Enterprise should not be selling its product or service to the smaller firms through the project.

For the fiscal years 2018-20 the PACT has a total budget of USD 70 million.

Source: Heng, J. (2018[19]), "Pact scheme to include to tie ups among SMEs", The Business Times, https://www.enterprisesg.gov.sg/media-centre/news/2018/march/pact-scheme-to-include-to-tie-ups-among-smes.

Conclusions

While the global economic outlook changes rapidly and as new technologies redefine business and industrial organisation, the world also faces a pandemic that is generating economic consequences of unprecedented nature and depth. The outlook for trade and investment is highly uncertain, and the Dominican Republic needs to be prepared. The country needs to increase its resilience. Key elements of a forward-looking strategy for continuing benefiting from FDI include: 1) diversifying partners by defining an updated regional integration agenda with Latin America and the Caribbean and by paying attention to emerging partners, including China; exploring options in new economic activities, including cultural industries and start-ups; and 2) better integrating the FDI agenda in the overall national development strategy. This effort should also define incentives and tools to tap into the creative and demand potential of the Dominican diaspora in the United States and to incentivise new forms of investments from the United States beyond traditional manufacturing activities built around low labour costs.

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