

# ISSUES PAPER

## Caribbean Perspectives on Trade, Regional Integration and a Strategic Global Repositioning

### 1. Introduction

One of the most important and urgent issues the Caribbean<sup>a</sup> is facing is the contribution of trade and economic integration to the region's development, based on a strategic repositioning of their economies. This paper focuses on the challenges for the region in dealing with multiple negotiations externally, and essential adjustment and adaptation issues internally.

In short, it is argued that the current situation raises several vital questions that need to be studied urgently:

- Which trade and integration initiatives involve or affect the Caribbean ACP states, now or in the foreseeable future? How and when are these initiatives likely to do so?
- What structural transformation and adjustment is required in their economies to deal with these initiatives? What needs to be done in order to maximise new opportunities and engage in new types of economic activity?
- What are the implications for policy-makers (inside and outside the region)? What implications for development co-operation?

The present paper summarises some of the issues related to these questions and provides background for a more thorough study. The purpose of the proposed study is to inform policy makers; to provide insights to donors to the region; and to contribute to the discussions on Caribbean development in the context of the Caribbean Group on Co-operation in Economic Development (CGCED).<sup>b</sup>

### 2. Context

Before describing the main challenges faced by the Caribbean ACP states, it is useful to recall some specific characteristics.

The Caribbean states are characterised by small economic size and vulnerability. At the same time they are highly diverse in terms of physical conditions, level of development and cultural and historical background. Small economic size often leads to a high cost of financing public goods and to a lack of diversification and thus vulnerability to shocks. The region is also vulnerable to natural disasters.

On the positive side it should be noted that several Caribbean states have achieved middle-income status. Overall the human development indicators have improved considerably over the past few decades. At the same time there are countries that used to be in the middle-

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<sup>a</sup> In this paper, the Caribbean is defined as the 15 Caribbean ACP States that have special ties with the European Union.

<sup>b</sup> The CGCED will meet in Washington in June 2002.

income group are now in the low-income group. Only one Caribbean state, Haiti is in the least-developed group.

One of the main economic advantages of the Caribbean follows from its location close to the US and Latin American markets. The Caribbean also derives benefits, beyond those that would follow from its economic size, from its historical links to Europe. Another asset for the region is the diaspora community, which is a source of remittances, but also a network for economic opportunities. At the same time the location has negative effects in the form of exposure to the problems of drug trafficking and money laundering.

Given their small economic size, an inward-looking strategy is not at all a development option for Caribbean states. With some exceptions, they have generally been fairly open in terms of trade in goods and services and this has led to positive results.

As part of their overall development strategy, the Caribbean ACP states have made progress on regional integration by creating the Caribbean Community (CARICOM). In addition there is the Organisation of Eastern Caribbean States (OECS), which combines the smallest states in the region and which established a monetary union. There has been significant progress on functional co-operation, sometimes handled by separate successful institutions such as the Caribbean Development Bank (CDB) and the University of the West Indies. Two other regional institutions should be mentioned: the Regional Negotiating Machinery (RNM) and the Caribbean Export Development Agency (CEDA) There has also been important progress towards the Single Market and Economy, even though there are still outstanding questions and there have been delays with the implementation of the various protocols (see below).

It is a serious challenge for the Caribbean countries to handle the parallel issues in an optimal way. Certain themes will figure in all the negotiations so that expertise/capacity can have multiple uses. But there is also a risk that the results of different negotiation processes will lead to contradictory requirements.

### **3. Challenges**

#### **3.1 On the integration and trade fronts**

The main challenges confronting the Caribbean states in the area of trade and economic integration can be summarised as follows:

- To accelerate the completion of the single market and to widen its scope in terms of free circulation of production factors, and the involvement of new members and partners;
- To prepare forward-looking negotiating positions that go beyond purely defensive attitudes to create and foster new opportunities for trade, investment and development;
- To improve existing bilateral agreements (with the Dominican Republic, Cuba, Colombia, Venezuela, Central America, Canada);
- To ensure consistency between internal and external agreements and negotiations;
- To optimise the strategic and tactical approach to current and future negotiations.

These challenges emanate from several parallel developments in the area of trade and integration. In order to illustrate the issues at stake, the following developments can be mentioned:

- ***Completion of the Caribbean Single Market and Economy (CSME), including the integration of Suriname and Haiti in the CSME***

Once implemented, the CSME will facilitate economic integration and the movement of goods, services and capital throughout the CARICOM area. This will help with the integration of the region in the global economy, through improving the competitiveness of the region.

The completion of the CSME is vital to the further development of CARICOM, but in order to ensure its successful implementation, careful consideration will have to be given to the needs of countries, which might be disadvantaged, albeit temporarily, by the process.

It will be important that the private sector maximise the opportunities created by the CSME. The full commitment of CARICOM countries to the achievement of deadlines for the CSME is also essential.

The DFID funded study to be presented at the June 2002 CGCED meeting should help to identify the main issues, priority areas for action on the CSME, provide a time bound action plan to be addressed on a regional/national level and an assessment of the institutional, including legal framework, and financial needs of the region for implementation of the CSME. It is also intended to recommend the most appropriate role for donors/ development partners in the process.

- ***Effective implementation of the FTA between CARICOM and the Dominican Republic***

This free trade agreement was signed in August 1998, and provisionally entered into force in December 2001, with ratification still ongoing in several countries. The FTA adds an important element to the regional functional co-operation in place under the ACP-EC Lome Convention and its successor, the Cotonou Agreement. The Dominican Republic is the most populous Caribbean ACP country and has the largest GDP. Based on reciprocal market opening, with certain products excluded, the FTA makes special provision for the “less developed” CARICOM members, which will not have to grant preferences from the beginning, unlike the “more developed” countries (Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago). The FTA also covers TBT, SPS and investment issues, while further agreement will be sought on issues such as trade in services and government procurement.

Further economic integration between CARICOM and the Dominican Republic will enhance business opportunities, and help prepare the countries involved for trade liberalisation under WTO, FTAA and the ACP-EU Cotonou Agreement. It will build on established functional integration and joint institutions, including the Caribbean Regional Negotiating Machinery (RNM), which serves both CARICOM and the Dominican Republic. At the same time, it exposes the countries involved to new challenges resulting both from incomplete integration and increased competition. In general, increasing trade, transport and investment links is a major challenge for the region.

- ***Effective participation in the Doha Development Agenda***

In line with the principles and objectives of the Marrakech Agreement Establishing the World Trade Organisation, the Ministerial Declaration adopted in Doha in November 2001 aims at maintaining the process of reform and liberalisation of trade policies, with a view to promoting growth and development. In order to further these objectives, developing countries shall benefit from enhanced market access, balanced rules, and well targeted, sustainably-financed technical assistance and capacity-building programmes. Regional trade agreements can also play an important role.

The Work Programme undertaken in Doha includes a wide range of issues, including issues related to the implementation of existing WTO Agreements, the built-in agenda resulting from the Uruguay Round (agriculture, services), the Singapore issues (investment, competition, government procurement, trade facilitation), WTO rules, etc. Separate mention is made of least-developed countries, of issues relating to the trade of small economies, and of special and differential treatment for developing countries, which shall be looked at under the Work Programme.

Under the Doha Declaration, negotiations shall be concluded by 1 January 2005, with a stock-taking session of the Ministerial Conference in 2003 in Mexico. For the Caribbean this means having to handle a large number of issues in a relatively short period of time. The issues include complicated and controversial ones which Caribbean states might have preferred to keep off the agenda. However, now that they are on the table, the Caribbean must ensure their interests are properly taken into account. This includes not only special and differential treatment, but also offensive interests where further market opening or enhanced regulation may benefit the region. As for timing, the Doha Development Agenda now has the same target date as the Free Trade Area of the Americas (FTAA) ...

- ***Effective participation in the negotiations of the Free Trade Area of the Americas (FTAA)***

With the aim of promoting prosperity through hemispheric economic integration and free trade, all countries in the Western Hemisphere except Cuba are negotiating a free trade agreement that should be balanced, comprehensive and consistent with WTO rules and disciplines. Free and fair trade, increased investment and greater economic integration shall promote economic, social and environmental progress. It has also been stated, at the highest level, that differences in the level of development and size of the economies involved shall be taken into consideration. Technical assistance is to be provided for implementing adopted business facilitation measures, and on request where FTAA issues are concerned more generally, especially where smaller countries are involved.

The results of the negotiations shall constitute a single undertaking covering issues such as market access, agriculture, services, TRIPs, investment, government procurement, competition, subsidies, antidumping and dispute settlement. Alongside the corresponding negotiating groups, a consultative group on smaller economies has been set up to ensure that the interests of smaller economies are taken into account. Negotiations shall be concluded no later than January 2005 and implementation of the FTAA shall start no later than December of that year.

For the Caribbean states, the FTAA implies the opportunity of participating in hemispheric trade liberalisation. It would consolidate and secure the legal basis of access to the US market, which now depends on unilateral measures of the US (for example the Caribbean Basin Initiative). It should also improve access to the markets of major Latin American countries such as Brazil and Mexico. Trade and investment in the Caribbean should benefit from this as well as from enhanced regulation in many trade-related areas.

At the same time there are significant risks and uncertainties. Some privileges in market access (e.g. Caribbean – see below – or CBI) would now be extended to all the countries in the Western Hemisphere. Trade liberalisation may also result in reduced customs revenue as well as in increased competition in some sectors, thus affecting the profitability of Caribbean companies.

While there is some recognition of the special problems of small economies within the FTAA process, and while longer transition periods and technical assistance for them have been suggested, there are as yet not many indications as to the “special and differential” treatment that will be possible, or to which “smaller economies” it will apply. Nevertheless, these are particularly important questions for the Caribbean countries.

- ***Negotiating Economic Partnership Agreements (EPAs) with the EU***

Under the ACP-EU Cotonou Agreement, signed in June 2000, economic and trade co-operation shall aim at fostering the smooth and gradual integration of the ACP States into the world economy. To this end, their production, supply and trading capacity are to be enhanced as well as their capacity to attract investment. These objectives will be supported through the national and regional development strategies, and trade development measures as a means of enhancing ACP competitiveness. On the ACP side, appropriate trade and investment policies shall be strengthened, as well as the capacity to handle all issues related to trade.

In order to best achieve these objectives, ACP-EC economic and trade co-operation will build on regional integration, which is a key instrument for promoting integration, smoothly and gradually, into the world economy. To enhance the benefits and credibility of such regional integration, in terms of increased market size and specialisation, and a transparent and robust enabling policy environment, ACP and EU will negotiate new WTO-compatible trading arrangements that will progressively remove barriers to trade. Such barriers include not just border measures but also other factors causing market segmentation, such as uncompetitive practices, unprotected intellectual property rights, diverging product standards, etc. Thus co-operation shall be stepped up in these and other trade-related areas.

In view of the above objectives and principles, ACP-EC economic partnership agreements (EPAs) shall be negotiated, in accordance with the procedures agreed by the ACP Group and taking into account regional integration, between September 2002 and December 2007. During the negotiations, due account will be taken of differences in level of development, the likely socio-economic impact, and ACP capacity to adapt and adjust to liberalisation. Negotiations will therefore guarantee flexibility with regard to the duration of a sufficient transitional period (starting in 2008), the final product coverage and the timetables for tariff dismantlement, while remaining in conformity with WTO

rules. It is anticipated that EU liberalisation will be implemented earlier, faster and with less exclusions than ACP liberalisation.

The EPAs hold out the prospect of increased trade and investment based on economic liberalisation, consolidating and deepening regional integration and taking full account of the development needs of the Caribbean countries. Consolidating and securing the legal basis for access to the EU market is an important aspect of this, but this is far from the whole story.

As in the case of the FTAA, liberalisation will require adjustment and adaptation, including risks of reduced customs revenue and pressure on the profitability of Caribbean companies. The EU seeks to address these risks by negotiating flexible liberalisation arrangements and by supporting policy reform and private-sector competitiveness in the Caribbean.

- ***Negotiating an FTA between CARICOM and the Central American Common Market (CACM)***

Both the Dominican Republic and CARICOM have sought closer relations, including a free trade agreement, with the CACM countries (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama). Such an agreement was reached between the Dominican Republic and the CACM countries in 1998, but not all countries have as yet ratified it and discussions are continuing about some sensitive products. At the same time, CARICOM has worked on improving relations with the CACM countries, with the first meeting of the countries' leaders taking place in February 2002. This followed a series of ministerial meetings over the years, during which a CACM-CARICOM FTA was called for as a priority. These meetings and agreements are clear attempts at alliance building with regard to WTO, the FTAA process and preferential access to the U.S. market. By defining joint positions, the CARICOM and CACM countries can increase their bargaining capacity.

- ***Enhanced trade relations between CARICOM and Canada***

At their Summit in Montego Bay, Jamaica, in January 2001, Heads of Government of CARICOM and Canada decided to begin exploratory work on "a more mature trade relationship." In this context, a Joint CARICOM/Canada Working Group was set up to prepare for negotiations. The objective of enhanced trade relations should be seen against the backdrop of the FTAA negotiations and of the Caribbean scheme for preferential access to the Canadian market.

Since 1986, Caribbean gives the CARICOM countries and the Dominican Republic duty-free access. A WTO waiver applies until 31 December 2006. Footwear, textiles and clothing have been excluded, while for other products relatively strict rules of origin apply. Despite preferential access to Canada, the Caribbean countries have seen their exports decline after 1996. This may be one of the reasons for seeking enhanced trade relations. Another reason may be the FTAA negotiations. Firstly, because these are to result in enhanced market access for all countries involved, including non-Caribbean competitors over whom the Caribbean countries would like to have a head-start. Secondly, because it may be that the Caribbean expects Canada to give more positive

consideration to their specific situation and development needs, which could then influence the shape of the FTAA.

- ***Trade relations with other Latin American countries: Venezuela, Colombia and Cuba***

CARICOM has trade agreements with Colombia and Venezuela which are evolving from unilateral to more reciprocal arrangements. Since 1995 and 1993 respectively, CARICOM exports have benefited from trade preferences with the aim of providing additional CARICOM access to the markets of some of its closest South American neighbours. However, exports have not increased (Colombia) or remain limited (Venezuela). In 1999, CARICOM agreed for its “more developed” members to grant preferential treatment to Colombia. Likewise, reciprocity is due to be introduced in the trade agreement with Venezuela. For CARICOM, these agreements offer prospects of greater integration, enhanced competitiveness and increased exports, as well as public and private sector alliance-building. At the same time, they put additional strain on CARICOM negotiators and may raise specific adjustment issues.

Cuba, a member of the Caribbean Forum of ACP States, and CARICOM signed a trade and economic co-operation agreement in July 2000. This includes duty elimination or reduction for several products (with preferences for Cuba given by the “most developed” CARICOM members), as well as investment and intellectual property issues. For CARICOM, Cuba represents a relatively large market and a partner for functional co-operation, e.g. in education. While increased CARICOM exports to, and investment in Cuba have been reported, there are still significant obstacles to both trade and investment.

### **3.2 Structural transformation and a strategic repositioning**

In view of the above, there is a need for a strategic repositioning of Caribbean economies, including a reorientation towards new types of activities in order to achieve economic diversification and sustainable economic growth. The assumption that small economies cannot compete in international markets is not valid. There is scope for a strategic economic repositioning that taken into account a number of elements: a highly educated and skilled labour force; the possibilities for niche marketing, strategic alliances and co-operation involving governments, business and civil society in the wider Caribbean, etc. One missing element is corporate integration of national companies that outgrow their markets and accelerate the flow of goods and services, capital and finance throughout the region. Furthermore, the region needs to complete and consolidate internal integration arrangements, notably the CSME.

Some of the main challenges which the Caribbean is facing under the heading of structural transformation and adaptation, and strategic repositioning, include the following:

#### ***3.2.1 Adjusting proactively and forging an enabling environment for business***

The trade and integration initiatives mentioned above will involve a restructuring of the economies of the Caribbean countries. However, this offers certain opportunities which should be seized. Restructuring can break traditional trade dependencies on a small number of markets and commodities, and as such is a precondition for addressing marginalisation in terms of trade and investment. As argued above, it is

obvious to the EU that this restructuring process must take place in line with the adaptation capacity of the ACP countries concerned.

Furthermore, economic integration and liberalisation cannot by themselves tackle supply-side constraints, nor are they able to ensure the full integration of the Caribbean ACP countries into the world economy, nor to promote their sustainable development. It is therefore essential that liberalisation is accompanied by appropriate flanking policies of the ACP and that appropriate support measures are made available.

Indeed, trade liberalisation will need to be complemented by development policies in areas such as regional integration, macroeconomic and social policies, environmental policies, good governance (e.g. administrative and legal reforms), supply-side measures (e.g. private sector development, infrastructure development), fiscal reforms and assistance in trade-related areas such as customs administration, investment promotion and protection, competition policies and standards.

These policies and measures are needed to enable rapid adjustment in anticipation of and in response to global changes. Such adjustment is required at macro, sectoral and micro level, and involves both public and private actors (also see below).

### ***3.2.2 Macroeconomic harmonisation and deepening of regional integration structures***

A natural complement of deepening integration is the gradual harmonisation of macroeconomic policies. A first step in that direction can be in the form of joint surveillance of macroeconomic policies. This calls for the collection and processing of reasonably comparable data. Peer pressure, on the basis of regular joint reporting on a set of agreed indicators, is a rather gentle way towards sound economic policies. Sanctions can only be considered as a last resort and provided that integration is sufficiently deep. Monetary cooperation can take the form of pegging the exchange rates to the same outside standard (US\$ or a combination of US\$ and Euro). In the long run monetary union could be considered

Stronger regional policies and decision-making mechanisms including a functioning Court of Justice may dilute the influence of rent seekers and foster competition, accelerate and lock-in necessary reform, promote the collective use of qualified HRs across the region, increase bargaining power vis-à-vis 3<sup>rd</sup> parties ...

It is necessary to improve regulatory frameworks and economic legislation to match best practice in particular in taxation, alternatives for government financing (decreasing dependence on tariff revenues), financial services, procurement, dispute settlement, IPRs, technical, labour, environmental and sanitary standards ... regional harmonisation of liberalised investment regimes ...

More effective regional institutions and policies would make the Caribbean more attractive for investors. The strengths of the region include locational advantages, education levels, language skills (including diversity) and trade openness. The liberalisation of trade and services between countries will also call for a more pro-business climate within countries. Government policies, procedures and administrative systems must facilitate inward investment.

The private sector must respond to the changed regional and international trading environment through increased competitiveness and innovation. This will require improved human resources and focussed research, including support via relevant government institutions. Public and private sector alliances are necessary to identify strategies designed to achieve competitive advantage for the region. This will include the development of physical infrastructure, but also education and training programmes that will exploit the region's potential.

It is necessary to develop support services and to foster competition in transport and communications: 1. Maritime: improve infrastructure and facilitate competition introduce information system for shipping, trans-shipment centres, etc.; 2. Air: improve institutional and legal framework sub-regional hubs? ... facilitate extra-regional joint ventures 3. Telecommunications: harmonise laws and common regulatory framework; to put in place a pro-competitive regulatory framework for communication services, through the adoption of policies which promote access to ICT notably through investment and partnerships, therefore reducing the digital divide.

### **3.2.3 *Diversifying exports***

The Caribbean has been dependent on a narrow range of traditional exports, which were largely protected under preferential trading arrangements (EU, US, Canada). Aspects of these preferential trade agreements are increasingly seen as non-compatible with WTO obligations. This necessitates that the Caribbean region moves from outmoded exports to the development of more diversified new export opportunities.

The diversification process must particularly look at the export potential of services, as well as non-traditional goods linked to the services sector.

The development of service exports will include tourism and financial services, but also a wide range of other services such as medical and health, education, informatics, etc. This should help to establish a set of priorities for policy development, which could direct investment and other incentives for improved export performance. It should also identify obstacles to investment in these areas.

### **3.2.4 *Strategic corporate alliances, clustering, vertical integration***

With the opening up of markets, there should be scope for the development of business networking, with joint ventures of local and international investment

Countries within the Caribbean should exploit opportunities for joint activities and marketing, including exploiting the potential for increasing value added within the region.

Transnational corporate alliances and multinational corporations may facilitate a complementary relationship derived from differences in wage levels and factor endowments ... locational differentiation, improved capital base, larger pool of expertise and resources.

### **3.2.5 *Capital, services, new technologies and marketing***

Negotiations at hemispheric and international level will oblige CARICOM member states to consider its particular comparative advantages. This will also take account of the advantages accruing from the implementation of the CSME. CARICOM's approach to negotiations at international level must be consistent with the desired development of the capital and service sectors.

There is a need to re-examine national policies so as to increase access to foreign investment flows and to exploit the opportunities offered by a harmonised Caribbean investment area.

The negotiation of extra-regional free trade agreements will also increase the attractiveness of the region as an investment location, through providing a more favourable trading environment. However, this will also require the abolition of the many obstacles to investment (e.g. restrictions on movement of capital and labour, licensing).

The liberalisation of the telecommunications environment within the Caribbean should help to exploit new business technology opportunities. The facilitation of long distance services should help to mitigate the impact of the islands' small internal markets.

There is a need to encourage research into the new opportunities offered under the potential trading agreements and to devise strategies to respond at a national and regional level. Information technology and its infrastructure should be central to the planning efforts of national regional authorities.

To avail of opportunities, governments and the private sector must work together. This will entail joint promotion and marketing efforts and full participation of regional and national bodies (such as Chambers of Commerce).

The advances in trade liberalisation need to be accompanied by support for increased competitiveness of firms and organisations and improved marketing and information will be critical. This will require continued donor support for the trade facilitation efforts of the region.

#### **4. Results**

Taking into account the above challenges, the proposed in depth study should describe and assess the opportunities and risks for the Caribbean countries of the on-going and foreseen trade and integration initiatives. The study should address:

- the objectives of these initiatives: what do they aim to achieve?
- the development logic behind these initiatives: What are their development objectives? How are these to be achieved? What linkages between trade, aid and poverty eradication are assumed or fostered? What role for governments, donors, private sector?
- the main issues involved in these initiatives: What is at stake in the negotiations?
- the question of timing: When are negotiations supposed to start, accelerate, finish, result in implementation?

The second dimension of the proposed study should analyse and define different strategic repositioning scenarios, taking into account the challenges identified above (adjusting proactively and forging an enabling environment for business; economic convergence, using the CSME, human resources, research and development, diversification, strategic corporate alliances, capital , services, new technologies, etc.).

Lastly, the proposed study should outline the options for policy-makers involved in the above trade and integration initiatives; suggest implications for economic and development co-operation; and formulate recommendations. The recommendations should also address the role of donors.

The study should be completed between April and June 2002 so that it can be presented to the CGCED meeting.