RNM/OECS COUNTRY STUDIES TO INFORM TRADE NEGOTIATIONS: OVERVIEW

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PREFACE

The OECS Country Studies were commissioned by the Regional Negotiating Machinery (RNM) and the OECS Secretariat, primarily to assist the member countries in identifying their interests in the on going international negotiations regarding the successor to Lomé IV, the Free Trade Area of the Americas (FTAA) and the ongoing and projected negotiations under the auspices of the World Trade Organisation (WTO). It is expected that the country studies would be used in national consultations to sensitise the public to the issues involved in these negotiations. The studies will also provide information, which can be used by the RNM and the private sector in crafting their approach to the negotiations. The studies cover the six independent territories (Antigua and Barbuda, Dominica, Grenada, St. Kitts-Nevis, St. Lucia and St. Vincent and The Grenadines) while companion studies would be completed independently for Anguilla, the British Virgin Islands and Montserrat.

The studies were conducted based on the following Terms of Reference:

1. Review the immediate past and current economic performance of each country, while accounting for such performance.

2. Identify and assess the critical economic sectors and sub-sectors of each country. Particular attention should be paid to the export-oriented sectors and sub-sectors. The identification should be according to country, firm and product. The assessment should include a careful characterisation focussing on, among others:-

    (i) production structure and capacity;
    (ii) contribution to GDP, employment and foreign exchange earnings;
    (iii) export performance
    (iv) investment; and
    (v) fiscal measures.

3. Review the development agenda of each country while situating the critical economic sectors and sub-sectors therein. The sectors and sub-sectors of interest to each country, from the standpoint of their respective future economic development, should be carefully examined.

4. Carefully identify the major constraints to expansion facing each of the identified critical sectors and sub-sectors. The constraints should be in the context of the sectors and sub-sectors ability to compete domestically, regionally and internationally.

5. Analyse the implications of the on-going negotiations for a successor Convention to Lomé IV, the FTAA and those taking place and projected under the WTO, at the national, sectoral and sub-sectoral levels with recommendations regarding negotiating interests that could surmount/realise any problems/opportunities that are likely to arise.

6. Identify the rationale for any differentiation of the OECS position from the rest of CARICOM.

The consultants met on two occasions in Barbados to review the terms of reference and discuss the work programme on August 10, 1999 and September 04, 1999. The work programme was submitted to the RNM and final approval for go ahead on the project was received on October 14, 1999.

The schedule of introductory visits was to have commenced on November 22, 1999 starting with St. Kitts, but had to be rearranged due to the intervention of hurricane Lenny. The consultants met in Dominica on 25 November and held discussions with a number of officials and agencies, including EDADU. The meetings set out the purpose and objectives of the project and sought to identify sources of information and to establish contacts for further consultation. Preliminary data on the performance of the major sectors and leading firms were collected. Similar meetings were held in St. Lucia, St. Vincent and Grenada between 28 November and 3 December 1999. Initial field visits were made to St. Kitts and Antigua during 9 to 13 January 2000 and a number of follow-up visits were undertaken to collect further information.

The study consists of an overview paper that discusses the crosscutting issues that affect all of the OECS economies and six country papers that provide more detailed information on the individual countries. The difficulty of separating regional issues from those related to the individual counties may mean that some of the information is repeated.

After the introduction the Overview paper provides context to the studies by giving a brief discussion of the recent economic performance of the OECS and the factors that underlie it. The paper then looks at some of the general issues related to the competitiveness of the productive sectors. The common issues affecting the agricultural, manufacturing and services sectors are discussed. Attention is then turned to the trade policy issues that arise from the analysis of the sectors and the imperatives for transitioning to the new global trading environment. The discussion of the fiscal implications of trade liberalisation and the results of the simulation of the fiscal effects are then presented along with some recommendations to minimise the impact on the revenue of the countries.

The individual country papers follow a similar outline. The recent macroeconomic performance, including fiscal developments, of the economies is reviewed and the factors determining the same are discussed. The economic development strategy as presented in recent Medium Term Economic Strategy Papers are reviewed identifying the major sectors of interest to the countries, the major constraints on macroeconomic performance and the major policy issues that the countries face. The economically important sectors and sub-sectors are reviewed in terms of their structure, contribution to GDP, foreign exchange earnings and the constraints and opportunities. The analysis then turns to the trade policy issues and the fiscal implications of trade liberalisation. Simulations of the revenue impact were conducted for all the countries where dada are available. The difficulties experienced in obtaining data for Antigua and Barbuda severely curtailed the range of simulations that could be conducted for that country.

While the individual country studies are independent of each other they should be read in conjunction with Overview paper.

INTRODUCTION

The member countries of OECS face a difficult period of transition to a more liberalised international environment. The emerging international order is less accommodating, even hostile to small developing countries and hence it calls for more focussed policy-making and strategic planning. The authorities are largely aware of the gravity of the circumstances they face and have sought to address the situation in a variety of ways. The Medium Term Economic Strategy Papers which set out the near-term strategy for dealing with the challenges of globalisation represent the national responses to these difficult circumstances. At the regional level the OECS Economic Development Strategy is an attempt by the authorities of these countries to pause and take stock of the current situation and engage in an exercise of strategic visioning for the future. This involves:

(i) A comprehensive audit of the current resources, policies, programmes and projects to determine the state of the economies.

(ii) The development of a comprehensive and focussed vision of the future of the economies, which covers a twenty-year horizon and involves the identification of the structure of the economies to give effect to the vision.

(iii) The articulation of a feasible and focussed implementation strategy for the achievement of the stated objectives.

In order to survive the vagaries of globalisation and liberalisation, small states like the OECS must re-position themselves in a relatively short space of time. Their development strategy must be guided by a rational and pragmatic philosophy, and must be informed by the facts of globalisation, liberalisation and the special circumstances of small states. The critical imperative is to transform these small, vulnerable and underdeveloped economies into competitive entities. This calls for deliberate policies for building capacity at all levels and for determining the mix of economic activities in which these economies can be internationally competitive. Even producers for the domestic market will have to face this acid test, since they too will be open to competition from abroad.

The Commonwealth Secretariat-World Bank (2000) study of small states identified the following, with respect to the transition to a changing global trade regime:

(i) Small states would need to adapt/transform their economies to take advantage of the benefits of the changing global environment. Since trade policies would be a critical part of the adjustment they would need to send clear signals about the direction of trade and regulatory policies and the length of the transition period that would be necessary.

(ii) They face special problems in adjusting to the changing environment and would need time to adjust. The vulnerability of small states provides justification for special consideration.

(iii) These states lack the resources to participate effectively in international trade negotiations and assistance in building the capacity would be necessary.

(iv) Trade liberalisation would adversely affect the fiscal position of these economies and they would need to adopt more broad-based consumption taxes as they switch towards the production of services.

All of these issues apply with equal force to the OECS economies and the development strategies of the countries seek to address some of these. The major issue seems to be lack of consistency between the trade policies and the development objectives. This dilemma seems to arise from a timing problem. While all states are aware of the need to adopt more liberal trade regimes in the long run concerns about the adverse impact on economic activity and employment forces caution in the dismantling of protective domestic trade regimes.

RECENT GROWTH EXPERIENCE

During the Decade 1980 to 1990 the OECS economies grew at an average of approximately 6%. The real growth rates ranged from 4.4% to 7%. This growth performance was achieved in spite of two recessions in the developed countries at both ends of the decade and the passage of destructive hurricanes. The growth in the economies was due to the conjuncture of favourable circumstance, which may not be repeated:

- Expansion in agricultural production as a result of trade preferences and favourable exchange rate movements;
- Growth in tourism due to the expansion in the infrastructure (airports and hotels) largely funded by concessional financing and Foreign Direct Investment (FDI);
- Improved fiscal performance of most of the OECS countries;
- Increasing economic integration both at the OECS and CARICOM level which implied freer trade between the states;
- The OECS countries ability to attract concessionary external financing from multilateral and bilateral donor agencies.

During the 1990's real growth rate in the OECS countries fell off drastically averaging about 2%. This was mainly due to the international recession of the early 1990s but also reflected some of the structural weaknesses of the economies. These weaknesses include:

- The narrow resource base and consequently the export concentration of the economies.
- The OECS economies were operating under protective trade regimes, which adversely affected their competitiveness and inhibited structural changes.
- There was too heavy reliance on the government sector for growth and development. Growth was largely driven by the Public Sector Investment Programme (PSIP) of these countries.

With respect to the sectoral changes in the economy the following can be observed:

- Agriculture has declined significantly over the period. It declined from 14.4% of GDP in 1984 to 8.5% of GDP in 1998. In 1977 the percentage was 19.8. While the decline in the contribution of agriculture to GDP is a natural tendency in economies historically the large decline experienced by the OECS countries is noteworthy.

- Hotels and Restaurants which serves as a proxy for tourism grew from 9.05% in 1984 to 10.02% in 1998.

- The contribution of the Manufacturing sector declined from 7.14 in 1984 to 6.0% in 1998. The contribution of this sector peaked in 1984, as its contribution was 5.9% in 1977.

- Government services contributed 18.5% of GDP in 1980 and its contribution declined to 15.2 in 1998.

- Communications is one of the fastest growing area in these economies. Its contribution increased from 3.5% in 1984 to 9.6% in 1998. This growth is reflective of the increased dependence of the modern economy on telecommunication services and consequently the need to have competitive prices.

- Financial services in the form of banking and insurance also increased its contribution, from 6.7% in 1984 to10.8% in 1998.

What clearly emerges from these observations is that the economies have been restructured away from agriculture and manufacturing towards the provision of services. The most surprising has been the phenomenal growth in communication services, which has experienced growth at an average in excess of 25% per year.

AGRICULTURE

The OECS has long realised that reliance on a single economic activity for a predominant share of their income and employment makes for a risky, uncertain and unstable world. More recently, economic globalisation and the move towards trade liberalisation have brought this reality into sharper focus. Member countries have always toyed with the idea of diversification, but in this global economic world, they are looking upon diversification with greater urgency. However, Habasch et al have shown that diversification in agriculture has a negative effect on productivity. They offer that a country would have problems maintaining its comparative advantage if it were to spread its research capabilities among too wide an array of agricultural activities. What this suggests is that, while diversification is a desirable goal, OECS policy makers should avoid spreading their resources too thinly and they should be selective in the economic activities they diversify into. The consensus among economists is that a country is best served by concentrating its productive resources in the activities in which it has a comparative or international competitive advantage.

This section analyses the export competitiveness of OECS agriculture. The concept of Revealed Competitive Advantage (RCA) was employed to conduct the analysis. RCA is based on the notion that a country's comparative or competitive advantage in a given commodity is revealed in its observed trade patterns. Accordingly, RCA indexes are derived from import and export shares. The particular RCA index used in the analysis, RCA10, was conceived by Vollrath, and is attractive because its construction comes closer to the theoretical definition of comparative advantage than that of most other RCA indexes. A positive RCA10 reveals comparative or competitive advantage, while a negative value reveals a comparative disadvantage. The larger the RCA10, the more competitive is the country in the export of the commodity in question.

COMMODITY COMPETITIVENESS

Traditional Export Crops

Some of the traditional exports of the OECS include sugar, bananas, cocoa, spices, and citrus fruits. All four of the Windward Islands export bananas, while Antigua and St. Kitts and Nevis are importers. The RCA10 indexes suggest that all the countries in the OECS are trade competitive in bananas. As to be expected, in terms of relative competitiveness, the Windward Islands led the way. During the 1991-1993 period, Dominica, with a RCA10 of 7.3, was deemed the most export competitive. St. Lucia and St. Vincent followed, respectively, with RCA10 values of 7.2 and 7.1. However, between the two periods of study, 1991-1993 and1994-1996, the competitiveness of Dominica, St. Vincent and Grenada declined such that St. Lucia replaced Dominica as the most competitive of OECS states in banana exports.

Among OECS states, only St Kitts and Nevis were net exporters of sugar and honey. Not surprisingly, it was the only country shown to be export competitive in this commodity. Nevertheless, the RCA10 results suggested that over the periods of study the competitiveness of St. Kitts and Nevis declined slightly from a RCA10 of 5.0 to a RCA10 of 4.8.

During the study period only Grenada, St. Vincent and St. Lucia traded in cocoa. By far, Grenada was the largest exporter of the commodity, and the most export competitive. All three countries gained in export competitiveness, with Dominica registering the largest gain, from an RCA10 of 0.87 to 1.6. Grenada was also the largest exporter of nutmeg. Its export competitiveness (RCA10 value of 9.2) in nutmeg during the 1994-1996 period was almost twice as high as that of St. Vincent, the only other OECS country to export nutmeg in that period.

Dominica was the largest exporter of citrus fruits among OECS countries, and with an RCA10 index of 2.8 for the 1994-1996 period it too was the most export competitive. St. Lucia, on the other hand, saw its position changed from being competitive (RCA10 of 2.9) during the 1991-1993 period to being non-competitive (RCA10 of -1.5) during1994-1996. Meanwhile, St. Vincent? s position improved from being non-competitive (RCA10 of -0.5) to being competitive (RCA10 of 0.4).

Non-Traditional Export Crops (See Annex for RCA 10 Indicators).

The non-traditional exports under consideration include tannia, taro, plantains, yams, coconuts, avocados, cinnamon, mangoes, ginger, pumpkin, sweet potatoes, papayas and pineapples. Regarding tannia and taro, over the periods of study, Dominica was the only country that traded in these commodities and with computed RCA10 values of 9.4 for tannia and 6.6 for taro, the country was considered export competitive in both commodities.

Dominica, St. Lucia and St. Vincent were the three OECS countries that traded in yams. All three countries were considered competitive, but, with an RCA10 of 7.7, Dominica followed by St. Vincent (RCA10 of 6.1) was the most competitive. Similarly, these three countries were the only ones that traded in plantains during the 1994-1996 period. All three were deemed export competitive, with Dominica being the most competitive and the largest exporter.

Only the Windward Islands traded in coconuts. St. Vincent followed by Dominica was the largest exporter and the most competitive. However, while the export competitiveness of St. Lucia and Dominica improved over time that of Grenada and St. Vincent declined, respectively, from RCA10 values of 4.3 and 6.1 to 2.5 and 5.8.

St. Lucia and Dominica were the only countries that traded in avocados and ginger over the periods of study. Dominica was not only the largest exporter of both commodities but was also the most export competitive. For example during 1994-1996, Dominica had an RCA10 index of 4.7 for avocados and 3.9 for ginger, compared with 2.3 and 1.1, respectively, for St. Lucia.

Except for Grenada, the windward islands were exporters of mangoes. Dominica, followed closely by St. Lucia, was the most export competitive. The competitiveness of all three countries (Dominica, St. Lucia, and St. Vincent) improved overtime, with Dominica showing the greatest improvement.

Dominica, St. Vincent and Grenada were considered competitive in exports of pumpkin. The export competitiveness of all three countries improved over time. Based on the RCA10 results, Dominica followed by St. Vincent was deemed the most export competitive.

St. Lucia was the only country to trade in pineapples, and with exports of $95 thousand its competitiveness improved from a RCA10 of 0.6 during 1991-1993 to 2.9 during 1994-1996. Likewise, St. Lucia was the only country that traded in papayas. However, it exported only $2 thousand worth of the commodity over the 1994-1996 period, and with an RCA10 index of 0.586 it was marginally export competitive.

St. Vincent and St. Lucia were the only countries to trade in sweet potatoes. St. Vincent was by far the largest exporter. Between 1991-1993 and 1994-1996 the export competitiveness of St. Lucia improved from a RCA10 index of 1.0 to 1.7. Notwithstanding, with an RCA10 index of 6.8, St. Vincent remained the more competitive of the two countries.

AGRO-PROCESSED COMMODITIES

The analysis focuses on beverages, oil and fats, rice, wheat bran and wheat flour. St. Lucia and St. Vincent were the only two countries that exported beer during the 1994-1996 period. Both countries were considered competitive, with St. Lucia exhibiting the greater degree of competitiveness. The other countries were shown to be non-export competitive. Regarding exports of non-alcoholic beverages, only St. Kitts was considered to be export competitive.

St. Kitts, St. Lucia and St. Vincent were the three exporters of oil and fats. With a negative RCA10 index, St. Vincent was deemed non-export competitive, while with a RCA10 index of 1.5 St. Kitts and Nevis was considered the most competitive. Considering just coconut oil, Dominica with, a RCA10 index of 4.7, followed by St. Lucia with a RCA10 of 3.4 was considered the most competitive.

St. Vincent and Grenada were the only exporters of wheat bran and wheat flour. Both countries were competitive in each of the two commodities. Of the two countries, St. Vincent exhibited the greater level of export competitiveness.

St. Vincent was the only exporter of rice, and it was the only country that was shown to be export competitive in the commodity. Between 1991-1993 and 1994-1996 the RCA10 index increased from 1.2 to 1.8, suggesting that St. Vincent's export competitiveness was improving over time.

CROSS COUNTRY COMPETITIVENESS

St. Lucia

According to the RCA10 calculations, among crops, St. Lucia had the greatest competitive advantage in bananas, mangoes, pineapple, plantains, coconuts, avocados, yams, sweet potatoes and ginger. All of these commodities had a RCA10 index of greater than one. However, with a RCA10 index of 7.4, bananas were ranked as the most export competitive, not only of all crops but of all food commodities. Mangoes, pineapples and plantains followed bananas in order of competitiveness with RCA10 values of 3.9, 2.9, and 2.9, respectively. On the other hand, citrus fruits, milk, and meats registered negative RCA10 values, suggesting that St. Lucia had a competitive disadvantage in these commodities. Among beverages and processed foods, St. Lucia was shown to have a competitive advantage in coconut oil and beer, but a competitive disadvantage in non-alcoholic beverages.

Antigua

Consistent with the fact that Antigua exports very little food commodities, few of the RCA10 values for Antigua were positive.

Dominica

According to the RCA10 computations, Dominica was export competitive in a large range of fruits and vegetables including tannia, yams, plantains, taro, bananas, citrus fruits, coconut, avocados, cinnamon, mangoes, ginger, pumpkins, and cocoa beans. All of these crops exhibited positive RCA10 values and most of the values were greater than two. With a RCA10 value of 9.4, tannia was the most competitive. Yams followed with a RCA10 of 7.7, plantains with 7.0, and taro and bananas each with RCA10 values of 6.6. Comparing the two periods (1991-1993 and 1994-1996) for which RCA10 values were computed, it appeared that while tannia, yams, avocados, cinnamon, mangoes, pumpkins and coconuts increased in competitiveness overtime, plantain, taro and bananas became less competitive.

Grenada

Nutmeg had a RCA10 value of 9.2, making it the most export competitive of all Grenada? s food exports. Plantains, cocoa beans, cloves, and bananas followed, respectively, with RCA10s of 6.4, 5.8, 4.9, and 4.7. Cinnamon and coconuts, with RCA10 values of 4.3 and 2.5, respectively, were also deemed export competitive. Except for bananas and coconuts, the export competitiveness of all of these crops increased between the two periods of study. Among processed foods that Grenada exports, wheat bran and wheat flour exhibited RCA10 values of 3.6 and 2.7, respectively, suggesting that these products were export competitive.

St. Kitts and Nevis

Sugar is one of St. Kitts' few export crops and, with a RCA10 of 6.1, it ranked as one of the country's most competitive commodities. Other RCA10 computations showed that St. Kitts was also competitive in exports of margarine, fish, and beverages.

St. Vincent

In order of competitiveness, sweet potatoes, bananas, yams and coconuts, all with RCA10 values greater than 5.7, were the most competitive of St. Vincent's export crops. Also export competitive were nutmeg, plantains, mangoes, pumpkins, rice and citrus fruits. However, while the competitiveness of nutmeg, mangoes, pumpkins, and rice increased over time, that of bananas, coconuts, and plantain decreased. Among processed foods, St. Vincent was shown to be export competitive in wheat flour, cereals, beer, and coconut oil.

THE MANUFACTURING SECTOR

The manufacturing sector in the region is in the early stages of development, having only taken root in the early seventies. The sector went through a period of rapid growth during the seventies; peaked in 1983 and since then has been relatively stagnant, contributing less than 10% to the regional GDP. The manufacturing sector consists mainly of light manufacturing and food-processing establishments characterised by an abundance of small- to medium-sized firms with relatively high turnover and mortality rates because of the constraints of finance and management.

The sector can be broadly divided into three sub-sectors: enclave, traditional import substitution and agro-processing. These sub-sectors vary in their potential to be internationally competitive and contribute to real output of the local economy. The enclave sub-sector, which produces mainly garments and electronic components is dependent on special trading regimes like the Caribbean Basin Initiative and the 807 regime. Its net contribution to the local economy is small. The import substitution sub-sector, which produces assembly-type products, does not have much potential to be internationally competitive, and its net contribution to the local economy is small. The agro-processing sector has strong linkages with the agricultural sector and has the potential to be competitive in selected niche markets.

The enclave sub-sector is dominated by foreign garment and highly specialised electronics firms that export mainly to the United States and have marketing arrangements either with their head offices or other US firms. For the most part, they operate at a higher level of efficiency than the locally owned firms. Their contribution to the local economy is mainly in the form of employment generation and the development of a skilled and disciplined labour force, but their value-added to real output is quite low because most of the inputs are imported. Moreover, their contribution to government revenue is also small because of the number of concessions they receive. They could be a source of uncertainty to the orderly development of the industrial sector since they are usually very footloose, catering to very volatile export markets where recession and technological changes can decimate the sector in a short space of time.

The import substitution manufacturing sub-sector is characterised by a high import content in the production processes as a result of the fact that the industrial deepening process has not progressed very far in the OECS region. Not only are capital goods imported, but also in some cases up to 100% of raw materials are imported from extra-regional sources. Production is geared mainly to the local and regional markets, and very little is exported extra-regionally. This is compounded by industrial incentives, such as the granting of blanket duty-free import of inputs that have a high anti-export bias, which only encourages inefficient production for the local market. The wanton duplication of productive capacity also adds to the inefficiencies in the sector.

The agro-processing sector is characterised by four types of production structures: home based family production; small processing employing 5 to 20 employees; agro-laboratory experimental processing; and large processors. The technology is characterised by varying degrees of sophistication, but in general there is little modernisation of equipment and facilities. The local raw material content ranges from 80 to 100%. Surplus agricultural output is the main component of local raw materials. The size of the market, the uncertainty of supply and the variability of the quality of the inputs create excess capacity in the sector which can be as high as 80% in some cases. Agro-processing in the OECS region suffers from excess production capacity, primitive technology and deficient technical skills, all of which constrain development.

The Emerging OECS Development Strategy identifies the following characteristics of the manufacturing sector:

- The majority of manufacturing firms (54%) can be categorised as small i.e. having less than 20 employees. Montserrat leads that category with 95%, while St. Lucia has the smallest number of small firms. St. Lucia also has the largest number of firms (80) followed by Grenada (57), Dominica (48) and St. Kitts and Nevis (46);

- The contribution of manufacturing to GDP has remained relatively stable across Member States averaging above 7% for most of the nineteen-eighties and declining slightly in the 1990s, to the current level of about 6.1%. This is a consequence of the modest growth rates experienced during the nineteen- nineties;

- Since the 1980s there has been a general reduction in the reliance on manufacturing except in St. Kitts and Nevis;

- The sector directly employs nearly 13,000 people within the sub-region. It accounts for approximately 22% of total employment in St. Kitts and Nevis; 9.3% in Saint Lucia ; 8.3% of total employment in Grenada; and 8.7% in Dominica;

- The sector is highly dependent on government subsidies, provided through a non-differentiating regime of fiscal incentives;

CONSTRAINTS TO THE DEVELOPMENT OF MANUFACTURING

The manufacturing sector in the OECS operates under several constraints. These include:

Finance

Although large firms have access to foreign finance or can attract local financing quite easily, indigenous firms face great difficulties in accessing finance. The commercial banks have a penchant for short term less risky lending and hence lend more for mercantile activities, rather than for manufacturing and agriculture. The percentage of loans to the personal and distributive sectors account for more than 60% of loans outstanding while the manufacturing sector receives less than 10%. Moreover indigenous firms do not have the requisite expertise in the conceptualisation of projects and presenting them to commercial banks as projects for financing. Neither do the commercial banks have the expertise to assist in this type of activity. In addition, the lending policies of the development finance institutions are also not sufficiently supportive of investment in the sector.

Most of the firms are under capitalised and highly leveraged and businesses are reluctant to develop corporate structures that would encourage equity investment.

In addition, the high cost of finance in the face of high price elasticities of consumer demand, severe competition in the regional market, excess production capacity, primitive technology, deficient technical skills, unreliable transport and quality of raw materials all constrain the development of the sector.

Technology and Technical Skills

These are two other sources of concern. The rapid pace of technological development worldwide hastens the obsolescence of capital and erodes the competitiveness of less technologically dynamic countries. The high cost of upgrading capital and the inadequacy of technical capability to speed up the transfer and diffusion of technology retards the export competitiveness of the firms. Hence their inability to penetrate extra-regional markets and even its ability to hold on to domestic markets. The paucity of technical training results in wastage of raw materials, inadequate maintenance leading to loss of production during down times, and the need for foreign technical assistance to diagnose and solve some very simple problems.

High Labour Costs

The OECS is by no means a low wage area. The boom in prices of traditional agricultural exports during the 1980s pushed up the price of agricultural labour and had a demonstration effect on the other sectors. Thus the type of manufacturing sector which emerges must take this as a given. Moreover higher remuneration in the tourism sector has tended attract workers away from manufacturing. Although the differential between wages in the two sectors is not very large, in tourism, tips and other gratuities increase the earnings of workers in tourism.

Inadequate Transportation Links

The paucity and reliability of transportation links is another constraining factor. Sea transport is not only scarce but sometimes unreliable. In addition, the cost of sea transport is not significantly lower than air transport which is usually more reliable. Due to the relatively high value to volume of the products it produces, the enclave sector depends heavily on air transport to get raw materials in and the final product out. Even countries like St. Lucia and Grenada with superior air access, still suffer from a shortage dedicated cargo space resulting in delays and additional cost due to roundabout routing of final products.

The Size of Firms and Local Market

As mentioned earlier, most of the manufacturing firms in the country employ less than 20 employees. This limits the ability of the firms to reap economies of scale and spread overheads. Moreover the majority of indigenous firms are contented to produce for protected local markets which are extremely small. The markets are protected by the CARICOM CET and in some cases by Article 56 of the CARICOM treaty[1].

The Regulatory Framework for Businesses

The regulatory and legal framework in which businesses operate may have impeded the development of the manufacturing sector. The process by which projects are approved is too long and circuitous. In addition, there is the perception that the process favours foreign investment over local investment. Some regulations and legal requirement tend to impede the flexibility of the firms.

The Effects of Protection

The protection accorded by the CET along with an incentive regime, which treats production for the local market and production for export in the same way, create an anti-export bias. There is no incentive to produce for the more competitive, more risky export market, while production for the protected local market is quite profitable. The reduction in the CET would tend to redress this bias to some extent but specific incentives have to be put in place to encourage production for export. However the regime of quantitative restrictions is being phased out via a process of tariffication which would initially increase the import duty. The incentive regime reflects the earlier inward looking policy of industrialisation and need to be given a thorough overhaul to reflect an external orientation.

Fiscal Charges

The size of the country and the inadequacy of transportation links already impose severe disadvantages on the countries in terms of their ability to compete internationally. Thus it is essential that no inordinate charges are imposed to prevent the firms from sourcing their inputs at

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[1] Article 56 allows the less developed CARICOM countries to impose quantitative restrictions and suspend origin treatment for goods of the more developed countries in an effort to develop the manufacturing sector in the less developed countries.

international prices. Additional charges like high port charges impose further restrictions the ability of the firms to compete internationally. The consumption tax on inputs which is not rebated on export goods creates a disadvantage for OECS firms vis-à-vis their CARICOM counterparts whose exports are zero-rated under the VAT.

Non-Tariff Barriers in Export Markets

The existence of non-tariff barriers in the export markets especially the USA has tended to impede the growth of manufacturing exports. OECS exports face a myriad of regulations which only experience in the markets can help to get around. Many firms are seeking ISO and HASIP certification to facilitate entry into international markets. Although the greater transparency under the new WTO rules may have reduced the uncertainty of entry, many indigenous firms may be unable to finance the cost of the barrage of legal challenges that they may face in these markets.

Knowledge of Export Markets

The paucity of knowledge about export markets is another significant obstacle to export development. Basic information regarding the structure of markets, changes in taste, import regulations in the foreign country, appropriate technology, new processes, new products and potential competitors has to be assembled. Market intelligence is a costly undertaking for the individual producer and there are also externalities associated with this activity. This suggests the need for co-ordinated action at the OECS level. The activities of Export Development and Agricultural Diversification Unit (EDADU) are aimed at reducing some of these difficulties, but the organisation remains largely under-funded and suffers from a lack of clear commitment and strategic focus. In addition tapping into international producer and market information networks would reduce significantly the cost of gathering market intelligence.

Inadequate Infrastructure

The inadequacy of economic and social infrastructure of some of the countries is a significant constraint on the development not only of manufacturing but all of the productive sectors. The inadequacy of the infrastructure translates into higher cost of utilities and in the case of electricity into downtime losses due to frequent interruption of power supply. It will be necessary to upgrade to a varying extent, the roads, electricity, water and waste disposal.

THE SERVICES SECTOR

Because of the importance of the service sector in terms of its contribution to GDP and employment, OECS economies are more likely to benefit from trade in services than from free trade in goods. In order to compete in this highly competitive field, careful study will need to be undertaken to identify which services are likely to be most beneficial. In general, however, this is a sector that will need to be modernised and liberalised as quickly as possible in order to compete with well-developed service sectors in a number of other countries. Full involvement of the private sector will be a precondition for effectively improving costs and competitiveness, along with significant efforts to develop the human resource capability required.

The OECS have largely accepted similar obligations for the liberalisation of trade in services are related to its commitments under the GATS and Protocol II amending the CARICOM treaty. The commitments under Protocol II were patterned on the GATS hence this section begins with a discussion of the GATS.

LIBERALISATION OF TRADE IN SERVICES

The international obligations of the OECS countries in the area of trade in services are given in their commitments under the GATS. The objective of the GATS is to develop a set of rules that would foster increased transparency, consistency, certainty and non discriminatory norms and regulations in the governance of trade in services. The services not covered by the agreement pertain to transportation and airline services. With regards to modes of supply four specific mechanisms apply as follows:

(1) cross border supply;
(2) consumption abroad;
(3) commercial presence; and
(4) presence of natural persons.

The Most Favoured Nation (MFN) principle under the GATS dictates that trading partners whether within the Free Trade Area of the Americas (FTAA) or the Regional Economic Partnership Agreements (REPA) of the EU should be offered the same treatment in respect of their exports. Albeit that temporary exemptions may be allowed for transitional purposes. The principle of National Treatment dictates that once a foreign entity supplies a service to WTO member country then there should be no discrimination between this entity and a local one.

The OECS countries have made largely similar commitments under GATS for the following services:

(1) Health Related Services, specifically hospital services;
(2) Financial services, specifically insurance and insurance related services;
(3) Tourism and tourism related services;
(4) Recreational, cultural and sporting services; and
(5) Transport services.

In the above five areas limitations to market access pertain to horizontal commitments are specific to commercial presence and presence of natural persons. In the case of commercial presence, joint ventures are encouraged with prior approval from the authorities. Foreign providers are required to incorporate locally in accordance with the countries' Commercial Code. These entities are also subject to the Exchange Control Act, Withholding Tax, Insurance Act and Aliens Landholding.

The employment of non-nationals is also subject to work permit and Immigration regulations.

Financial Services

Commitments under financial services are specific to insurance and insurance related services. There are no limitations to market access or national treatment other than those articulated in the Insurance and Insurance Premium Acts, Withholding Tax, Commercial Code and Exchange Control Act.

Health Related Services

There are no limitations to national treatment but with regards to market access, the issue of commercial presence is subject to Commercial Code, Exchange Control Acts, and Alien Landholding Act. The presence of natural persons is also subject to work permit laws, and Immigration Regulations.

Tourism and Tourism Related Services

As in the case of health-related services and financial services there are no limitations to market access and national treatment other that those enshrined within the Hotel Proprietors Act, Commercial Code, Exchange Control Act and withholding tax. These services are heavily dependent on FDI flows and so are already at fairly high degree of liberalisation. The incentive regime provided under the Fiscal Incentives and Hotels Aid Acts are designed to facilitate these inflows without undue restriction.

Recreational and Sporting Services/Transport Services/Transshipment/Free Zones

Cross border supply is restricted to laws that deal with moral matters. Under limitations to market access commercial presence is governed by the Commercial Code, Exchange Control Act and Alien Landholding Act. The presence of natural persons as is the case for all commitments are subject to work permit and immigration regulations

LIBERALISATION OF TRADE IN SERVICES IN CARICOM

If the CARICOM regime of free trade in services is to have meaning, it must provide for a greater level of liberalisation than is implied in the current bindings of the countries under the GATS. Protocol II amending the Treaty of Chaguaramas provides the framework for the regime of free trade in services. However, in its current form Protocol II provides a statement of intentions and the elements of the regime will only be clearly defined when the implementation schedule is adopted.

Protocol II provides for Rights of Establishment, Provision of Services and the Movement of Capital. Article 35 provides for a standstill on restrictions to the rights of establishment and for member states to notify the Council for Trade and Economic Development (COTED) of the existing restrictions. It also provides for establishment of criteria to safeguard these rights. The Article also addresses the abolition of restrictions on the right of establishment on a phased basis. It also establishes a consultative mechanism for the establishment of a programme for the abolition of restrictions on right of establishment in progressive stages. COTED would identify the activities to which rights of establishment shall not apply; establish the conditions under which it would be achieved and the stages and time frames for the removal of restrictions. Article 35 also provides for access to land and buildings, free movement of skills, the treatment of monopolies and the mutual acceptance of certificates and other evidence of qualifications.

Article 36 provides for a standstill and the progressive removal of restrictions on the provision of services within the community. It also mandates COTED in consultation with the competent organs of the community to establish a programme for the progressive removal of restrictions on trade in services. The Article does not explicitly mention the various modes of provision of services, together with the Article 35 and Article 37 which deals with the movement of capital all four modes would be covered. However, the right to exclude certain financial services from the provisions of this Article is given to the Council for Finance and Planning (COFAP). As with the GATS certain government services are excluded from Protocol II. These include the operations of Central Banks or monetary authorities, national security and the maintenance of public order, social security and public retirement plans.

Protocol II provides a framework for free trade in services, by providing for a standstill on current restrictions and a progressive liberalisation of the existing restrictions. The nature of the regimes that emerges depends on the strength of the programmes established for the progressive removal of restrictions. If the current WTO commitments are anything to go by, member states would have to improve significantly these if the trade in services regime is to be meaningful. The proposed regime for trade in services under Protocol II has some limitations including the fact that there are several levels of safeguards and the absence of a firm schedule for the liberalisation of trade in services. The liberalisation of telecommunication services has special significance for the OECS countries and is discussed in some detail in the next section.

TELECOMMUNICATIONS

The liberalisation of basic telecommunications under the General Agreement on Trade in Services (GATS) signed in 1997 has unleashed a wave of competitive pressures which has resulted in a spate or international mergers, as formerly protected national telecommunications companies scramble to position themselves to be players in the global market. No doubt this development has forced the monopoly provider of telecommunications services in the Organisation of Eastern Caribbean States (OECS) countries to soften its stance and agree to renegotiate its contract with five of the independent OECS countries[2]. Many of these contracts date well into the new millennium.

At the same time, technological advances in the telecommunications industry is threatening to create a glut of bandwidth internationally that would force the price of telecommunications services to near zero levels. These advances are taking place at all three critical points in telecommunications networks, i.e., international/long distance carrying capacity, switching gear and the local loop. Cost reduction in the local loop is critical for 75.0 to 80.0% of the cost of a call consists of the cost of the link in the last couple of miles. About two thirds of the assets of

[2] Five of the independent OECS countries are involved in a World Bank financed project to reform the telecommunications industry. The five countries are Dominica, Grenada, St Kitts-Nevis, St Lucia and St Vincent and The Grenadines.

telephone companies is invested in this segment hence making them a candidate for natural monopolies.

The telecommunications reform occasioned by the re-negotiation of the licenses and continued advances in technology will usher in major changes in the industry for which the country needs to be prepared.

Implications of the Liberalisation of Telecom

For the countries of the OECS, the dominant provider of telecommunications services (CWWI) operates a monopoly. The reforms that are geared towards containing monopolies and introducing market/commercial-oriented principles in the provision of services can have a positive impact for the countries of the OECS. This is so because developing countries such as the OECS offer exceptional opportunities for telecommunications reform as untapped demand make attractive markets and spurs investment. Firstly, the implications for the market are examined.

(i) Market Structure

It is clear that the process of reform would lead to a change in the market structure and two alternative market structures may emerge - monopolistic competition or oligopoly. However, the size of the countries suggests the market structure that is more likely to prevail after the liberalisation of the telecom sector would be oligopolistic.

This type of market lends itself to strong rivalry among firms, which creates incentives for the frequent introduction of new products, reduced prices and aggressive advertising. On the other hand, the firms in an oligopolistic market can collude to set the market price. Although the consumers may have a choice of a variety of products and services, monopoly prices may be set, resulting in a loss of economic efficiency and consequently reduce national welfare. Hence one of the task of the regulatory agencies is to ensure that there is orderly competition. Careful attention would also have to be paid to the number of firms given licenses to operate especially in the provision of domestic services. The frequent entry and exit of firms from the industry can leave consumers without service for considerable periods of time[3]. Thus while some competition is good, too many firms may well lead to a decline in the quality of service if they have to exit the industry because the level of business is not sufficient for all firms to make a reasonable profit.

Although CWWI has invested a substantial amount of capital to establish a modern telecommunications network; CWWI has benefited from the investment as it has enjoyed guaranteed tax concessions, high rates of return coupled with no price caps on the collection of charges. This translates into high domestic and international rates charged to consumers for the use of the services provided. CWWI has not provided a clear basis to justify its rate structure. The introduction of competition would not only change the market structure, but it is expected that consumers and service providers would have better knowledge of the sector and therefore would seek to eliminate a number gray areas in the context of information sharing.

[3] While it is easy to switch long-distance carriers domestic service is not as flexible.

Because Cable and Wireless has a presence in all of the territories there are certain synergies that it can achieve as a regional company that licensing of individual entities in the various countries may not be able to achieve. Hence the OE CS authorities should give consideration to offering regional licenses for companies to operate all of the countries. This would provide opportunities for companies to take advantage of a larger market and give them the capacity to implement new technologies more readily. Such regional licenses could be auctioned off since they would be more valuable than the sum of national licenses. This may be one way to provide competition when the individual local market may be too small to support more than one service provider.

(ii) Investment Climate

The investment climate that would prevail following the process of reform hinges on the reduction of tariffs due to competition. This is so because the cost of telecommunications services in the OECS is substantial. A reduction in rates leads to a reduction in the cost of doing business. Firms would now be able to conduct more business at a lower cost. In addition, there would be an incentive for the introduction of new industries, such as informatics and offshore financial services which relies heavily on telecommunications services but to some extent have been hampered because of the high rates. The climate for investment would be enhanced as many potential investors who may have been deterred in doing business in the OECS countries because of the high cost of communication may now look at the region as a potential investment opportunity. In addition, opening the market to different service providers creates opportunities for diversity in managerial expertise and know-how as each firm has its unique way of doing business.

(iii) Fiscal Effects

The fiscal impact of the reform process would be determined by the taxation policy that the OECS countries agree upon. Currently, CWWI pays corporation tax and a license fee, however, for most of the countries, the company is exempted from paying withholding tax, customs and other import duties and stamp duty. This policy translates into a loss of revenue for the governments of the OECS. Given CWWI monopoly status and no price caps on collection charges, there is no apparent justification for CWWI to have been granted guaranteed tax concessions. Its monopoly status alone allowed it to realise large returns and therefore compensated for the substantial capital investment made in the countries of the OECS. Given the new environment, in which the market is expected to operate, an elimination of these concessions is essential. In addition, the new service providers would be expected to pay the necessary taxes to government. In the past, there may have been some justification for the granting of concessions to CWWI since both the government and the local private sector were not in a position to undertake the large capital outlays that were needed. With the new technological advances, large-scale investments in small communities may no longer be required and therefore government would be in a position to collect the necessary taxes without much debate.

Telecommunications and Other Service Sectors

Telecommunications like most other services are both final products consumed by the final user and also intermediate products that are inputs into the production of other goods and services.

Thus the analysis must take account of the effect on the demand for telecom services and also the effect on other services.

Modern production structures are characterised by the pervasive use of telecommunications and related services. The use of telephone, fax, telex and the Internet have become indispensable inputs in the production and marketing of goods and services. This dependence is likely to increase even more in the future as the cost of telecom service decline and further advances in technology are achieved. Thus the high cost of telecom services not only inhibits the expansion in other services, it also inhibits development of value-added telecom services, which themselves are indispensable in the conduct of modern business. Thus there would be a series of knock-on effects associated with the reduction in the price of telecom services consequent on reform.

The effects of telecom reform can be divided into two, static effects and dynamic effects. The static effects arise from a reduction in price as a result of the break up of the monopoly. This reduces the cost of communication intensive production. Hence making them more competitive. The consequent increase in output would increase the demand further for telecom services. In addition the income generated by these activities creates a second source of demand for telecom services since the final demand for telecom service is usually income elastic. This suggests that demand would grow at a faster rate than income.

The dynamic effects arise from several sources. Firstly the breaking of the monopoly and the reduction of costs creates completely new opportunities that did not exist before. For example informatics production that was inhibited by high-cost telecom services now becomes possible. In addition, private value-added networks would be able to undertake activities in the telecom area that are not now being done by the monopoly provider even if it has exclusive rights to their production. Such activities include data transmission and transformation.

Secondly, the opening up of competition would increase the efficiency of the market and reduce cost. Wasteful processes and over-manning of the organisation are usually reduced by competition. Moreover, new forms of organisations are developed to penetrate markets, new products are developed and obsolete technology is jettisoned in order to improve the quality of service.

Framework for the Development of Services

The development of a service sector in the OECS region with the capacity to compete internationally will depend on joint production and other forms of complementary production activities. This would require the creation of an adequate infrastructure, particularly in telecommunications, and its integration into the global network; the development of producer services and the tightening of links with the manufacturing and other sectors; and the improvement of the trade balance in services by expanding exports of services.

The development of a viable regional service sector through production integration would require the free movement of skilled labour, even more so than production integration in respect of goods. The implementation of Protocol II amending the CARICOM treaty would go a long way toward encouraging the development of a competitive services capability in the area. The encouragement of the service sector would also require the prompt implementation of the proposals to change the region's incentive regime to take account of the special characteristics of the service sector. It is important that these incentives be regional in scope, rather than national, in order to encourage the development of strong regional enterprises, which are just as necessary for international competitiveness in services as they are for goods.

OECS countries should try to develop and/or enhance capability in the following services:

(i) tourism-related services, including airline reservations, entertainment, culture, health and sports;

(ii) telecommunications-based services, including informatics, geographic information systems and drafting;

(iii) financial services;

(iv) environmental services; and

(v) business services, including accounting, legal and marketing.

The strategy would be to develop two loci for services. The first would be tourism around which a number of related services would develop like those covered under (i) above, environmental and financial services. The second locus would be the telecommunications services around which would radiate a set of related services like informatics, GIS, drafting and business services. The two groups of services would be linked by telecommunications service sector, as greater use is made of the synergies between the two. Cheaper telecommunications would open avenues for people to holiday or work in the Caribbean if greater connectivity were provided. Hotels would need to provide easy access to the Internet from guestrooms, in addition to a range of business services.

In order to develop capability in the service sector, the following issues would need to be addressed:

1. **Human Resource Development**: One of the goals of the strategy for the development of services is to move up to the higher value-added services rather than perform simple services such as data entry. In order to take advantage of the increased opportunities in the area services, the countries would have to pay more attention to human resources development. The emphasis must be on training a skilled and flexible labour force. The education system would therefore have to reflect the need for technical training as well as business and managerial skills. The nature of transfer of technology for information services would need to be different from the developed countries, given the limited access of OECS countries to telephone lines and computers. In particular, governments would have to provide public access points to the global information network in schools and other public places such as post offices and community centres. Some efforts have been made to provide training in advance of the development of these service industries but not nearly enough is being done. For Example St Vincent and The

Grenadines has a programme for training in keyboarding skills, the level of training would need to be increased if the country is not to remain in the low end of the skills spectrum.

2. **Reduction of Telecommunications Costs**: The majority of these services is dependent on the availability of a good telecommunications infrastructure and cost effective telecommunications services. Although the telecommunications infrastructure in the OECS is not at the level of the developed countries in terms of international access, waiting time, faults etc., it ranks quite high among developing countries. The major problem is the cost of telecommunications services as a result of the monopoly status held by the main carrier and this would be addressed by increased competition. Hence the need for the countries to move urgently on the liberalisation of the telecommunications sector.

3. **The Regulatory Framework and Incentive Regime**: An appropriate legal and regulatory framework would need to be put in place to encourage the development of services. The current incentive regime of the OECS countries is heavily biased towards the production of manufactured goods. The incentive regime may need to be reassessed to address the peculiarities of service production. The OECS-World bank informatics project has made some suggestions for the improvement of the incentive regime. Given the high technological component in these services, incentives should be given to foreign service-providers to establish commercial presence in these countries.

In most of the service sectors in which the OECS have a strong interest they are able to make commitments for greater liberalisation almost immediately or it would be in their interest to make that step at this time. This would become apparent by an examination of the major service sectors. The first is Tourism. In spite of the recent weakening in the performance, if there is one area in which the OECS countries have a competitive advantage it is tourism, so that this area can be liberalised immediately. There may be certain tourism-related services like restaurants and water sports which countries would like to reserve for local participation, so these can be addressed by entering the appropriate restriction if necessary.

The second area is financial services. In this area, it may be useful to separate domestic and offshore financial services. In the area of offshore financial service there is no local market to protect and the objective is to encourage foreign service-providers to establish in these territories, thus this area can be liberalised immediately.

In the domestic economy the two major sub-sectors are banking and insurance. In the area of banking except for prudential restrictions (permissible under the GATS) foreign banks are free to establish. Some foreign banks have left and new ones are not coming because they have ceded the market for retail banking services to the local competition. Thus, this sub-sector can also be liberalised. The same is not true for the lucrative value-added financial services like investment services, investment baking banking etc. The nature of these services are such that the foreign competitors need not set up commercial presence in these countries but can send in operatives to solicit business from governments, firms and individuals of high net worth. This area of activity has been heavily dominated by Trinidadian financial institutions and to a lesser extent some Wall Street investment houses. The local financial institutions have neither the financial resources nor the expertise to compete in this market. The indigenous financial institutions in the OECS may need to come together and pool their financial and human resources to mount a credible competitive response.

Quite a number of foreign companies in the insurance sector have left the OECS countries because they perceive of the area as high risk. Thus liberalisation will not bring foreign firms back except there is a fundamental change in their risk assessment of the region.

In the area of telecommunications, liberalisation of telecommunications could be the key to breaking the monopoly of the major service provider. Like in the area of offshore financial services the major market for telecommunications based services are outside of the region. The local market is inconsequential in the scheme of things. Thus the countries would have more to gain by guaranteeing access into the foreign markets than they lose by allowing foreigners access. Moreover, the aim is also to encourage commercial presence of foreign firms to exploit foreign markets.

With respect to construction, local firms face several disadvantages. Most do not have the financial strength to provide effective competition to foreign firms. The also do not have the depth of expertise and experience to pre-qualify for major construction projects. These major projects are usually funded by official development agencies and institutions and their procurement rules have the effect of opening up the market to international competition. Firms operating only in the local market are subject to import duties on equipment imports which foreign-based firms can avoid by the strategic movement of heavy equipment. For example if a foreign base firm wins a contract in Dominica it brings in the heavy equipment temporarily free of duty. At the completion of the project it can then move the equipment to another project in another country, never having to pay import duties for the life of the equipment. The above disadvantages provide a strong case for OECS construction firms to seek to establish strategic alliances with other OECS entities and also with foreign operators.

In the area of business services the market is already quite open to foreign service-providers. The international accounting chains dominate the accounting profession. Apart from the withholding tax on income, business consultants both regional and foreign have a relatively free rein to ply their services in the sub-region. Software maintenance services are usually contracted to firms in the larger CARICOM countries, Puerto Rico and Miami. Even some business equipment maintenance services are sourced from Barbados, Trinidad and Puerto Rico.

The above cover the economically significant tradable services in the OECS countries. The general conclusion is the OECS market for services is already quite open and international obligations would not permit any new restrictions. It would therefore be in the interest of the OECS countries to negotiate for the speedy liberalisation of trade in services. The completion of a regime in services would unleash competitive effects similar to goods with a consequent reduction in the price of these services. Because the use of services especially financial services permeates all types of production (including services themselves), there is a further knock-on boost for all types of businesses using these services. Competition in the provision of financial services can lead to the reduction in cost of credit if firms can raise their loans in other CARICOM territories. Similarly, the prices of insurance services can be reduced by increased competition.

Although the movement of labour is not currently included in any of the negotiations, the regime in services can be used as the thin edge of the wedge to move in that direction. The OECS countries would benefit from the provisions related to the movement of natural persons and the establishment of commercial presence under the services regime. This would provide some degree of reciprocity for the de facto unilateral liberalisation that now exists for most of the economically important services.

TRADE LIBERALISATION

INTRODUCTION

The economies of the OECS are at a critical juncture in their development. Negotiations mandated under the built in agenda of the WTO and negotiations aimed at the creation of an FTAA are continuing. Recently, the ACP countries reached agreement with the European Union (EU) on a framework for LOMÉ. The past decade has also evidenced the signature of a number of bilateral agreements (CARICOM-Columbia, CARICOM – Venezuela) and as well initiatives towards the establishment of bilateral agreements with the Dominican Republic and Cuba. While these initiatives hold tremendous importance for the economies of the OECS, the precise implications are generally not well understood.

EXISTING SITUATION WITH RESPECT TO TRADE POLICY AMONG THE OECS COUNTRIES

Export Profile

The export profile of OECS countries reflects the dominance of agricultural products. In St. Vincent and St. Lucia, agricultural exports account for greater than 65% of total exports. In the remainder of countries, this percentage averages between 45% and 50% except St. Kitts and Nevis. Such relatively high shares of agricultural exports were, however, dominated by traditional exports of bananas, spices and sugar. The OECS have had only limited success in manufacturing exports and have depended on preferential trading arrangements. These countries, to varying degrees, have made use of the Caribbean Basin Initiative (CBI) and special trade provisions with the United States to penetrate some niche manufacturing export markets.

On average, the manufacturing sector averaged 7% of GDP in the OECS, and contributes a relatively smaller share to total export earnings than agricultural products. While St. Lucia has traditionally been the largest manufacturing country in the OECS, manufacturing exports have declined considerably. The overall value of exports in 1999 was EC$46 million, representing a 29% share of total exports. This represented a 54% and 16% decline in export value and share, respectively, from 1995. In fact, the total value of manufactured exports from St. Lucia in 1997 was equivalent to one exported product from Dominica, laundry soap, with exports valued at $53million.

The main manufactured goods produced in the OECS fall within the category of consumer goods, led by food, beverages, tobacco and household products. In most OECS countries, the manufacturing sector is dominated by agro-industrial products, led by fruit, vegetable and beverage processing, and household products derived from the oils and fats industry. In St. Vincent, for example, two-thirds of the major manufactures are by-products of rice, flour and animal feeds, produced by one company. With the exception of electronics and clothing, the other industries generally average a relatively small share of the manufacturing sector. The electronics sub-sector operates predominantly as an enclave industry and therefore manufacturing production is geared primarily for the major export markets of the US and Europe.

Main Manufactured Products
Alcoholic & non-alcoholic Beverages
Juices and concentrates
Jams and jellies
Tobacco & Cigarettes
Seasonings
Pasta
Flour
Laundry and Household soaps
Paints & Varnish
Paper and Paperboard
Candles
Electronics

Trade Policy

The framework for trade policy formulation amongst most OECS countries is fairly incoherent. This incoherence exists at two levels, among OECS countries as a group and between the external and internal policy environment. Among OECS countries, there exists broad coherence regarding the application of the Common External Tariff regime, which is the principal trade policy instrument applied by CARICOM counties, however, the actual application of the regime renders the trade policy framework of these countries somewhat less than desirable. Internally, there is little coordination between the domestic and external policy framework, in extreme instances the policy framework of the two manifest "reverse isomorphism". The following section assesses the relationship between the countries of the OECS grouping and their external trading partners and explores the implications of recent developments for the future relationships across the various agreements and groupings.

CONTRIBUTION OF LOME TO OECS DEVELOPMENT

The agreements between the ACP and the EU provide important external resources for the development of the OECS States. In summary, these inputs can be identified as follows:

TRADE

The commodity arrangements in Lomé are important to the OECS. Bananas and sugar, the two main agricultural exports from the region, are covered by the sugar and banana agreements. Approximately 40% of OECS merchandise exports go to the European Union on the basis of the preferential trade arrangements embodied in the Banana and Sugar Protocols. The arrangements governing rum and rice are also of some importance as OECS countries do produce and export some rum and St. Vincent and The Grenadines and Montserrat have exported rice from Guyana to the European Union under the agreement even though the rice agreement has been recently changed to discourage this possibility.

Bananas

OECS banana exports provide a substantial amount of the export earnings of Dominica, St Lucia and St Vincent and The Grenadines. OECS banana exports into the EU are currently regulated under LOME 1V. The banana regime establishes tariff quotas and licensing for the importation of bananas into the European Union. The ACP countries have duty-free quota under which each banana-producing OECS country exports. The tariff quota imposed on Latin American bananas also provided some support. This system was rejected by the WTO panel and the EU has been called upon to set up a new system which is now under construction.

Sugar

OECS sugar from St. Kitts-Nevis is marketed in Europe under the Sugar Protocol of the Lomé Convention. This Protocol goes beyond the life of the ACP/EU Agreements and is based on an import quota which is shared among the ACP members of the Protocol.

Non-Traditional Exports to EU

Fish and some fruits and vegetables such as ground provisions, ginger, mangoes, citrus fruits, and cut flowers are some of the non-traditional items that are exported to the EU in small quantities and would enjoy some degree of preference

FINANCE

In terms of total development assistance, excluding the EU resources that have been committed to regional programmes, the OECS states were collectively allocated ECU$252[4] million between 1976 and 2000.

Programme Aid

Programme aid includes support for Structural Adjustment, STABEX and SYSMIN. STABEX seeks to compensate ACP countries for the shortfall of export earnings due to fluctuations in the prices or supply of non-mineral – largely agricultural – commodities and like other programme aid is fast disbursing. Actual disbursement (to the end of 1998) of programme aid between 1989-1998 has been slightly over 7.4 million under STABEX and about .25 (1/4) million under the structural adjustment fund. (TABLE 1).

STABEX allocations for shortfalls in banana export earnings are actually much larger. The banana producers in the Windward Islands have benefited from STABEX compensatory transfers to the tune of ECU $35 million between Lomé I and IV

[4] This figure may exclude some recent STABEX and other resources.

Table 1
Lomé Financial Assistance To OECS -
Disbursements 1989-1998 (ECUs)

Structural Adjustment	254,386	1%
STABEX	7,420,130	17%
National Indicative	21,008,387	49%
Other	14,557,517	34%
Total disbursement	43,240,420	100%

Project Aid

Project aid covers natural resources productive sectors, other productive sectors, economic infrastructure and services, social infrastructure and services, governance and civil society, multi-sector/crosscutting and unallocable items. Under the 6^{th}, 7^{th} and 8^{th} EDFs, the OECS was allocated under the national indicative programme 97.5 million ECUs. Between 1989-1998, 21 million under the national indicative programme was actually spent. The OECS countries would have benefited from some concessional loans financed from the EDF (risk capital) and from the EIB's 'own resources'

Food, Aid to NGOs, Humanitarian Aid and Aid for Refugees

Approximately, 14.6 million ECUs were spent for the above purposes, especially for emergency assistance during 1989-1998.

CONCLUSION

Both trade preferences and EC financing continue to be of significance to OECS development. OECS diversification away from traditional exports requires over some transition the continuous support of EU preferences. In addition, in order to achieve higher growth rates, OECS countries have to turn towards foreign capital for larger flows. With ODA declining since 1994-1995, EC ODA has been increasing in importance to the OECS.

MAJOR CHANGES IN THE NEW ACP/EU PARTNERSHIP AGREEMENT

The main changes in the new agreement between the European Union and the ACP countries are briefly as follows:

- A new framework for trade cooperation that sets out a process of adaptation over 20 years and addresses for the first time trade-related areas in connection with non-tariff barriers;

- The abolition of STABEX, SYSMIN, and the Rum Protocol;

- The reduction of financial instruments and the introduction of a new system of rolling programming that flexibly allows a country to adjust its programme;

- The establishment of an Investment Facility to support the development of the private sector;
- A new focus on poverty reduction strategies with the allocation of funds based not only on an assessment of each country's needs but also of its policy performance;
- The promotion of participatory approaches and the involvement of civil society in the reforms and policies;
- An enhanced political dialogue.

THE NEW TRADE FRAMEWORK

The new ACP-EC Partnership Agreement establishes a framework that pursues trade liberalisation between the parties and offers provisions in the area of trade-related matters. This framework agreement covers 20 years, and in 2002, a formal negotiation period of 6 years will be opened. Provided the EU can obtain a WTO waiver which is now under examination in the WTO, existing Lomé preferences will be continued for a preparatory period of 8 years until 2007 after which individually or collectively for the ACP countries a new trade regime is expected to be in place that would either be a Free Trade Area (FTA) in the form of an Economic Partnership Agreement (EPA) which would go over a transition period of 10 or 12 years up to 2018 or 2020; or the GSP or some other alternative to be determined. Since both parties agreed "to remove progressively barriers to trade" between them, there is already some commitment to reciprocity in an EPA for the ACP non-LDCs who choose to do so. This EPA will be WTO-compatible and cover "essentially all trade" and implemented within 10 to 12 years. ACP countries are invited to sign as groups, building on their own regional integration schemes. For countries not wishing to enter EPAs, alternative arrangements will be examined that are WTO-compatible and provide a level of market access equivalent to current preferences. Unless the WTO arrangements are modified or a waiver secured, a WTO-compatible regime that offers market access equivalent to what the ACP enjoys under Lomé would imply the granting to non-ACP developing countries the same treatment as ACP Lomé countries.

ACP Least Developed (LLDCs) are guaranteed free access to the EU market for essentially all their products. Such liberalisation would start in parallel in 2000 for almost all imports from all LDCs and on the basis of GSP be completed by the year 2005, at the latest on a non-reciprocal basis[5]. The current all-ACP non-reciprocal tariff preferences are maintained until 31 December 2007. The Protocols on sugar and on beef and veal would be maintained but reviewed in the framework of negotiations for new trading arrangements. Formal negotiations on Economic Partnership Agreements will start by September 2002 at the latest and in 2004, the situation of non-LDC ACP countries not in a position to enter into EPAs will be assessed and alternative possibilities would be considered. The progress in negotiation of EPAs will be assessed and new trading arrangements will enter into force by 1st January 2008 at the latest.

[5] The European Commission has recently put out its "everything–except-arms" proposal for GSP treatment for all ACP and non-ACP LDCs. The proposal is causing quite a stir among the ACP non-LDCs. It is still to be examined by the EU Council.

Liberalisation of trade by 2008, at the latest, will begin during a transitional period of at least 12 years.

Cooperation in trade-related areas such as competition policy, protection of intellectual property rights, standardisation and certification, sanitary and phytosanitary measures, trade and environment, trade and labour standards and consumer policy and protection of consumer health is also planned.

FINANCIAL COOPERATION

A major innovation in the new agreement is the regrouping of the financial instruments of cooperation. All EDF resources will now be channeled through two instruments – one envelope for providing grants and one for providing risk capital and loans to the private sector. The grant envelope for support to long-term development will be €10 bn from the 9th EDF plus €1.3 bn for regional programmes. The other envelope will, through the deployment of €2,200 million from the 9th EDF, be managed by the EDF.

Each country will have a national allocation from the first envelope that will cover different types of operations to be financed. It will be possible to use these resources for macroeconomic support, sector programmes, traditional projects and programmes, debt relief, additional assistance in case of shortfalls in export earnings, decentralised cooperation and (in exceptional circumstances) humanitarian aid.

The new Agreement replaces STABEX and SYSMIN, the export revenue stabilising instruments, with a system for support for short-term fluctuations in export revenue. Resources for this will be drawn from the National Indicative Programmes. Support is provided if a worsening in the public deficit coincides with a loss of overall export earnings or a loss of export earnings from all agricultural and mineral products. Least developed countries enjoy a more favourable threshold on export losses required for triggering support. An aim of this support system is to adopt a more comprehensive approach that makes the link between public deficits and export revenue.

The rationale for this change is that in the past, each EDF was split into several instruments with each instrument functioning according to its unique set of procedures and method for programming. This affected the coherence of Community assistance as well as the dialogue between the Commission and the partner country which remained fragmented. Fixed allocations per instrument also reduced flexibility within each country programming. The most important difference therefore is that no resources are assigned for a specific purpose. This permits flexibility and the re-deployment of resources as necessary which may involve frequent reallocation within a country programme to respond to frequent developments or reallocations between countries in order to guide the resources to where they are best needed. Grants from this envelope will be managed by the Commission with the ACP State concerned through a system of rolling programming €1.3 bn from the 9th EDF will be reserved for regional programmes which the ACP themselves shall define, in particular, ACP regions that are committed to negotiate new trading arrangements with the EC.

Another innovation is the creation of an Investment Facility (IF) to replace the Lomé IV risk capital and interest-rate subsidy facilities. The European Investment Bank will manage the IF which shall be set up through the allocation of €2,200 million from the 9th EDF. It will function as a revolving fund and the returns accruing from its operations will flow back to the Facility. The aim of the IF is to help develop businesses in ACP countries which are income earning, commercially and economically viable enterprises whether they are public or private. Businesses will have direct access to the Facility, or indirect, through intermediaries.

The IF will participate in privatisations and aim to strengthen local financial institutions and capital markets and leverage foreign investment. It will focus operations which cannot be financed from private capital or by local financial institutions - in other words, requests for medium and long-term finance, risk capital and flanking measures (guarantee funds, etc,) and will invest in the form of loans, equity and quasi-equity. It will also be able to write guarantees in support of domestic and foreign private investment in order to leverage other (mainly private) sources of finance. At the same time, the EIB also intends to continue to use its own resources (€1.7 bn from 2000 to 2005) for other financing operations in ACP countries. Interest subsidies will be allowed under certain conditions for loans to investment projects meeting criteria such as environmental or social components. The Private Sector can access these funds without guarantees.

The aid volume may be equivalent in real terms to the levels provided under the 8th EDF but the level of resources provided under the new agreement may not be adequate for the implementation of the international development commitments and targets made by ACP and EU governments. As a result, a new objective is to double the current rate of disbursement of aid through reforms and to this end the new Agreement introduces significant changes to programming procedures and resource allocation. Future aid will be performance-based and aid will be allocated according to an assessment of each country's needs and performance, combined with regular adjustments through a system of "rolling programming."

With one programming exercise per country/region planned and the re-grouping of the EDF instruments accompanied by rolling programming involving regular reviews, flexibility and continuous update of developments in the partner country are catered for. Evolution towards budgetary assistance / sector programmes will also mean faster disbursement. With allocations no longer automatic and subject to revision in the light of developments in need and performance, resources will no longer be permanently allocated to countries that do not put them to good use.

One positive change with regard to the previous Lomé Convention is that ACP States, in elaborating Indicative Programmes, are now supposed to identify eligible non-state actors and the resources allocated for non-state actors. Disbursement should be facilitated by the involvement of non-state actors in the formulation of support strategies and in the implementation phase. Non-state actors will also be given direct access to resources. As a result of dialogue, the completion of reviews is set within time-frames in the new agreement and procedures surrounding the project cycle have been simplified, though the basic system applied under Lomé has been retained.

In terms of procedure, the new agreement now allows particular sectoral policies and strategies to be incorporated in a Compendium of Reference Texts providing objectives, policy orientations and operational guidelines in specific areas of co-operation. The Joint Council of Ministers may revise the Compendium of Texts annually if required. The intention is to allow for the incorporation of new ideas into the partnership stemming from external sources such as the UN Conferences as well as from internal processes such as the European Community's review of aid policy and the reform of the European Commission. The first edition of the Compendium of Reference Texts was produced at the time of the signing of the new Agreement in June 2000. Annexes relating to financial and trade co-operation may also be reviewed on an annual basis if required. In addition, it adopts a new approach by locking in economic reforms based on the concept that trade liberalisation in the context of a fully WTO-compatible regime, coupled with social development policies, will lead to economic growth with poverty reduction.

IMPACT ON EXISTING SUPPLY OF RESOURCES ON THE OECS

TRADE

In the light of universal and regional trade liberalisation, the potential preferential benefit of the Cotonou Agreement to the OECS has been greatly reduced. In general, according to one estimate, the Uruguay Round eroded the ACP preferential margin by 30%. Thus, the preferential margin now enjoyed by the ACP States in the year 2000, fell from 3.6% to 2.9% on the basis of the MFN regime and from 2.5% to 2% on the basis of GSP tariffs.

The total value of the EC market access arrangements no longer give significant advantages to exports from ACP countries except for certain sectors such as agricultural products, chemicals, textiles and footwear, where the specific preferential margin remains significant. The present round of multilateral negotiations along with CAP reforms could further reduce this margin of preference.. Textile exports are expected to be affected the most with the MFA carded for elimination. The current and forthcoming negotiations with a number of Mediterranean countries, Mexico, Mercosur and Chile will result in an equivalent preference level in sectors where ACP countries have succeeded in developing their exports such as fish, plants, vegetables, fruit, processed fish products, processed fruit and vegetables, tobacco and clothing.

In the above scenario of declining significance between MFN and Lomé, the EU demand for reciprocity is also expected to increase. Under these conditions, the future options will differ among the ACP and even the CARICOM countries. Those who cannot compete may wish the freedom to use national protection under non-reciprocity. The others may opt for a position to trade either on a reciprocal basis or on a non-discriminatory MFN basis. The above could have divisive consequences for Caribbean regional integration.

For some, reciprocity is expected to help CARICOM countries integrate "smoothly and gradually" into the world economy by attracting foreign direct investment, "locking-in" the process of trade liberalisation and assisting in the restructuring of Caribbean economies by a combination of trade-induced incentives and financial and technical support. There are others who view its eventual impact as negative in so far as it may cause sharp falls in tariff revenues (difficult to offset by a diversification of fiscal revenues in the short to medium term); and force countries to liberalise their trade at a pace and to an extent less optimal than could be achieved unilaterally.

While the next 8 years of continued EU trade preferences (provided the WTO waiver is obtained) may provide a sense of security in an increasingly liberalised world economy, it merely buys time before difficult decisions must be made. The OECS countries are considered as non-LDCs in the ACP/EU arrangement that should opt either for an EPA or the GSP or some, as yet, undefined alternative.

Commodity protocols account for most of OECS exports to the EU. For these products, MFN tariff-equivalent duty is probably around 100%. For St. Kitts, St. Lucia and Dominica, more than half of the countries' exports consist of sugar or bananas; for St. Vincent and The Grenadines, exports of products covered by Protocols are just above 20%. For Grenada, the use of the commodity protocols is minimal. The present GSP does not offer preferences for these products.

The current GSP could provide Grenada and Antigua & Barbuda with a margin of preference "globally equivalent" to that granted by the Lomé Convention. It should be noted however, that even for countries less dependent on preferences the withdrawal of these preferences may have an impact at the micro-economic level as well as limit the scope to diversify their exports in sectors rated under the GSP as sensitive or very sensitive.

OECS countries have already indicated a strong interest in non-reciprocity in trading relations even with larger regional developing countries. It would therefore be important to them to see what improvement of preferences under GSP is possible that would be in their favour in the sense that the ACPs are the principal exporters and the GSP beneficiaries have a minimal share of the EU market. In this way, improvement of GSP would be mainly in favour of the ACPs and their present preferences would not be eroded in relation to other suppliers of the community market.

There are several reservations as to whether an improvement of GSP would allow the inclusion of the commodity protocols especially since the present GSP has abolished tariff quotas. The maintenance of the preferences granted under these protocols for ACPs who would benefit from the GSP alone in 2008 would necessitate specific waivers in the WTO. The present EU GSP comes up for renewal in 2004 and the OECS may wish to ensure that this alternative possibility is thoroughly examined.

Bananas

The EU banana regime introduced on 1st January 1999 dismantled country-specific allocations for individual ACP countries (these were previously found to be inconsistent with Article XIII of the GATT) in favour of a quota of 857,700 tonnes for the twelve "traditional" ACP suppliers of bananas to the EU market. This regime has since been found to be inconsistent with World Trade Organisation (WTO) rules.

The options facing the EU essentially fall into three categories which are:

- removing the tariff quota and applying a high flat rate tariff;
- retaining the two existing tariff quotas and removal of the limit on ACP preferences, which is at present 857,700 as recommended by the WTO panel;
- establishing a new tariff quota outside the current tariff quota for a volume higher than current ACP exports, within which ACP exports would benefit from a zero tariff.

The European Commission recently adopted the first "tariff only" approach but it has been rejected by some important EU member states. During the interim period, the January 1999 regime remains in force to avoid market collapse. From the discussion so far, it appears that whatever system is introduced would bring more competition for the OECS states. Exporters of bananas in the Windward Islands of the Caribbean are particularly vulnerable in this respect. They are located in Small Island Developing Countries (SIDS), and this complicates the diversification process in a number of ways due to a limited internal market, climate changes, vulnerability to natural disasters, etc.

Sugar Protocol

The Sugar Protocol will remain in force after the expiry of the present Convention. It is compatible with GATT rules since a concession for the ACP quota was secured by the Community during the Uruguay Round. It will be reviewed in the framework of the post-Lomé negotiations. It could, however, be contested within the WTO by other producers such as Brazil, which might also try to get it liberalised or seek a preference under the EU agreement with Mercosur. This could imply some loss to the OECS. In addition, current CAP reforms pose a threat to the Protocol. At the start sugar was not included in the CAP exercise but recently the EC has placed sugar on the table.

Rum

Duty-free quotas for rum will be fully dismantled by January 1, 2000, and from this date all imports of ACP rum into the Community will therefore be completely liberalised. In addition, imports of high quality light rum will be fully liberalised by 2003 at MFN level, meaning that other suppliers will be able to compete on a level-playing field with equivalent ACP rum. Total ACP export earnings for this product equalled ECU 225 million in 1997, the main region of origin being Caribbean countries for which this product constitutes 13% of all their exports to the EU.

FINANCE

The second important implication of these changes is the further reduction of financial resources. The ACP/EU agreement has been forced to compete with new EU interests in the post-cold war period and resources must be spread to achieve a greater geographical balance. As a result Lomé has had to sharpen its priorities with a focus on the poorest. The Caribbean middle income countries among which are the OECS find themselves between the least developed and the newly industrialising countries and are now targeted for a relative reduction in resources.

In addition, provisions on resource allocation under the new agreement appear even less clear than under previous Lomé Conventions. The new system provides the EU with more discretionary power in allocating resources. Resource allocation to ACP countries is now based on both needs and performance. An Annex to the Agreement states that needs are assessed according to criteria relating to per capita income, population size, social indicators and level of indebtedness, export earning losses and dependence on export earnings, in particular from the sectors of agriculture and mining with more favourable treatment for least developed, land-locked and island countries. It is not clear how these different criteria will be weighted and calculated but most of them are not favourable to the OECS.

With no real increase in EDF indicative allocation since the 6th EDF, the OECS may well find that the situation either continues or deteriorates. In addition, the removal of interest subsidies and risk capital may even worsen the situation since the OECS private sector lacks the capacity to borrow internationally.

The EU should be asked to explain the detailed formula used for calculating resource allocations for the National Indicative Programmes in the Compendium of Reference Texts. Criteria for resource allocation should be transparent and take into account the peculiarities of small island developing states.

Another consequence of new financial stringency is the loss of direct commodity protection for some of the basic export commodities protected by export stabilisation mechanisms as STABEX and SYSMIN that guaranteed stable export earnings, mainly from exports to the EU. The change to transfers from national indicative programmes to take account of budget deficits that stem from a fall in export proceeds may not be fully compensating, especially to the producers. In any case it is programmed in the future that commodity export stabilisation should come from market-based risk management systems the benefits of which cannot be taken for granted especially for very small micro-states.

A third significant impact is the growth of conditionalities regarding human rights and democracy and their likely impact on the flow of development finance. Under severe resource constraints, efficient aid distribution requires a greater policy framework characterised by good governance, a key feature of which is participatory democracy. Even though issues of human rights and democracy have already been introduced since Lomé III, these provisions have been reinforced within the framework of greater collaboration with other international aid donors. One positive aspect however, is the intention to promote greater policy dialogue through partnership and equality that would create policy ownership by mutual agreement.

The above discussion does suggests that Lomé advantages in the final analysis could remain mainly in the financial and technical support from the European Development Fund which under its regional and national indicative programmes offers assistance in the development of a wide range of infra-structural projects, provides emergency aid and facilitates structural adjustment.

The commodity arrangements in Sugar, Bananas, although they are being adjusted, will also remain important over some transitional period.

Over the years the Lomé Convention has been extended way beyond economic cooperation where it initially started. Today it includes political, social and cultural dimensions that touch on human rights, good governance, conflict prevention, migration and cultural exchange programmes. All these dimensions are interlocked in a web of policy dialogue in an effort to devise a holistic approach to development. It also makes any assessment of costs and benefits problematic, especially if it is coupled with the introduction of the Euro with its uncertain potential effects.

IMLICATIONS FOR A FUTURE OECS IMPLEMENTATION STRATEGY

In the new arrangement resources will be allocated in two ways. One allocation (A Base Case) will cover macroeconomic support, sectoral policies, programmes and projects; and another (A High Case) will cover unforeseen needs such as emergency assistance (where support cannot be taken from the EC budget), contributions to internationally agreed debt relief initiatives and support to stabilise export earnings. Following mid-term and end of term reviews the EC may revise resource allocation to ACP States according to their needs and performance. Resources can also be drawn from the High Case and transferred to the Base Case if the country is performing very well and need a replenishment to finance the regular programme.

The new procedures and programming approach geared to double the rate of disbursement will place some strain on the OECS to perform. Since allocations are no longer regarded as entitlements and automatic and will be subject to revision in the light of developments in need and performance, resources will no longer be permanently kept for countries that do not put them to good use. As performance will be rewarded, the OECS has to ensure that its institutional and human capacity for project formulation and implementation is boosted to guarantee this performance. From many assessments of the condition of microstates, capacity building both at the national and regional level is needed to ensure this result.

There could be advantages in one programming exercise per country/region through the re-grouping of the EDF instruments. Rolling programming involving additional regular reviews and the avoidance of parallel programming, however, while it allows for flexibility and continuous update of developments, also puts a strain on the limited human resources in small states. This problem could be exacerbated especially since the parties have undertaken to respect specified time limits for completion of each review - the annual operational reviews shall be completed within a period of 60 days. When the review is expanded to include a review of the Country Support Strategy (CSS), the parties have another 30 days to complete the process.

Evolution in the nature of aid towards direct budgetary assistance / sector programmes can be viewed as positive as it would encourage faster disbursement. The OECS record on disbursement has not been satisfactory in a comparative sense, especially on STABEX adjustment funds. By the end of 1998, for both EDF 7 funds (1990 - 1995) and the 8th EDF

(1995-2000), OECS disbursement rates fell below the average for the Caribbean region as well as that of the ACP as a whole. Efforts must be made to increase the rate of disbursement.

EDF disbursement rates have increased over the last year. It is however, foreseeable that the unfamiliarity of OECS (as well as EC) staff to new systems of operation under the new agreement may initially actually slow down the rates of disbursement.

The new setting requires that OECS countries must own and be accountable for their own policies as well as pursue an inclusive approach that involves non-state actors in the formulation of support strategies and in the implementation phase. Non-state actors must also be given direct access to resources and play a part in drafting Indicative Programmes. OECS countries are now supposed to identify eligible non-state actors and the resources allocated for these non-state actors. The new role for non-state actors implies that these organisations must equip themselves to actively participate in dialogue and manage resources. Some capacity building is needed in this regard.

The Investment Facility will replace the Lomé IV risk capital and interest-rate subsidy facilities and will function as a revolving fund with the returns accruing from its operations flowing back to the Facility. In the longer term, there will be no further replenishment of the Facility. Interest subsidies will be allowed under certain conditions for loans to investment projects meeting criteria such as environmental or social components. The big advantage of the IF is that state guarantees are no longer needed for private companies to access the EIB. It is questionable, however, whether the OECS private sector could meet the requirements of market borrowing without the guarantees that would be needed from large reputable international banks. As a result, the removal of subsidies and risk capital could impact negatively on the OECS.

The new agreement explicitly recognises the role of the private sector as an engine for development. A comprehensive and integrated programme of action to support the business sector is outlined at all levels. The new Investment Facility aims to stimulate regional and international investment, and to strengthen the capacity of local financial institutions. It will also encourage foreign investment and contribute to private sector development through project financing and support for commercially viable enterprises. The OECS may wish to focus on the specific conditions of small domestic firms and the types of lending that are most appropriate for them.

There is also a strong commitment to support an ACP-EU private sector business forum. This will articulate private sector interests and foster dialogue among ACP and EU private sector organisations. It will also operate as a platform for dialogue with ACP governments and the EU on development policy in general and on private sector development in particular. The OECS private sector would need to equip itself to meaningfully participate in this forum and dialogue.

According to the Agreement, performance will be assessed on the basis of progress in implementing institutional reforms, performance in the use of resources, effective implementation of current operations, poverty alleviation/reduction, sustainable development measures and macroeconomic and sectoral policy performance. Such performance seems vague and open to interpretation. An annual review, in addition to mid-term and end-of- term reviews of National Indicative Programmes, is programmed to determine any causes of delay in implementation and to propose remedial measures. It is in OECS interest that the ACP and EU should jointly agree to more precise and objective performance criteria. In the eyes of many ACP governments, this new system will give the EU more discretionary powers in allocating resources since it is not clear whether the criteria used will take sufficient account of the specific conditions prevailing in ACP countries.

The new Agreement replaces STABEX and SYSMIN, the export revenue stabilising instruments, with a system of support for short-term fluctuations in export revenue. Resources for this will be drawn from the National Indicative Programmes. Support is provided if a worsening in public deficit coincides with a loss of overall export earnings or a loss of export earnings from all agricultural and mineral products. Least developed countries enjoy a more favourable threshold on export losses required for triggering support. An aim of this support system is to adopt a more comprehensive approach that makes the link between public deficits and export revenue.

However, criteria for allocation for support under the new system appear to be more complex than under the previous systems of STABEX and SYSMIN. This can be partly attributed to the fact that measuring the public deficit in many ACP countries is problematic due to lack of data and differences in calculation methods. Meeting the criteria of losses in export revenue and worsening public deficit simultaneously may prove more difficult for some OECS countries than STABEX criteria, resulting in the countries receiving less support for export stabilisation than previously.

The new system does not carry-over the existing STABEX instruments which means that no set amount has been earmarked for this purpose and monies will be drawn as appropriate from the allocation for long-term assistance. The eligibility for the support has also been linked to whether the loss affects overall macroeconomic stability. If resources are granted, they will be programmed through the Country Support Strategy (CSS) and the Indicative Programme. In principle, they shall be used to finance the national budget. Inexplicably the new system excludes land-locked and island states from the more favourable treatment that is accorded to least developed countries as is done in other parts of the Agreement.

In light of he above, it would be important for the OECS to ensure that the Compendium of Reference Text of the Agreement should include details on how worsening public deficits will be calculated.

With the emphasis on poverty reduction, it would be useful for the OECS to link the programming process under the new Agreement to the national implementation process of the UN Social Summit Declaration and Plan of Action to ensure that the countries are not faced with more uncoordinated and incoherent demands from the donor community. The national strategies for poverty eradication should be implemented by governments, with the help of UN specialised agencies, International Financial Institutions and the full involvement of civil society organisations.

The aim of the new Convention is to allow for the incorporation of new ideas into the partnership stemming from external sources such as the UN Conferences as well as from internal processes such as the European Community's review of aid policy and the reform of the European Commission. Sectoral policies and strategies will be incorporated in a Compendium of Reference Texts providing objectives, policy orientations and operational guidelines in specific areas of co-operation. The Joint Council of Ministers may revise the Compendium of Texts annually if required. The OECS must gear itself for permanent monitoring and evaluating the performance of the new convention with the aim of introducing necessary changes in modalities and criteria of performance.

IMPLICATIONS FOR FUTURE NEGOTIATIONS

OECS Member States have a special interest in Post-Lomé IV (Phase Two) negotiations. As regards the timetable for negotiations, notably the preparatory period, ACP states gained some ground (eight years instead of five proposed by the EU). Negotiations will start no later than 2002. A six-year period is programmed for these negotiations.

The main principle of trade cooperation is that co-operation in this area will build on regional integration initiatives of ACP States. Regional integration is a key instrument for the integration of ACP States into the world economy. This preparatory period must be used to strengthen regional integration processes (both OECS and CARICOM). Some account will be taken of the economic and social constraints of the ACP countries to conduct trade negotiations by helping the ACP States to be active in the international economic and trade system, through capacity building and cooperation in multilateral fora. The OECS must seek to take advantage of these arrangements.

According to the provisions for future trade arrangements, limited time and options for OECS countries are available to choose the trade arrangements that respond to their best interests. According to the new Agreement, the parties agree to a preparatory period of 8 years before moving to new WTO compatible trade arrangements. Formal negotiations for these agreements will start in September 2002 and enter into force by January 2008 unless both parties agree on earlier dates. In the 8-year period, OECS states are supposed to use the time to prepare themselves for these new trade arrangements, especially in areas such as budgetary adjustment, fiscal reform, trade reform and investment promotion. In 2004 the EC will assess the situation of non-LDC ACP countries in relation to these agreements. If, after consultations, these countries decide they are not in a position to enter Economic Partnership Agreements, the EC will examine alternatives in order to provide these countries new trade arrangements equivalent to their existing situation but in conformity with WTO rules. The ACP and the EC will then carry out a formal review in 2006 of the future arrangements planned for all countries to ensure that no further time is needed for preparations or negotiations.

While the levels of regional integration and institutional capacities in most ACP regions do not suggest that these regions are on course to be able to embark on EPAs with the EC by 2008, CARICOM is considered to be more advanced. It will be important for CARICOM and the OECS to complete their single economy and market programmes before 2008.

If some CARICOM countries opt for EPAs, it will be difficult for those not choosing EPAs to control the movement of 'free' imports from the EU. Furthermore two sets of trade arrangements within one region, i.e. one maintaining trade preferences, while the other engaging in EPAs, could be a setback for regional integration in CARICOM.

The establishment of an autonomous regional integration process is important for CARICOM. This would imply that adequate financial resources should be allocated with the EDF Regional Programme for capacity building and institutional support. Most importantly, the promotion of integration should include support for fiscal reform to facilitate integration into the world economy. The issue of the replacement of revenue due to tariff reductions arises. Since there is very little local production, it has been suggested that VAT has the same effect as a tariff at that rate Research is now underway on this matter[6] that should assist in the formulation and implementation of improved tax policies.

The issues that arose from the World Bank-Commonwealth Secretariat study[7] on small states should also be examined as part of the negotiation strategy. The study has some interesting ideas in terms of dealing with volatility, trade adjustment and competitiveness, project management in small states and risk management, particularly commodity and disaster management. The focus of the Report however was largely on the World Bank programs and procedures where the intention was to try to introduce some flexibility to deal with the problems of small states. In the Lomé context, some work is needed as to how in Post-Lomé (Phase 2) some of these ideas can be pursued. With the elimination of SYSMIN and STABEX, the idea of dealing with export fluctuations has now fallen on the national indicative programme but it is not clear how well this would deal with volatility. Moreover, the new Convention introduces the possibility of market-based commodity management systems (commodity-hedging) in the future, possibly after 2008 similar to what the World Bank is saying. The OECS would need to take an integrated perspective of these issues as they relate to the EDF, the World Bank, IMF and other international financial agencies. New specific proposals would have to be developed to deal with each forum. As an example, the ACP/EU Agreement provides for a wide range of programs and measures and the proposals in the World Bank-Commonwealth Study do not fit neatly into this arrangement in many cases. They would have to be fine-tuned. The EU has accepted the concept of vulnerability of small and land-locked countries and has already made some concessions to these countries in the new agreement. Further work for the Phase 2 negotiations would be needed, bearing in mind that the EU wants to shift these countries more to private capital markets as is the trend with the new Investment Facility.

There are also several implications for FTAA negotiations some of which are, like those for Lomé, tied up in the WTO. A major one is the scope for manoeuvre with the trade regime and the recognition that whatever is decided in the Post-Lomé context must respect the principle of non-discrimination in tariff treatment by the Caribbean ACP between the EU and North America. The non-reciprocal alternative (sui-generis or otherwise) essentially comes down to what the EU is prepared to offer in the 1994 GSP reform that would be Lomé-equivalent on existing exports. Some countries may feel comfortable in going that route if it means that, even

[6] The ECCB in collaboration with the World Bank/IMF has been examining the question of fiscal reform in the context of trade liberalisation.

[7] World Bank/Commonwealth Secretariat. Small States: Meeting Challenges in the Global Economy. March 2000

though the GSP is less than Lomé, they will be prepared to accept it once it covers a fair amount of existing exports and does not have any reciprocal adjustment costs. The trade-off would be the loss of some existing and potential market access for a greater gain in having no adjustment costs.

The 2004 EU GSP exercise will not cover potential exports which the Caribbean has not used under the existing Lomé tariff preferences. In addition, and more importantly, the GSP will not cover the Protocols. Even though the Protocols are tied up in CAP Reform and the new WTO Agricultural Round, an adequate solution to continue the preferences in the Protocols in some form can still be tied in to the question of FTA since duty-free tariff quotas are permissible under Article 24 and it may be possible to grant the EU asymmetrical treatment on the same products out of a concern for subsidised EU exports on similar products.

The biggest obstacle to extending Lomé-equivalent concessions under the GSP is that the EU would have to give it to other non-ACP developing countries which would be costly for them. Unless they can get a waiver under the Enabling Clause for the ACP, this would be an impossibility since juggling rates in the existing EU GSP for different countries and regions would hardly be appropriate. The present delay with the obtention of an 8-year WTO waiver request for the Cotonou Agreement may be indicative of what is possible in the future.

The EU already has a clear concept of how it wants to proceed with its EPAs. It believes that Article 24 in the WTO is flexible enough to go beyond 12 years if necessary. According to one interpretation of Article XXIV, a country only has to inform the WTO General Council that it needs more adjustment time (beyond 12 years) and that cannot be challenged in the WTO. Examples of FTAs such as in Latin America and other regions which have taken over 25 years or more to meet this Article XXIV requirement abound and are used to buttress this legal position. At present, no one wants to challenge Article XXIV in the WTO since the flexibility that is needed is already is there.

On the basis of this flexibility, the EU believes that different transition periods could be arranged for different countries. It is even encouraging the ACP LDCs to become part of the REPA process under Article XXIV and enjoy longer transition periods, perhaps 25 or 30 years of transition or even longer if they wish. In accepting to assist the ACP countries integrate gradually into the world economy, the EU has accepted to work with a "soft" REPA and strengthen regional integration movements as the basis for doing so.

The African regional integration movements are already taking steps within the next 8 years to position themselves in the event that the soft REPA option with the EU is considered desirable. As a matter of fact, things are moving rather quickly. UEMOA is already talking about a REPA, ECOWAS is taking steps to deepen its process of integration, first through monetary integration by the non-UEMOA countries and then later full monetary integration among all its members. COMESA is moving towards a customs union with the possible acquisition of external competence to negotiate FTAs with other regions and speak with one voice in the WTO. The African regional integration movements are therefore subscribing to the premise that in the context of globalisation, they have not only to go to the EU with one voice but also to the WTO. Even if a REPA with the EU is not considered acceptable at the time of negotiations, regional integration of this type with WTO recognition of the regional integration movement is regarded as laying a solid basis for integration into the world economy. The process has thus already started with the EU planning to inject a substantial amount of funds to strengthen these regional movements as the basis for world integration.

The above has major implications for the FTAA. Since CARICOM has to give equal treatment to the EU and the US, then the three main alternatives that it faces are as follows:

- stay out of FTAA and REPA and remain on non-reciprocal arrangements (CBI and Post-Lomé GSP);
- go to FTAA at the same pace as it goes to REPA under Article 24 of the WTO;
- go to FTAA and move to a graduated GSP with the EU with all the implications for the loss of certain EU preferences;

The above remains subject to developments in the WTO and the EU. If reforms, especially waivers and changes to the Enabling Clause, are possible, then the picture can change somewhat. This uncertainty is still keeping some options open.

The question of FTA versus a non-reciprocal solution is best examined in a context of scenarios about non-reciprocity, degrees of reciprocity on both sides, “hard” versus “soft” EPA and possible wider reciprocal package arrangements, in particular those linking the new trade preferences areas (standards, services, etc) in an asymmetrical way to negotiations in market access in goods. As yet, the EU proposals both in terms of GSP and FTA remain vague and lacking in the required details.

The OECS countries have been strong on the non-reciprocal line even with larger neighbouring developing countries. The extent to which this line is sustainable and needlessly retards the necessary adjustment measures has to be examined. It may be possible for the OECS as non-LDCs but vulnerable small states to obtain transitional paths (beyond the normal 10 or 12 years) that could be longer than the other non-vulnerable non-LDCs ACP countries. Different transitional speeds under Article XXIV would create administrative problems for the rules of origin but this be a price that have to be paid to mitigate adjustment costs for some and meet market access requirements for others.

The various reciprocal and non-reciprocal scenarios that face the OECS have to be examined. It would be instructive to work out transitional and adjustment paths with all the necessary trade adjustment support and development assistance along with the required safeguards. In the context of the ACP/EU arrangement, it would also be helpful to consider how EU financial and technical assistance could in the future best support trade adjustment and competitiveness-building over some desirable transitional period.

It would also be critical for the OECS to develop a capability to negotiate simultaneously in the WTO and with the EU since many developments in the Post-Lomé negotiations will depend on new WTO arrangements. The present multilateral round will be important for providing some umbrella cover to either of the options proposed or some new sui generis arrangement. The securing of waivers as well as possible changes or clear interpretations of Article XXIV would be important as well as new measures for special and differential treatment in the WTO.

Future negotiations with the EU will deal with trade in services. Given the expected increase in the importance of services to the OECS, the development of services would require agreements, inter alia, on freedom of movement of natural persons, mutual recognition and accreditation, and rights of establishment. OECS countries should try to develop negotiating capability in the following services: tourism-related services, including airline reservations, entertainment, culture, health and sports; telecommunications-based services; financial services; environmental services; and business services, including accounting, legal and marketing.

Despite the importance of the tourist industry for the OECS, there is inadequate attention to it in the new agreement. New proposals for post-Lomé negotiations are needed that would embrace not just marketing arrangements, but also the all-important areas of air services and the further development of environmental and cultural heritage tourism in the OECS. It is also of critical importance to take account of the current impact of the General Agreement on Trade in Services (GATS) on future negotiations with the EU.

Finally, while pursing the above, the OECS will also have the task of securing the best arrangement for the banana industry. It will also have to prepare itself to negotiate in many trade-related areas where new forms of preference are important.

CONCLUSIONS AND RECOMMENDATIONS

The OECS face the task of preparing for negotiations on several fronts and at the same time ensuring that an adequate implementation strategy is pursued with respect to the new convention. The following steps should therefore be taken:

IMPLEMENTATION

- Measures for addressing potential slow disbursement rates would be important and should be identified very early to ensure adequate performance that would avoid the loss of resources from rolling programming and the abolition of carry-overs from this convention. In this vein, support for capacity building in project formulation and implementation as well as programme design and management would be critical. With no real increase in EDF indicative allocations expected, the latter initiatives would be important;

- The EU should be asked to explain the detailed formula used for calculating resource allocations for the National Indicative Programmes in the Compendium of Reference Texts. Criteria for resource allocation should be transparent and take into account the peculiarities of small island developing states;

- The OECS private sector would need to equip itself to meaningfully participate in the Business Forum and dialogue. It may also wish to focus on the specific conditions of small domestic firms and the types of lending that are most appropriate for them to take advantage of the new Investment Facility;

- Capacity building would be important for many civil society groups to allow them to meaningfully participate in the policy dialogue and manage EDF resources;

- The OECS should review the new Convention with a view to determining where clearer strategies, guidelines and criteria need to be inserted in the Compendium of Reference texts. Areas such as the calculation of public sector deficits and export earnings, performance criteria, etc should receive some particular attention;

- With the emphasis on poverty reduction, it would be useful for the OECS to link the programming process under the new Agreement to the national implementation process of the UN Social Summit Declaration and Plan of Action to ensure that the countries are not faced with more uncoordinated and incoherent demands from the donor community;

PREPARATIONS FOR NEGOTIATIONS

- The timetable (September 2002 for post-Lomé (Phase 2) negotiations as well as the preparatory period up to 2008 for agreement is short. Maximum use must be made of the time to put in place the negotiating capacity as well as the regional arrangements regarding the single economy and market;

- The various reciprocal and non-reciprocal scenarios that face the OECS have to be examined. It would be instructive to work out transitional and adjustment paths with all the necessary trade adjustment support and development assistance along with the required safeguards. In this context, it would be helpful to consider how EU financial and technical assistance could in the future best support trade adjustment and competitiveness-building over some desirable transitional period. OECS countries have already indicated a strong interest in non-reciprocity in trading relations even with larger regional developing countries. It would therefore be important for them to see what Lomé-equivalent preferences under GSP would be needed. The present EU GSP comes up for renewal in 2004 and the OECS may wish to ensure that this alternative possibility is thoroughly examined along with all the other available trade options;

- Post-Lomé proposals for trade and the development of export services must be developed that take account of the current impact of the General Agreement on Trade in Services (GATS) on future negotiations with the EU;

- The OECS will have to prepare itself to negotiate in many trade-related areas where new forms of preference are now important;

- The constraints facing OECS countries to conduct trade negotiations must be clearly articulated and measures taken through capacity building and cooperation in multilateral fora. The OECS must seek to take advantage of promised EU assistance in this area.

ASSESSING THE FTAA NEGOTIATIONS

Market Access

The negotiations on tariffs and non-tariff measures, safeguards, rules of origin, customs procedures, and standards and technical barriers to trade proceeding within the Negotiating Group on Market Access (NGMA) holds tremendous implications for the economies of the OECS. Negotiations in the (NGMA) are closely related to negotiations in the area of agriculture.

Tariffs

Work has focused on updating the Hemispheric Market Access Database with information on trade flows, tariff rates, duties and charges. FTAA member countries are responsible for submitting information through to the year 1999. This information will facilitate an inventory of measures which affect the applied tariff (including customs surcharges, other fees levied on imports, tariff rate quotas and price bands) and has been developed as a means of determining the manner in which the gamut of measures imposed by FTAA members on tracking goods within the hemisphere should be treated in the negotiations. Regrettably, the OECS countries have not submitted information on these measures. Unless attention is accorded to the provision of this information, this dearth of OECS generated information could yet emerge as a poor strategic move, potentially limiting the scope of measures afforded to these countries within the emerging FTAA framework.

The discussions on the method, modalities and timetable for the elimination of tariffs also hold particular significance for the OECS. These countries should accord particular attention to the formula approaches as well as the possible timetables being advanced for tariff elimination. While negotiations on methods, modalities and timetables for the elimination of tariffs remain important to most CARICOM countries, the relative importance of international trade taxes to most OECS economies renders negotiations in this area of relatively greater importance than for most CARICOM countries. Discussions regarding the development of safeguards, elimination of market access barriers and subsidies in hemispheric markets are also of tremendous importance to the OECS, since few non-tariff measures are imposed within the hemisphere by these countries. The narrow scope for trade policy among the countries of the OECS also renders discussions on the base for tariff reductions (bound vs applied) critical.

By the same token OECS countries have not participated in the discussions regarding the application of percentage preferential margins. The possibility of binding unilateral preferences such that their market access opportunities are not curtailed upon entry into force of the FTAA is a theme which should be of major interest to these countries.

Non-Tariff Measures

Tremendous non-tariff measures confront OECS exports to major markets of the hemisphere. Along with their CARICOM counterparts, OECS exporters have experienced tremendous difficulties in seizing market access opportunities. Given the concentration of agricultural exports in total OECS exports and the low pay-off to further tariff reduction in certain markets (US, Canada, Mercosur), negotiations within the framework of the FTAA, in areas aimed at reducing NTMs could be of particular importance to further market access opportunities.

Discussions on non-tariff within the NGMA measures have covered a range of topics which include, import and export restrictions, import licenses and other administrative procedures, export taxes, dealer protection laws among others. Increasing transparency in the application of non-tariff measures is being driven by a process of notifications on the part of member countries. Based on the notification process and the development of an inventory of the NTM's instituted by FTAA members, establishment of procedures and timetables for the elimination of the non tariff measures which constitute barriers to trade will be developed. The OECS countries have participated actively in the submission of the required information on the non tariff measures being applied by their own members.

Safeguards

Safeguards are an important area of the FTAA negotiations for OECS countries. The negotiating group has relied on a process of notification as a means of identifying the various measures being applied by all FTAA members. The notification of safeguard regimes being applied by FTAA countries within the context of sub-regional preferential agreements has also been an important element of the process.

Discussion regarding the possible elements of an agreement in the area of safeguards has covered topics, such as, the period of application of the safeguard regime, conditions for application (increased imports, existence and qualification of injury or threat thereof, causal relationship), nature of the measures (tariff measures, suspension of phase-out process or snap back to initial or MFN tariff), rights of the affected parties and safeguards for specific sectors, particularly agriculture.

The discussion on safeguards, while having important implications for smaller economies, has proceeded largely without input from OECS countries. Many of the smaller economies are adamant that the development of a safeguard regime within the context of the FTAA should not impair their ability to resort to the safeguard facilities negotiated in the WTO. Most CARICOM and all OECS countries maintain an interest in the development of special safeguards for certain sectors. This is particularly important since the OECS countries while having recourse to the use of the general safeguard provisions, did not reserve the right to use the "Special Agricultural Safeguard (SSG)". Several Latin American countries as well as the United States and Canada have reserved the right to apply the special agricultural safeguard. While the WTO Agreement on Agriculture contemplated the special agricultural safeguard as a temporary measure, many smaller economies dissatisfied with the general safeguard provisions are articulating the need for a permanent simplified safeguard provision/mechanism for the agricultural sector.

Rules of Origin

The complexity of implementing the rules of origin provisions (criteria) within certain regional agreements, such as NAFTA, has underscored the importance of this topic in the negotiations, particularly so for small countries with limited administrative capacity. The difficulties which some

Canadian firms continue to experience in satisfying the origin requirements should act as a lesson to smaller states on the importance of ensuring that origin rules are developed in a manner consistent with their trading interest as well as their administrative and institutional capacities if they are to be truly beneficial. The negotiations have focused on a number of important themes, including the general criteria for the qualification of goods with origin status, qualification of specific types of goods and materials, direct shipment and transit and trans-shipment.

Specific criteria have been advanced for the determination of origin, these include:

(i) goods wholly obtained or produced entirely in the territory of one or more of the contracting member states;

(ii) goods made entirely in the territory of the contracting Parties from originating materials; and

(iii) goods made from originating and non-originating materials. The negotiations have reasserted the importance of a change in tariff classification as one of the priority criteria for origin status.

Issues in this sphere are of major significance to the OECS. To begin with the trend among the manufacturing sector in the OECS has been towards increased dependence on imported intermediate material, both from within and outside the Hemisphere. By contrast, many of the major Latin American exporters are major producers of intermediate inputs, such as, juices, concentrates and purees rendering them less reliant on imported intermediate product. Rules of Origin criteria, which maintains strong regional content provisions or "wholly produced" criteria are therefore not necessarily in the interest of OECS manufacturers. However, there may be other circumstances, such as spices and condiments, beers and aerated water, rum and spirits where stricter, rather than more liberal rules of origin criteria may be desirable. The OECS' position in the negotiations should also be guided by the recognition that as global trade liberalisation proceeds and competition for hemispheric markets become more aggressive, the problems limitations posed by underdeveloped transportation infrastructure will also fade, giving rise to greater market opportunities as well as greater access, including increasing concerns with issues related to transit and trans-shipment of goods. In developing criteria for origin classification, OECS countries should be vigilant to ensure that whatever basis is used (change in tariff classification) is in consonance with their trading interest. Closer attention to these areas could begin the task of crafting meaningful special and differential provisions for OECS and other developing countries.

Customs Procedures

Given the diverse nature of the preferential arrangements already existing within the hemisphere, the NGMA has emphasised the imperative of norms regarding customs procedures which ensure consistency with the obligations assumed in the WTO. The possibility of improving these disciplines through further negotiations or through FTAA countries acceding to other agreements and conventions that promote the modernisation of customs procedures was raised as a further issue. The NGMA has so far established the need for procedures that are clear, precise, impartial, transparent, consistent and which are administered with predictably.

FTAA members have so far identified four sets of issues which should form the basis for negotiations in this area. These include general principles and obligations, other customs procedures relating to the entry of goods, customs procedures relating to the administration of the origin regime, and technical cooperation.

In order to facilitate the identification of the constituent elements for inclusion in the Agreement in the area of customs procedures, a NGMA resorted to a process of notification of the customs procedures applied by the countries of the Hemisphere within the context of the various sub-regional preferential agreements. It is important that OECS countries participate in this notification process, `as it will undoubtedly provide an avenue to constructively address many of the complaints raised by the private sector regarding their frustrations with customs procedures, as they attempt to exploit opportunities in some hemispheric markets.

Standards and Technical Barriers to Trade

Four essential elements have emerged throughout the negotiations which are of particular significance to OECS countries, these include scope and coverage of the rules governing standards and technical barriers to trade, objectives and general principles, standards and technical regulations and conformity assessment.

The discussions regarding scope and coverage, has underscored that the rules governing standards and technical barriers to trade should be in conformity with those of the WTO Agreement on Technical Barriers to Trade; and, that trade in services, sanitary and phytosanitary measures and government procurement should be excluded.

In the discussions on objectives and general principles emphasis has been placed on ensuring the full and effective implementation of the obligations embodied in the WTO-TBT Agreement. The difficulties which some countries were experiencing regarding implementation of the WTO TBT Agreement arose as a possible opportunity (area in which) the FTAA could go beyond the WTO Agreements in facilitating implementation. This is of particular importance to OECS countries since they too have experienced untold difficulties with undertaking their commitments under the TBT Agreement. The participation of OECS countries should be oriented toward reducing the difficulties experienced during implementation of the Agreement through, *inter alia*, the securing of better than best endeavour commitments from developed country partners.

The harmonisation of standards and technical regulations with international standards, wherever possible and appropriate has also been a guiding principle of the NGMA in this area. The emphasis has been on the adoption of international standards as the basis of standards and technical regulations, strengthening and improving the roles and functions of standard setting bodies; and increasing the participation of countries within the Hemisphere in the work of the various international standard setting bodies (Codex, IPPC and OIE). The importance of the work being undertaken by the regional and sub-regional organisations responsible for coordinating the harmonisation of standards for the Hemisphere has been a major focus.

OECS exporters have consistently registered their dissatisfaction with mandatory technical regulations due to their propensity to act/be used as obstacles to trade. Another major complaint by

OECS producers has been the establishment of standards by some countries that far exceed developing countries capacity to satisfy them. This also constitutes an area in which the commitments in the FTAA Agreement could surpass those of the WTO Agreement. While asserting that most technical regulations do not constitute obstacles to trade, within the context of the disciplines established by the WTO TBT Agreement, most FTAA members have underscored the importance of transparency as an essential element of the standardisation and technical regulation process. Pursuant to this some delegations proposed initiatives that would tend to facilitate the transparent development (elaboration), adoption and review of technical regulations (such as the compilation of a hemispheric guide on the elaboration, adoption and review of technical regulations and the establishment of a Regional Information and Documentation Centre). Mutual recognition of technical regulations of other countries being equivalent to their own, as enunciated by the WTO TBT Agreement has also been a major theme of the negotiations in the NGMA.

FTAA members emphasised the importance of conformity assessment procedures which are aimed at obtaining effective access to markets and eliminating unnecessary technical barriers to trade. These procedures should be transparent, non-discriminatory and should be no more trade-restrictive than is necessary to fulfil legitimate objectives. Among the proposals for facilitating the acceptance of the results of conformity assessment made by bodies in other countries were suggestions for the establishment of disciplines to ensure that administrative procedures such as homologation, authorisation and registration which are additional to conformity assessment procedures are non-discriminatory. Developing country members were of the view that the principle of one standard, one test, acceptable everywhere, should be adopted where appropriate. This possibility of such a principle being adopted appears far more likely within the framework of an FTAA than in the WTO. The concerns of exporters regarding the conduct of multiple tests for the same product based on destination renders this issue of major significance for the OECS.

Agriculture

Agriculture was created fairly late in the FTAA process as a Special Working Group within the negotiations The Negotiating Group on Agriculture (NGAG) has responsibility for the negotiation of tariffs and non-tariff measures, export subsidies and other trade distorting practices which affect trade in agricultural products in the hemisphere. Consistent with the WTO framework, areas, such as, sanitary and phyto-sanitary (SPS) measures as well as some aspects of the Technical Barriers to Trade (TBT) Agreement are also covered within the NGAG. There exist a close relationship between the themes covered by the NGAG and those covered by the NGMA. In terms of scope and coverage of the negotiations, many of the themes covered in the NGAG and NGMA are cross-cutting in nature and the interest of the OECS countries repeat. As a result, only the salient elements of the negotiations as they relate to agriculture, and insofar as they might not have been adequately treated within the NGMA, will be examined.

1. Scope and Coverage

- **Tariffs**

In addition to the issues previously mentioned on the progress of negotiations in the NGMA, base rates of tariffs, base periods and years, tariff nomenclature, method, modality and time-table for tariff elimination, differential treatment based on levels of development (FTAA terminology for Special and Differential (S&D) Treatment for small economies and provisions regarding special regimes (drawback, duty deferral programs, temporary admission, free zones, import monopolies and re-importation) there are a number of issues of particular significance to agriculture. These include:

- seasonal tariffs
- tariff rate quotas (TRQ) and the modalities for TRQ administration
- the modalities for the administration of tariffs
- tariff peaks and non ad valorem tariffs, as well as customs processing fees
- measures affecting applied tariff rates

Seasonal tariffs are of particular importance to the perennials, such as, citrus and mangoes. The issue of tariff rate quotas and their administration is of both direct and indirect importance for OECS countries, particularly in relation to products such as sugar (exported into the US under CBI) and increasingly for products exported outside preferential arrangements. The outcomes of the negotiations in this area could directly and indirectly alter the balance of trade for several products, many of which are of particular interest to the OECS. While many of these issues have been previously examined and disciplines within the context of the WTO, they also hold tremendous, and in some instances, special significance for OECS countries within the context of the FTAA.[8]

Negotiations on some elements of agricultural tariffs and non-tariff barriers have proceeded at a faster pace in the NGAG than in the NGMA. This underscores the need for greater collaboration between the two working groups and places an even greater demand for OECS participation in the process.

Negotiations on the base rate to be used for tariff negotiations have been fairly consistent with those which have occurred in the NGMA. The manner in which preferential arrangements would be treated within the context of the evolving FTAA has been an area of particular concern for many delegations. So far a number of options have been proposed, including the application of some concept of preferential margins (perhaps on a percentage basis, with some strict definition of the margins to be applied). Yet another option proposed as a means of limiting the extension of preferences to non-beneficiary states, would be to use the preferential rate being applied during the period between the beginning and the end of the negotiations as the lowest applicable rate. To the extent that discernable trends are evident, it is the tendency towards the "grand-fathering" of existing preferential arrangements into the FTAA.

In addition to the measures that affect the applied tariff, the NGAG has also considered non-tariff barriers (NTB) and other measures with effects equivalent to NTBs. Such measures have included tariff surcharges, tariff rate quotas, price bands, reference prices, discretionary import licensing systems and distributor protection laws. To date the process has been aimed at the

[8] For instance, as countries of the hemisphere move toward an FTAA with all the attendant implications for tariff reductions and easier market access, CARICOM countries will face increased competition from countries, whose production structures are "competitive" and who have reserved the right to use domestic support and export subsidy measures. These challenges will be of far greater significance within the context of an FTAA, than for the multilateral process.

development of a hemispheric inventory of measures as a first step toward the definition of a program for the progressive elimination of trade distorting measures. While several OECS countries maintain a number of NTBs which impact trade in agricultural products, they are in no worse a position than several other negotiating partners. While the conventional thought among these countries is that notification will serve only to further undermine their ability to develop "trade defense mechanisms", this study takes the contrary view. The increased transparency which the notification process facilitate will in all likelihood improve, rather than diminish the trade policy options of these countries. Equally important for the OECS countries are the trade distorting policy measures of other countries of the Hemisphere and the impact which they continue to have on their agricultural trade. The importance which OECS exporters have attached to non tariff barriers and other trade distorting measures on their exports into some hemispheric markets, would appear to be justification enough for their enhanced participation.

- **Safeguards**

From the inception of negotiations, the imperative for a special safeguard provision has attracted the interest of many of the smaller economies participating in the FTAA. Many of these countries, despondent by the practical complexities of invoking the general safeguard mechanism under the Agreement in legitimate circumstances and particularly so for agri-food products at the multilateral level, viewed the FTAA as a forum for the development of a more practical and flexible framework of rules and regulations. Several other FTAA members have from the inception opposed the establishment of a separate and special agricultural safeguard facility, contend that it is premature to a priori determine the need for such a regime before the architecture of the hemispheric trade liberalisation process and the general safeguard regime are defined. This notwithstanding, there appears to be some emerging support for an agreement of this type and in particular, on the scope and conditions for application of the safeguard regime, nature and implementation of the measure, and the provisions for investigation and notification.

There has been no clearly discernible trend on issues such as: the nature of the special safeguard arrangement (transitional or permanent, comprehensive or limited), the criteria for invoking the regime (automatic or conditional), whether the regime will be subject to an injury test or not, the scope for provisional remedies (tariff-only or quantitative restrictions) or the duration of safeguard action. The discussions regarding the nature of the safeguard facility which is likely to emerge is of tremendous importance to the OECS. The fact that the countries have to date not participated in the negotiation to any significant extent should be viewed as a major oversight. The incorporation of a "special agricultural safeguard" facility with applicability to certain agricultural products and with differential provisions for countries based on differing levels of economic development (a restatement of the small economies concept) would appear to be in the interest of the OECS.[9]

[9] While the CARICOM proposals for agriculture within the context of the ongoing WTO is still being prepared, it appears certain that the establishment of an expeditious safeguard mechanisms for agriculture will be proposed. Such a facility must be flexible in its application and must be based on pre-determined criteria, such as the level of production and marketing, as well as the importance to the rural economy and the sensitivity to import surges.

- **Export Subsidies**

There is an emerging consensus that export subsidies should be defined on the same basis as in the Uruguay Round, AoA. A WTO plus definition which admits to other measures which affect export competition is also being considered (Articles 1 (e), 9 and 10 of the AoA, plus Article 3.1 (a) of the WTO Agreement on Subsidies and Countervailing Measures). The consensus is that export subsidies should be curtailed on all products traded within the Hemisphere by FTAA members themselves as well as by third countries. The process for export subsidy elimination has also been an important component of the negotiations. Some FTAA members are interested in the total elimination of export subsidies for trade in agricultural products with virtually immediate effect. Smaller economies have signalled their intention to press for longer phase out periods, however a few other countries have indicated their reservation to the extension of "blanket special treatment" to small economies. The position of OECS countries on this matter continues to be somewhat unclear. Conventional economic theory suggests that as net-food importing countries, these countries should be net-beneficiaries of export subsidy programs, largely through lower food prices. The position of OECS countries on export subsidies is however, obscured by their status as preference beneficiaries since these export subsidy programs are an artifact of the policy measures aimed at surplus product disposal mainly by the EU.[10] OECS countries have not registered the use of export subsidies in the Uruguay Round.

While there has been no definite pronouncement, regarding the most feasible forum for the negotiation of export subsidies (FTAA or WTO), there is recognition that if it appears that there will be resolution at the multilateral level, interest in pursuing this matter in the FTAA could wane. If on the other hand, no resolution is reached within the context of the WTO negotiations, several interesting permutations regarding a possible solution set exist. Indeed, since no such subsidy measures are employed by CARICOM or OECS countries, which are subject to reduction commitments many and varied positions are possible.[11]

<u>Treatment of Export Subsidies by FTAA Participants to Third Country Markets</u>

In the context of the elimination of export subsidies in the Hemisphere, some delegations were concerned about the potential that export subsidies used by FTAA participants on exports to non-FTAA countries could displace non-subsidised exports from other FTAA participants in those non-FTAA markets. In this context, the following options were mentioned:

- To achieve, as an integral solution, the global elimination of export subsidies within the framework of the WTO during the next round of agricultural negotiations;

- To establish, within the Hemisphere, a mechanism for prior consultation and agreement between FTAA countries on export subsidies for exports to non-FTAA participants, and to agree among the FTAA countries that funds no longer used to subsidise exports within the Hemisphere will not be applied to subsidise exports to non-FTAA countries (netting out).

[10] The CRNM is in the process of commissioning a study on export subsidies and its impact on CARICOM agriculture.
[11] In fact two studies have been commissioned by the Regional Negotiating Machinery which should provide the basis for an informed position to be adopted on this matter.

Discussions on Conditionalities in the Liberalisation Process

Some delegations pointed out that tariff liberalisation must be conditioned on the elimination of export subsidies and domestic trade distorting measures in agricultural products. In addition, other delegation noted that the beginning of the tariff phase-out process should be conditioned on the achievement of agreements for the elimination of export subsidies, tariff peaks, tariff escalation, tariff seasonality, and the subsidy elements of export credits, insurance and credit guarantees related to agricultural exports; and disciplines on the trade-distorting practices of state trading enterprises, export tax differentials, and other measures and practices which distort trade in agricultural products. Some delegations suggested that some of these issues should be dealt with multilaterally in the WTO and not within the framework of a regional agreement such as the FTAA.

Sanitary and Phytosanitary (SPS) Measures

Various proposals were received and there was a detailed discussion on how to fulfil the mandate from the TNC for the consideration of SPS issues by the Group. Most of the proposals called for full implementation in the Hemisphere of the WTO SPS Agreement. One delegation proposed a draft SPS agreement specifically for the FTAA. Many of the proposals suggested specific topics for further discussions toward fuller understanding and implementation within the Hemisphere of the WTO SPS Agreement, including topics such as:

- equivalence
- harmonisation
- recognition of free areas
- adaptation to regional conditions (regionalisation)
- transparency and technical assistance
- risk assessment
- control, inspection and approval procedures

With the objective of initiating this exercise, one delegation proposed discussing the application of the provisions of this Agreement concerning equivalence and regionalisation which included specific provisions on general principles for determining the equivalence of certain measures and the application of this concept in the area of poultry and meat inspection systems.

Some proposals also included topics relating to technical assistance and consultations and dispute settlement. It was pointed out that there was already a Group on Dispute Settlement and horizontal provisions on technical assistance in the Agriculture Group which might address these particular SPS concerns.

Future Steps

The complexity and vast scope and coverage of the agricultural negotiations requires some critical sector-specific analyses of country and group proposals, in order to be able to gauge how a regional agriculture FTAA agenda can be developed and on what discipline areas it should concentrate. Likewise, analyses are required to ensure compatibility of such a regional agriculture agenda in the FTAA with WTO agriculture negotiations and agreements.

The Group's lack of clear consensus on proposals for scope, coverage, and implementation (e.g., export subsidies and similar measures), lends itself to allowing CARICOM an opportunity to identify initiatives in the following areas of priority action:

- focus attention on market access/entry issues aimed at the elimination of tariff and non-tariff barriers to agricultural exports;

- given the highly protected and non-competitive nature of regional agriculture, there is a need to identify scope for trade-offs in the negotiations between sensitive disciplines such as agriculture and services, investment, IPR, among others;

- CARICOM needs to seek continued protection for its agri-food market, especially because high tariffs remain the only WTO-compatible instrument to safeguard the sector;

- prioritise technical and financial resources for the development of a comprehensive agriculture negotiation strategy to cover all trade regional, hemispheric, and multilateral negotiations, a la the suggested format of an Agricultural Trade Negotiation Unit with regional and national scope;

- focus on seeking to ensure that some form of special consideration be negotiated for smaller economies, in line with some of the features of the multilateral Special Agricultural Safeguard, for example;

- develop a strategic negotiating linkage between multilateral trade initiatives supporting preferential arrangements for agriculture (e.g. WTO use of waivers under the enabling clause) and the commitments under the FTAA.

CARICOM can clearly benefit from a less dynamic and active agenda in the agriculture negotiations, thus allowing for more time for preparation and adjustment. This would be in-line with the traditional MERCOSUR position which seeks to have a slow process of liberalisation in agriculture, thus lending itself to possible negotiation alliances for the region. CARICOM support for such a posture in the agriculture negotiations would surely be welcomed by MERCOSUR.

Analysis is required of agriculture-specific trade-offs which would benefit the region under such an initiative. Since CARICOM extra-regional agriculture exports are relatively marginal such an initiative would not be expected to affect regional agriculture export performance. However, given recent advances and successes of agriculture niche-export penetration in the U.S. market, there is a need to assess the impact of a position advocating a slower pace of FTAA agriculture trade liberalisation with the needs of regional agriculture/agri-produce exporters in extra-regional markets.

UNITED STATES AND THE CBI

The Caribbean Basin Initiative, enacted by Congress in 1983, accords to most countries in the Caribbean and the Central American Region non-reciprocal access to markets in the US. In addition there are development funds and other benefits to be derived from CBI membership. These benefits have been realised somewhat unevenly by CBI beneficiary countries, with some countries expanding exports rapidly and others hardly at all. As a group OECS countries have not derived as many benefits from the CBI as other countries in the Caribbean and Central America. Early benefits arose from the assembly of textiles and other apparel for countries such as St. Kitts, St. Lucia and Antigua. Exports from the other OECS countries were concentrated in non-traditional agricultural export categories. OECS countries have been concerned from the inception about the commodities that were excluded from duty-free eligibility under the CBI. These included textiles and leather shoes, which were accorded limited access, along with orange juice and sugar. Under the CBI, various tariff exemptions have been granted from goods re-imported into the US if produced largely from US originating inputs. In addition to the trade agreements the CBI countries have also been eligible for certain funds for development projects. However, there were often conditions attached to the use of this financing.

The CBI programme itself would appear to be vulnerable to charges that it violates international trade rules. It does not constitute a free-trade area under the terms of Article XXIV, which would require reciprocal access and wider coverage. Nor does it qualify as a scheme to grant developing countries "special and differential treatment' as it discriminates in favour of a group of such countries. The prospect is therefore strong that there will be pressure to make the CBI reciprocal, and hence more like a free-trade area. At the core of the US-Caribbean economic relations is a differing approach to the global economy. As a rule, the US holds to the view that all countries should compete equally in the international market. Caribbean countries, while eager to integrate with the global market, recognise that their small size, lower level of development, and underdeveloped export structures predetermine their limited capacity to participate effectively in global trade liberalisation without the benefit of special preference, or in the worst case scenario their phased elimination. The US has steadfastly objected to asymmetric international trade commitments based on difference in levels of development and in particular based on the concept of Small Island Developing states. This position was again manifested throughout the FTAA preparatory process as well as at the FTAA Toronto Ministerial. This pressure will no doubt intensify itself with the signature of the New Partnership Agreement between the ACP and EU in June of this year, which clears the way for some type of reciprocal trade agreement to replace LOME. While recent proposals have highlighted that the extent of reciprocity can be matched to the development levels of the different ACP countries. OECS countries could well face the prospect of gaining some degree of reciprocity to the EU and possibly the US in the near future.

The commitment by the US to specific commodity flows between the US and the Caribbean appears far more certain than arrangements between the Caribbean and the European Union. This is borne out by the experience with sugar and textiles, respectively. The value of sugar imports from Caribbean countries has declined throughout the decade of the 1980s and 1990s. Although the US sugar quotas are now safely embedded in the GATT Agreement, the size of the quota allocation continues to de dependent on the US domestic price and on the net-export status of Mexico. A comprehensive examination of the impact of the programme on the sole OECS sugar producer, St. Kitts and Nevis should include a determination of the extent to which the quota has been a binding constraint. In the case of textile, the CBI Bill enacted by Congress in 1990, provided almost duty-free treatment for all but a limited category of textile products exported from the Caribbean (products assembled from US components). Textile industries developed in several of the OECS territories. With the entry into force of NAFTA, much of the cost advantage which Caribbean Basin countries enjoyed were undermined by more generous benefits accorded to Mexico. While CBI 2000 has sought to restore the parity between the CBI textile products and their counterparts in Mexico, and the recent bill is a definite improvement on the first two (1984 and 1990), several commentators have indicated that the treatment of textile under the CBI and NAFTA are still divergent in certain respects[12]. The salient features of CBI 2000 are examined in the following section.

The Caribbean Basin Trade Partnership Act (CBPTA) provisions of the Trade and Development Act (TDA) of 2000 will take effect from October 1, 2000. The enhanced CBI arrangement provides immediate tariff reduction of NAFTA levels for imports excluded under CBI, specifically dome apparel, which received not only duty-free but also quota-free treatment. The provisions of the new CBI will be maintained until 2008, or until the FTAA or another relevant trade agreement enters into force, if that date is earlier. This means the almost complete duty-free treatment for the region's exports to the United States for all but certain agricultural and textile products.[13] A major concern is that the legislation is saddled with a number of conditions that could prevent the Caribbean from fully utilising its benefits.

Lande (2000) in comparing the new CBI provisions concludes that the duty-free treatment accorded to CBI countries still does not provide true parity with Mexico for the following reasons as the enhanced CBI benefits are:

(1) not comprehensive;
(2) limited in time duration (concluded by 2008);
(3) subject to unilateral and restrictive origin rules;
(4) non-bound in the context of the WTO and is therefore not secure;
(5) is not subject to challenge under dispute settlement procedures.

The complex rule of origin criteria has also emerged as a constraint for some producers with NAFTA. The rules of origin allow products produced in two or more NAFTA countries to receive duty-free treatment within any of the NAFTA member states. Within the context of the CBI, any product incorporating significant input from a NAFTA country cannot enter another NAFTA member duty-free.

Most non-traditional agricultural products were already covered by earlier versions of the CBI (CBI 1984 and CBI 1990) and before this, under the Generalised System of Preferences extended

[12] See Lande, S. "U.S. Trade Regime Applicable to CBI Imports after Implementation of the Trade and Development Act of 2000"
[13] In earlier version of the CBI, important exceptions were for the agricultural products such as rice, citrus and tobacco.

to developing countries.[14] The successive CBI bills have had little impact on OECS agricultural exports. Supply-side constraints among the OECS countries themselves and the increased significance of non-tariff measures precluded countries from benefiting from the market access opportunities that have emerged. Matching technical and financial assistance to the areas where market access concessions have been granted based on strategic interventions throughout the "commodity chain" is an approach worth considering.

The US challenge to the European Union's agreements with the Caribbean and other ACP partners, for the sale of bananas poses the greatest challenge to US-CARICOM trade policy relations in the new millennium. The impact of the US trade policy stance on the EU banana regime has been disproportionately negative on the small economies of the OECS. The larger and more diversified production base of the other CARICOM producers has somewhat dampened the effect of the impending changes. In addition most OECS countries are constrained in benefiting from the concessions offered under other US directed programmes. The US' position has also raised concerns regarding the relevance of the US policy towards the Caribbean. The recent denial of the WTO Council for Trade in Goods by the US, Panama, Ecuador, Guatemala, Honduras and Costa Rica is further evidence of the commitment by US trade policy makers towards reciprocal trading relations with all countries, including the smallest and most vulnerable.

The development regarding sugar may not only be of academic interest to the OECS sub-grouping, if the industry in St. Kitts continues on its poor performance trend. CARICOM producers have continued to seek a CARICOM-wide sugar quota, which would allow reallocation among its members in the event of temporary shortfall by any one of their members. Quota transferability to CBI beneficiary countries after quotas have reverted to the “common pool” is consistent with the way in which the sugar programme already operates. In fact the US undertook to explore the legal implications of this request during bilateral discussion (CARICOM/US Trade and Investment Council) in 1999. A single CARICOM sugar quota would be consistent with the region’s efforts to create a CARICOM Single Market and Economy.

Current US proposals in the WTO to engage in sector specific negotiations to agree on further reform measures to include a further expansion of “zero to zero” agreement it negotiated with the EU, could also hold significant implications for the major rum producing countries of the OECS as this would further jeopardise the rum exports to the EU and US markets. The new Trade and Development Act 9CBI II) allows duty-free status to be maintained for CARICOM produced rums exported directly to the US as well as the conferring of duty-free status of rums blended and bottled in Canada from CARICM- originating rums. Specifically, the bill provides for liqueurs and “spirituous beverages” produced in Canada from CBI rum to be given duty-free access where they account for a minimum of 90% alcoholic content by volume. Excluding rums from the “zero to zero” proposals could also be significant to the OECS countries which are

[14] There were qualitative improvements in the benefits from the GSP which maintained a convoluted classification scheme which was determinant on the degree of tariff preference. For instance, under the GSP, non-designated products such as textiles and apparels, leather and footwear, were exceptions. Moreover, The GSP was subject to annual review that could result in the non-inclusion of products from GSP eligibility.

presently in the process of developing brands under the "Four Island Classic" label, as it would offer them some protection in developing market share.

CBTPA countries could take advantage of their newfound duty-free treatment by entering into a more aggressive export/investment programme. Initial attention will focus on using the apparel provisions of the new law to regain the region's competitive position vis-à-vis Mexico. Attention will then focus on defending market share against Chinese and Indian subcontinent competition once the current quotas under the WTO are phased out in the year 2005. The region should also focus on adding more value to its textile exports as well as diversifying into non-textile products. In fact, the programme does not contain significant exceptions from NAFTA duty-free treatment. Coverage is limited by the exclusion of shipments of textile mill products-yarns, fabrics and home furnishings (sheets, towels, tablecloths, etc.) except if incorporated in apparel production and in apparel produced from third country fabrics or fabrics in short supply in the United States.

The ability of the region to add-value is limited by additional requirements by at least 93% of the yearn incorporated in eligible products must be spun in the United States, no woven apparel can be produced from regional cloth, at least 75% of the fabrics used to produce brassieres and other undergarments is particularly significant to the OECS producers, since it places a premium on low cost labour and operating cost. This inability to add value through factors other than low cost labour has contributed to a shift in textile and garment operators from OECS to other producing countries (Mexico and other Latin American countries). The Dominican Republic on account of its newer capital stock and low cost of labour has emerged as a significant player in the region. Since parent companies operate in multiple jurisdictions facilitating an easy comparison of cost of production and productivity, it would not be unreasonable to conjecture that barring radical changes, the prospect for new investment in the area of textiles and apparel among OECS, arising from CBI 2000, will be fairly limited.

THE WAY FORWARD

The United States and the OECS can share a common interest on a number of issues critical to the Hemisphere. The Caribbean countries have their own perception of the sort of relations they would wish to develop within the context of trade and development assistance. The political and economic diversity of the countries of the Caribbean are too significant to offer the United States the opportunity of devising a single comprehensive foreign policy toward the region as a whole. The specific characteristics of the economics of the OECS are their declining participation in hemispheric trade necessitates the development of a mix of trade and development policies, which are more relevant to their specific circumstances as a group.

With the change in the US Administration it is an opportune time for the OECS countries to rethink their trade policy relationship with the United States. The small gains which are expected to emerge from CBI 2000 for the economies of the OECS raise serious questions regarding the relevance of the US trade policy relationship toward these countries. The opposition by the US to the WTO waiver for the EU banana regime and the increasing importance of new themes and topics in international trade such as services and intellectual property rights could nevertheless create a bias for the development of a new trade policy relationship.

It is important that CARICOM's relations with NAFTA-bloc countries move in a direction consistent with its relationship with the EU. The signature of the EU-ACP Cooperation Agreement has increased the possibility that this relationship will introduce a greater degree of reciprocity with the US and Canada (and opening up trade with Mexico). Once such reciprocity can be undertaken in a manner that provide adequate safeguards, it should be accepted as a desirable component of the OECS' long run strategy. Investment guarantees could be sought from the US and Canada as compensation for greater access in domestic markets. The small countries in the region have not so far demonstrated the same willingness to expose their economies to duty-free entry for US, Canadian and Mexican goods. However, the increasing probability that such eventual duty-free treatment may have to be accorded either under the auspices of a "renewed" trading relationship with the US, or potentially under the auspices of the still evolving FTAA, should provide sufficient grounds for the development of a long term trade policy strategy.

In addition, the improvement in access provided under the programme as well as the assumption of power by the new Administration in Washington, trade policy negotiators should fully consider their negotiating options in the World Trade Organisation (WTO) and Free Trade Agreement of the Americas (FTAA). Although the degree of duty-free treatment accorded under the CBI is significant for countries capable of benefiting from the provisions, parity with NAFTA will only be accomplished in the context of reciprocal free trade with the United States. Whether the political and economic costs of opening the region to such reciprocal trade with the United States is worth achieving full comprehensive duty-free treatment is a critical question for OECS policy makers.

FISCAL IMPLICATIONS OF TRADE LIBERALISATION

CURRENT SITUATION

The fiscal situation of the six countries of the OECS surveyed has been generally weak. During 1998, current account balances ranged from a deficit of 1.5% of GDP in the case of Antigua to 5.8% of GDP in the case of St. Lucia. Overall deficits ranged from 1.0% of GDP in the case of St. Vincent and The Grenadines to as high as 6.0 of GDP in the case of St. Kitts and Nevis. With declining flows of concessional financing and substantial outlays on investment expenditure, the high deficits have necessitated increasing use of domestic financing and lease/own arrangements, which in some cases have put some pressure on debt servicing costs. The use of domestic financing, however, has not generally had a "crowding out" effect since, except in the case of Antigua and St. Lucia, commercial bank liquidity has been generally high.

Available data on the public debt showed debt/GDP ratios ranging from 46.4% in the case of Grenada to 26.2% in the case of St. Lucia. Debt servicing cost was particularly high in Antigua at 11.2% of recurrent expenditure compared to 5.9% in the case of St. Lucia notwithstanding that debt service arrears in the former stood at 5.0% of GDP at the end of 1998. Debt service costs were also high in St. Kitts at 10.6% of recurrent expenditure while similar ratios for Grenada and Dominica stood at 8.5% and St. Vincent and The Grenadines at 5.9%. Grenada also had debt service arrears equivalent to 2.0% of GDP.

All of the countries surveyed have made strong tax efforts to improve recurrent revenue to GDP ratios ranging from 36.1% in the case of St. Kitts and Nevis to 24.8% in the case of Antigua. Tax buoyancy also showed varying results with high ratios in St. Lucia at 1.2, Grenada, St. Kitts and Nevis and St. Vincent and The Grenadines at 1.0, Dominica at 0.9 and Antigua at 0.8 despite significant distortions in tax burden-sharing and substantial revenue leakages. An analysis of customs revenue shows that revenue forgone as a result of concessions granted range from as high as 60.0% in the case of Grenada to 30.0% in the case of St. Lucia.

Recurrent expenditure during 1998 as a per cent of GDP ranged from a high ratio of 35.6 in the case of St. Kitts and Nevis to 22.6 in the case of St. Lucia. At the same time ratios of capital expenditure to GDP ranged from 14.8 in the case of St. Vincent to 5.0 in the case of Antigua. The combined effect of these ratios against revenue to GDP ratios shows central government borrowing requirements of 6.1% of GDP in the case of St. Vincent and The Grenadines and 3.0% in the case of St. Lucia allowing for grant funding of 4.7 and 3.9% of GDP respectively. Similar ratios were obtained at 6.4 for St. Kitts and Nevis, 5.5% for Antigua and Grenada and 4.0% in the case of Dominica.

An analysis of recurrent expenditure by economic classification indicates that wages and salaries account for the largest share of total recurrent expenditure ranging from 56.7% in Antigua to 47.0% in Grenada. St. Kitts apportioned a higher percentage of recurrent expenditure to the procurement of goods and services at 27.8% compared to its lowest comparator, Dominica, at 17.1%. Interest payments were also highest in Antigua at 11.2% compared to 5.9% in St. Lucia. However, Grenada accounted for the highest proportionate allocation to transfers at 22.1% compared to only 10.6 in Antigua and 10.9 in St. Lucia.

Similarly indicative is the proportion of recurrent expenditure allocated on a sectoral basis. Expenditure on administrative services ranged from 39.9% in the case of Antigua to 26.2% in the case of Grenada. In contrast, St. Lucia spent 27.7% of its recurrent budget on education while Antigua spent 11.6%. Expenditure on health showed minor variation from 14.2% in Dominica to 12.6 in Grenada and St. Lucia. Wide variations occurred in allocations to economic services from 21.4% in the case of St. Vincent and The Grenadines to 13.0% in the case of St. Lucia. Generally low percentages obtained for allocations to social services; but there were significant variations from 13.6% in Grenada to 6.1% in Antigua.

A number of important issues derive from the above analysis. Firstly, to achieve the level of savings needed to support the high levels of investment indicated in the 1998 data, stronger tax efforts will be required as well as more effective control of expenditure to keep within a prudent GDP ratio. The dilemma facing the countries is how to bring convergence between tax/GDP ratios that are not unattractive to investment and the need for services and vital infrastructure to be provided and maintained at satisfactory levels in an environment where delivery of basic services and basic infrastructure are persistently affected by diseconomies of scale.

The second issue concerns the mobilisation of revenue resources. Although revenue buoyancy has been high in most cases, ranging from 1.2 in the case of St. Lucia to 0.8 in the case of Antigua, tax potential is far from being realised. High tax rates and unequal distribution of the tax burden encourages non-compliance; a situation compounded by the weakness of most tax administrations to enforce tax laws. This is manifested in high accumulation of arrears due to arbitrary assessments and inadequate collection machinery. Recent initiatives have been taken to strengthen inland revenue departments through the SIGTAS programme which has assisted in streamlining operations, computerising assessment and collection processes and improving technical skills of tax personnel. Some improvements have been made in broadening the tax coverage; but in many cases coverage in still at 80.0% of potential. Moreover tax officials are constrained in enforcing tax collection because of inappropriate tax legislation and the lack of support of tax attorneys to pursue defaulters in court. In addition, the incentive regime creates distortions in burden sharing as well as opportunities to divert taxable income from the tax net.

Customs revenue suffers similarly in spite of the introduction of ASYCUDA and institutional strengthening recently assisted by DFID. Large-scale under-valuation of imports as well as smuggling has eroded the base for realising higher revenues from international trade. Additionally, generous concessions have resulted in exceptionally substantial leakages in revenue in some cases as high as 60.0% of potential collections. E-commerce and electronic transactions have introduced an additional challenge to customs officers many of whom have received only basic training in customs procedure. The situation is worsened by the increasing diversion of trained customs officers to preventive work involving the very complicated area of surveillance against drug importation. The result has been high rates of import duties and consumption tax on a continuously shrinking base in order to maintain revenue requirements.

The third issue concerns the inefficiency of the tax system. There are too many taxes, licenses and charges, many of them low-yielding. As shown in the country profiles, domestic taxes consist of a plethora of taxes on income, withholding taxes, stamp duties and property taxes, sales taxes, consumption taxes, excise duties, hotel taxes, restaurant taxes, entertainment taxes, insurance premium tax, overseas telephone tax, cable TV tax, vehicle rental tax, a number of licenses and fees as well as charges for various minor services. Given the present size and weakness of most tax administrations, it would be more cost-effective to utilise available manpower, skills and facilities to administer fewer tax handles with maximum efficiency. Similarly, taxes on international trade and transactions include import duties, various surcharges, consumption taxes (some with multiple rates), customs service charge, embarkation taxes, security taxes, cruise ship passenger taxes and environmental levy. A comprehensive tax reform to reduce the number of taxes and to broaden their coverage would improve cost effectiveness in their administration.

Tax efficiency is also affected by the distortions in relative burden sharing between sectors and even within sectors. As illustrated in the profile on Dominica, tax incidence on the various sectors of the economy varied widely as far as income tax was concerned. Agriculture was virtually tax free while commerce bore a high burden of 21.9% of the sector's share of GDP, with utilities at 14.1%, government (PAYE only) at 9.9%, banking and insurance at 8.8%, manufacturing at 4.6% and construction at 1.1%. Such distortions affect allocative efficiency and tend to drive investment in areas where economic rents in the form of tax incentives to preferred sectors are more readily available. The appropriateness of this approach to investment stimulation becomes questionable in a situation where diversification and broadening of economic activity has featured so prominently in the strategies recently espoused by all administrations, especially with regard to non-traditional activities, particularly in the services sector. This situation is not confined to direct taxes only; but is evidently even more pervasive in the administration of customs revenue where substantial concessions are granted on an ad hoc basis. In addition to the direct revenue loss attributable to these formal and informal incentives/concessions, lack of transparency in incentives policy as well as lack of accountability on the part of recipients of incentives tend to undermine the authority and morale of tax administrators leading to increasing difficulty in enforcing compliance. Urgent action should be taken to review the incentives framework and, as part of a comprehensive tax reform, to introduce broad based taxes that will apply equally to all sectors of the economy.

The fourth issue concerns the provision of economic and social services and cost recovery. Service and user charges have become uneconomical in a number of instances resulting in low cost recovery and, where public enterprises are concerned, persistent increases in transfers from central government revenues to finance the deficit of failing enterprises or inefficient para-statal bodies. With regard to economic services provided by government, service or user fees should be brought up to date to full cost recovery as a first stage. As a second stage governments might consider commercialisation or outright divestment as appropriate. Utility tariffs should be revised so as to eliminate the need for transfers from central government revenue.

With recurrent expenditure ranging from as high as 35.5% to 22.6% of GDP the need to rationalise the provision of government services is very apparent. The cost of administrative services at figures ranging from 39.9% to 26.2% of total recurrent expenditure and the share of salaries and wages in total recurrent expenditure ranging from 56.7% to 47.0% point to the critical importance of obtaining value for money spent. Two important initiatives are directed towards this objective:

- Public service reform
- Budget reform

The former has tended to focus on administrative structures, salary gradings and the establishment of performance measurement criteria. While this has helped to justify present levels of public spending within the traditional organisational framework, the persistent problems of over-employment, under-utilisation of manpower, insufficient management and technical skills and wage distortions remain.

Budget reform has introduced new concepts of evaluating government expenditure programmes and monitoring performance. The initiative has the potential to strengthen the review process in decisions affecting the allocation of resources, to enhance accountability by wider participation in decision making and to generate management information for policy reformulation through the SIGFIS programme. However, both programmes have been superimposed on a rigid planning and institutional framework that does not allow sufficient flexibility in resource allocation. Although the new budget systems are designed to review existing expenditure programmes and to bring in new initiatives within approved strategic framework, the programmes themselves are built around existing and deeply entrenched institutions, which creates rigidity in budget allocations.

In both public service reform and budget reform there is a need to step back and relook what governments should be doing and what is required to do them. A strategic approach to programme design and resource allocation is urgently required. This approach should indicate the numbers and quality of staff required to carry on the business of government within the framework of sensible and achievable programmes and activities that focus on priorities. This could have implications for a radical reorientation of existing institutions and a major shift in government employment policy.

The proper use of programme and performance budgeting has the potential for improved accounting that will bring to the fore the unit cost of service delivery. This can lead to a rationalisation of user charges especially for economic services provided to the public and to other service agencies; and eventually to commercialisation or divestment. The substantial share of the recurrent budget allocated to transfers also calls for the review of the operations of para-statal bodies and public enterprises. In the case of para-statal bodies, many of them were established to deliver services to the private sector and to the public generally in the belief that greater efficiency will derive from operating outside the civil service regulatory and incentive framework. This has not always been the case. In many cases large bureaucracies have developed with the same rigid structures that characterise the civil service, but without the prudent disciplines that govern its behaviour. Public enterprises are similarly affected in the quality and cost of the services, which they provide. Public sector reform should extend to all para-statals and public enterprises to rationalise their operations and reduce costs imposed on the government budget. Actions to be taken include:

- divestment of government owned assets, especially loss-making enterprises;

- where para-statal bodies are established to provide assistance to the private sector or the public generally, reducing the size of their establishment and outsourcing services as and when required.

The implementation of all these measures may not necessarily reduce the size of the recurrent expenditure budget in the short term. For one thing a transitional period will be required over which change can be implemented. More fundamentally, even if civil service staff numbers are reduced and the quality of personnel improved over time, the incentive for recruiting and retaining suitable personnel must be improved. Wage reviews within the civil service have tended to be inward looking and have tended to ignore conditions in the real world. As a result the relativities between grades have been skewed with narrow differentials between management and support staff salaries. Support staff salaries have generally been above market prices while management salaries have been far below market prices. A realignment of civil service compensation using private sectors and regional institutions, as comparators should bring the civil service back to a competitive position in attracting the quality of staff and skills required for improved management. It must be emphasised that even if numbers are reduced, improvements to the compensation package could neutralise potential savings in the short term.

Moreover, many of the services are under-provided with support goods and services, which has led to inefficiency or ineffectiveness. In addition, with the new emphasis on economic diversification recognising the importance of the services sector, greater priority is given to human resource development. Poverty alleviation activities to cushion the shocks from external market changes and other exogenous factors requires increased outlays on welfare spending. The net effect in the short term is for neutral impact on the level of recurrent spending.

With regard to the public sector investment programme, current high levels of spending may have to be re-examined. The need certainly exists for additional provision and upgrading of social and economic infrastructure to support private investment. In many instances new monies have to be invested to replace or repair infrastructure destroyed or damaged by frequent natural disasters, which serves to reduce their viability and put an additional burden on the budget. In addition diseconomies of scale in providing basic infrastructure creates major distortions in the per capita cost of services and puts severe pressure on the capacity of the economy and the budget to generate sufficient income to defray investment costs. Even if more careful selection of projects is observed it is doubtful if the extent of actual and urgent need for public sector investment in basic infrastructure will diminish in the short term.

For all the countries surveyed prospects for realising higher levels of public sector savings in the short or even medium term appear to be unfavourable even with the major reforms indicated above. Drastic changes in the structure of revenues will have to be approached with caution. In particular the process of trade liberalisation with its potential for direct revenue loss and economic contraction will require prudent management.

This is particularly critical in view of the rising debt burdens of all the OECS countries. In pursuing their strategies of structural reform to raise living standards, strengthen their export bases and maintain economic growth, countries have invested in basic infrastructure and human resource development and have had to rely increasingly on non-concessional financing in view of the declining levels of official grants and concessionary loans following decisions to graduate them from their previous status as low income countries. In just ten years (1990 – 1999) the public debt of the region rose from 29.2% of GDP to 55.4% of GDP. By 1999 external debt accounted for nearly 60.0% of total debt, falling from 66.8% in 1990, (an indication that governments are making increasing use of domestic borrowing). Most of the debt is still denominated in US and sterling currency; but in an effort to increase and diversify financing, governments have had to increase borrowing risks by accepting other non-traditional currencies.

The change in the volume and structure of debt has brought about an escalation in debt servicing costs. Between 1990 and 1999, debt servicing costs rose from 4.8% to 6.7% of recurrent revenue. In most cases the growth of debt and debt servicing costs has exceeded growth in GDP, thereby putting a strain on debt servicing capacity. Indications are that planned spending levels will accelerate growth in debt and debt servicing costs. While this situation calls for better selection and prioritisation of projects and more careful financial planning/programming, in the context of the liberalisation of the economies of the region higher levels of strategic investment are needed to position the countries to benefit from economic reforms which have become mandatory and to increase their competitiveness to survive in an environment of trade liberalisation. The restoration of concessional aid and some measure of debt relief would provide greater flexibility for implementing the process of reform that is required of them.

THE REGIONAL COMMON EXTERNAL TARIFF

As part of the regional initiatives towards the restructuring of the economies of the CARICOM countries, a common external tariff was adopted for implementation in 1991. The tariff was later reviewed in the light of developments in the international economic environment with greater emphasis on trade liberalisation and competitiveness as well as the formulation and expansion of regional economic groupings. A number of factors were taken into account in formulating policies for the new tariff structures:

- differences in the levels of development of member states;
- differences in their industrial structures;
- their respective exchange rate regimes;
- the nature of their fiscal regimes;
- their respective administrative capabilities.

These factors determined the principles guiding the design of the new tariff:

i. international competitiveness;

ii. efficient production for the regional market;

iii. the preservation of government revenue;

iv. controlling inflation so as not to increase the price of basic foods and social services;

v. duty exemptions regime should be reduced/removed so as to foster uniform treatment of production inputs across the common market;

vi. there should be uniform rates for the same items notwithstanding their economic use;

vii. the special needs of the LDCs should be taken into account;

viii. the tariff structure should be simplified with fewer rate bands with less room for discretionary application.

The phasing of implementation of the new common external tariff for the OECS was as follows:

January – June, 1993	0 – 5% to 30/35%
January – June, 1995	0 – 5% to 25/30%
January – June, 1997	0 – 5% to 20/25%
January – June, 1998	0 – 5% to 20%

Only St. Vincent and The Grenadines kept to this schedule. At the time of writing this report progress on implementation was as shown below:

Antigua	Phase II
Dominica	Phase III
Grenada	Phase III
St. Kitts and Nevis	Phase II
St. Lucia	Phase II
St. Vincent and The Grenadines	Phase IV

Antigua and Barbuda intends to move directly to Phase IV during 2000 and is currently completing a study on the revenue implications of this move. Grenada also intends to move to Phase IV during 2000. Dominica has requested assistance to undertake a study to assess the trade and revenue implications of moving finally to Phase IV. Meanwhile it has taken steps to eliminate trade licenses by introducing a process of tariffication of Article 56 items at rates ranging from 150% to 200%, the only OECS country to have done so. St Kitts and Nevis has also requested assistance to undertake a study of the revenue and price effects of moving directly to Phase IV. St. Lucia has recently completed a study on the economic and financial implications of implementing Phase IV of the CET. The study is being reviewed at this time and a committee has been set up to examine proposals for compensatory measures to recover potential loss of revenue.

Except for Dominica no action has been taken towards the elimination of Article 56. A study has been requested to establish the viability of this move.

In general, the implementation of the various phases of the CET was done without significant disruptions to revenue flow. Most countries made minor adjustment to their consumption taxes in the first phase of implementation. Subsequent changes did not require significant compensatory adjustments to other taxes. Generally, countries reported increased revenue buoyancy after each phase arising from demand elasticity and to a lesser extent trade diversion towards third country goods.

Dominica's experience with tariffication of Article 56 commodities indicates that demand in this area has fallen with consequential decline in revenue. However, with the low volumes and values involved, the impact on revenue has been insignificant.

The price effect of revenue adjustments has been beneficial so far. Inflation rates have generally been low and have tended to decline during the period covered except in St. Kitts and St. Lucia where consumer prices shot up past 11.0% in 1997 from low rates of 3.0% in the previous year.

Preparations for changes to the CET were conducted without assistance of ASYCUDA which was designed to, inter alia, makes possible the compilation of data on CET collections and other taxes on imports by commodity category. However, a number of constraints to the utilisation of this facility exist (see Dr. Michael K Anyadike-Danes report on the Fiscal/Revenue Impact of the CET):

- current capacity precludes processing during normal working hours;
- commodity lists are not available in a format usable by the system and have to be compiled online separately;
- considerable processing time is required since storage capacity requires the maintenance of two data bases covering separate half year's data collection;
- not all the countries have fully implemented the system.

St. Lucia has been able to overcome these constraints by re-entering source documents on its statistical system (trade data) and calculating from there the effects of tariff changes. However, the exercise was not without difficulties as trade data was classified in HS93 format and it was necessary to convert to HS96 classification for purposes of running simulations. In some instances there were no direct correlations between HS93 and HS96 classifications. (See Report on the Implementation of the Fourth Phase of the CET: St. Lucia Committee of Government Officials).

The policies directing the study included:

- the use of consumption tax as a means of offsetting the adverse impact of the reduction of import duty;
- simplification of the consumption tax regime, reducing from nineteen to eight and the range of rates from 0% to 95% to 0% to 35%;
- revenue neutrality in respect of food items, clothing, medicines, basic education material and petroleum fuels;
- low inflationary impact;
- a reasonable degree of protection for domestic production.

It was recognised that there should be a trade-off between the policy objective of raising revenue and minimising inflation. It was also recognised that consumption taxes are by nature non-discriminatory and a shift from import duty to consumption tax would have the effect of reducing effective protection for domestic goods both as a result of reduced protection at the barrier and higher domestic prices arising from increased consumption tax on domestic production.

The report concluded that revenue loss would amount to $4.7 million for direct loss of import duty and $0.4 million consequential loss of consumption tax, a total of $5.1 million. The report recommended a general 5.0% increase on consumption tax, including computers which were previously zero rated, higher increases for items in which the import duty loss exceed the value of the general increase in consumption tax. The report also recommended the broadening of excise duties to include motor vehicles, alcohol and explosives. Altogether the compensatory measures are expected to yield close to $10.0 million or an incremental $4.9 million over the actual revenue lost.

It is reported that Antigua has commissioned a similar study, while Dominica and St. Kitts have requested assistance to carry out the necessary assessment. Grenada, on the other hand, does not contemplate compensatory measures as part of the final implementation except improvements in collection and reductions in concessions.

The difficulties experienced in accessing and utilising the database within the ASYCUDA system has been a major constraint in assessing the economic and fiscal impact of the CET. In some instances countries have proceeded to implement the tariff changes without the benefit of proper evaluation of the economic and fiscal impact. Fortunately, the fiscal impact has not been unfavourable and there has not been any noticeable or significant impact on domestic or regional production.

TRADE AND REVENUE EFFECTS OF THE CET

The Common External Tariff (CET) represents an attempt by CARICOM countries to promote industrialisation in the region and to harmonise their trade policies as a first step in meeting the challenges of global competition and trade liberalisation. The CET proposes that all CARICOM members should apply common tariffs on imports from non-CARICOM countries. Starting in 1993, the CET was to be implemented in four phases.

By the end of the last phase, which was adopted for implementation by1998, all CARICOM countries should have the following CET rates (on non-CARICOM imports) in place: (1) a 0-5% import tariff on non-competing, primary, intermediate, and capital inputs; (2) a 10% tariff on competing primary inputs and capital goods; (3) a 15% tariff on competing intermediate inputs; (4) a 20% tariff on non-competing final goods; and (5) a 20% tariff on garments, general manufactures and agro-industry commodities. For most CARICOM countries to meet the requirements of the CET, they would need to decrease import tariffs on some items and increase it on others. Declines in imports arising from tariff rate increases may suggest the extent to which CARICOM production is being substituted for non-CARICOM imports. On the other hand, tariff rate decreases imply loss of tariff revenues that member countries may need to make up by making compensatory adjustments in other taxes.

This study analyses the effect of changes in CET rates on OECS tariff revenues, and non-CARICOM agricultural imports. OECS imports were grouped in accordance with seven CET rate brackets: 0%, 0-5%, 5-10%, 10-20%, 20-30%, 30-45%, and >45%. The Analysis will help OECS policy planners to anticipate, in the presence of CET rate changes, the extent to which CARICOM production would substitute for non-CARICOM imports, and the amount by which non-CET import taxes would have to rise to keep net import tax revenues unchanged. To conduct the analysis, the study employed a simulation exercise in which the CET rate on non-CARICOM agricultural imports was increased by 5%, 10% and 15%. Next, CET rates were adjusted to ensure that commodities in each rate group faced a CET rate of 100%.

For the purposes of this exercise, the CET rate increases and adjustments were applied only to commodities that fell within the CET rate brackets of >20% (20-30%, 30-45%, > 45%). The study assumes that non-CARICOM imports entering the OECS face symmetric unitary import demand elasticities. The elasticities are symmetric in that a given percentage increase or decrease in CET rates (or in import prices) would produce the same magnitude of change.

In 1997, OECS (excluding Antigua) imports of agricultural commodities from non-CARICOM countries amounted to $232.62 million. About 54% of these imports faced no import tariffs, 21.4% faced import tariffs of 5% or less, 4.9% faced rates ranging between 5 and 10%, 4.2% faced rates between 10% and 20%, and another 15% faced tariff rates in excess of 20%. Over $15 million in CET revenues were collected, representing 41% of all import taxes. Commodities falling in the >20% rate groups accounted for a disproportionate 80% of the CET revenues**.**

The simulation results suggest that the CET rate increases on commodities in the >20% rate groups would cause imports to fall, CET tariff revenues to rise, and the resulting decline in imports would cause non-CET import tax revenues to decline. However, increases in CET revenues would more than offset non-CET revenue losses. For example, a 10% increase in the CET rate would cause OECS imports to fall by 1.2%, CET revenues to rise by 15.3%, or $2.40 million, and net import tax revenues to rise by 6%, or $2.25 million**.**

IMPLICATIONS FOR ONGOING NEGOTIATIONS (WTO & FTAA)

Within the context of global trade liberalisation, the elimination or major reduction of import duties takes on much greater significance than it did in the process of regional integration and economic adjustment. Import duties constitute between 9.3 and 15.3% of l recurrent revenues of the OECS. The size of adjustment required to achieve zero tariff is both considerable and challenging.

It has been demonstrated that if tariffs are reduced without complementary fiscal policies, trade liberalisation may falter or fail[15]. Furthermore, while the reduction of tariffs could stimulate change in the economy by increasing output with consequential positive effects on revenue and expenditure, complementary policies are required in other sectors including exchange rate policy that will adjust domestic prices to competitive levels. However, sector policies and exchange rate policies evolve at different speeds, especially taking account of the flexibility of responses from labour and capital, a consideration particularly pertinent to micro economies such as those of the OECS where sector response to changes in macro policies have been depressingly slow.

In principle lower tariffs ought not to result in immediate revenue loss as tariff reductions reduce incentives to evade taxes and increase disposable incomes and consumption. Furthermore price elasticity of demand should stimulate increased import volumes with beneficial effects on the revenue; but could also reduce demand for import substitute goods unless exchange rate adjustment is used to realign prices. It should be noted, however, that low value added industries such as generally exist in the OECS may not respond sufficiently to exchange rate adjustment due to the high import content of their production inputs, in which event only marginal price

[15] Adrienne Cheasty in an article in *Finance & Development* of March 1990.

changes may occur and changes in the relative price structure will continue to favour imports or will reduce effective demand for both domestic production and imports.

Generally, tax structures in the region are basically consistent with WTO rules. However, there are five exceptions which will have to be considered for negotiation:

1. At least two countries maintain a differential between rates charged for embarkation tax on nationals and non-nationals which appears to violate MFN principles. In this case, rate equalisation could be done without significant revenue loss.

2. The customs service charge applied in all countries except Dominica ranges from 3.0 to 5.0% of CIF values and exceeds the limit allowed for cost recovery under GATT rules. This is a high yield tax and its abolition would result in considerable loss of revenue as high as $34.0 million in the case of St. Lucia. The absorption of this tax into the consumption tax could be inflationary and could lead to contraction in domestic output. Any adjustment should be done within a comprehensive macroeconomic framework, specifically as part of a tax reform programme aimed *inter alia* at moving border taxes downstream to a higher base of expenditure on goods and services.

3. Similarly, stamp duties charged on customs entries in Antigua and Barbuda appear to be pseudo tariff items which could be dealt with in a manner similar to 2 above.

4. Antigua and Barbuda also maintains a 1.0% levy on foreign currency purchases. Although this tax has been recently lowered significantly below previous levels, it constitutes an additional imposition on imports. This tax could also be dealt with in a manner similar to 2 above.

5. All the countries require aliens landholding licenses from non-nationals to enter into land transactions with a fee ranging from 7.5% in St. Lucia to 10.0% in other countries. The requirement for a license and for the payment of a fee for non-nationals to purchase land or interest in land appears to be discriminatory and in violation of WTO MFN principles. However, social considerations demand a cautious approach to deregulation of land ownership so as not to alienate lower income groups from lands needed for basic shelter and small farming if such deregulation results in a demand/price spiral which would force them from the market for land. Consideration should be given to devising social safety schemes for ensuring land availability for basic shelter and rural settlements particularly respecting food security for the more vulnerable segments of the communities.

Antigua has abolished income tax on personal incomes earned by its nationals. Non-nationals, however, pay an income tax on personal income at rates ranging from 2.5% to 5.0%. In addition, the rates of property taxes paid by nationals are lower than the rates applied to non-nationals. Following the principle that no tariffs or taxes or regulatory restrictions should be applied on the nationals of MFN countries that do not apply to nationals, these discriminatory taxes should be leveled.

The scale and scope of the fiscal reforms needed brings into question the sequencing of the process towards trade liberalisation. In all the countries, economic structures are still undeveloped. Domestic markets, including financial markets, are rigid and not sufficiently competitive. Liberalisation by itself will not remove market distortions if those distortions arise from internal structural deficiencies. It is important, therefore to determine beforehand at what pace and in what sequence liberalisation should proceed. A critical issue is whether trade liberalisation can effectively be imposed on a weak and unstable fiscal structure with rising fiscal deficits and high levels of public debt. Given the distortions that obtain in the sectoral distribution of taxes, it is difficult to measure with any degree of accuracy the effects of tariff and other tax changes on output, wages and prices. The first order of business, therefore, should be a process of stabilisation through tax and budget reforms to improve allocative efficiency throughout the economy.

The move towards trade liberalisation should, therefore be done in two phases:

<u>Phase I</u>

- A comprehensive tax reform programme to rationalise and simplify the tax system and improve tax administration and planning so as to increase personal savings and improve the responsiveness of investment to growth in savings;

- Public sector reform to restructure government operations to make them more responsive to strategic plans directed towards sector policies and programmes and to rationalise the recruitment, compensation and use of manpower in the public service;

- Budget reform to rationalise government spending and improve accountability so as to improve efficiency, increase savings and effectively manage the public debt.

<u>Phase II</u>

- A study to assess the revenue and price effects of trade liberalisation and to establish if necessary transitional arrangements for moving towards complete tariff elimination;

- A phased approach towards the elimination of tariffs so as to minimise disruptions in revenue flow.

The first phase will require substantial support both financial and technical and should best be done within the context of structural adjustment programmes. While it is not possible at this stage to determine the transitional period required to complete this stage, it must be noted that acceleration by concentration of resources within a short period may be counter productive since the absorptive capacity of most of the countries is extremely low. This is especially true of the management of the wide range of technical assistance that may be needed within a narrow spectrum of change.

It follows that the second phase should begin after the full implementation of the first and should be programmed so as to move in tandem with agreed macro targets for revenue, expenditure, savings and investment within an approved fiscal plan for the public sector.

The prospect for a one off elimination of import tariffs is constrained by enormous difficulties in finding substitute sources of revenue. Consumption taxes are already at a high level. General rates apply in Dominica, Grenada and St. Kitts at 25.0%, 15.0% and 15.0% respectively. Graduated rates apply in Antigua, St. Lucia and St. Vincent and The Grenadines at rates ranging from 4.0 to 35.0% with special rates up to 65.0% on luxury items. It should be noted, however, that the consumption tax is chargeable on a narrow base that excludes services and with numerous exemptions of certain classes of goods. A one off switch from import duty to consumption tax without restructuring the tax system would result in exceptionally high rates, which, given the non-discriminatory nature of the tax, would undoubtedly lower demand for domestic production. A number of countries have indicated their intention to examine VAT as a possible option to facilitate short-term adjustment. Certainly from the point of view of its revenue earning capacity and its bias towards exports this option appears to be attractive. But to be successful the introduction of VAT needs intensive and extensive preparation and should best be pursued within a supportive macro economic environment.

SIMULATIONS OF THE EFFECTS OF TARIFF CHANGES

Given the degree of openness of OECS economies, they have been heavily dependent on taxes on international trade and transactions as a major source of revenue. This degree of dependence increases the vulnerability of the economies to shocks arising from increased trade liberalisation. A set of simulations was undertaken to determine the extent of the change in indirect taxes that would be necessary consequent on trade liberalisation. The simulation basically asks the question how much would sales tax/value added tax or excise tax revenues have to be raised in order to ensure revenue neutrality. The current revenue has three components related to (a) tradable sector; (b) non-tradable sector and (c) overall income. Revenue is therefore a function of the product of the import tariff rate times the real exchange rate times the value of imports plus the product of the sales/excise/value added tax rate times value of demand for the composite good plus the product of the direct tax rate times total income. Hence when the import tariff rate is cut it, the income effect results in more imports hence the quantity effect dominates the price effect for a given propensity to import in the revenue function. The second effect is traced through the sales/excise or value added tax rate as it is applied to demand for the composite good which is comprised of both imports and domestic goods. The sales or excise tax provides a compensatory mechanism that ensures that the savings investment balance is maintained for a given cut in the import tariff rate.

The simulations were based on a 25.0%, 50.0% and 100.0% reduction of import tariff rates in the face of increasing trade liberalisation. The method of adjustment assumed was internal based on a change in the tax regime. It was assumed that given the reliance on trade taxes for most revenue, indirect tax rates would have to change in order to maintain the existing savings investment balance. The indirect taxes could take the form of a sales tax or some other form of indirect tax on consumption. The baseline year chosen was 1998.

The table below gives the required changes in revenue from other indirect taxes given the three levels of tariff reductions.

Table 1
Required Changes in Revenue from Indirect Taxes to Replace Import Duties

Tariff cut	Antigua	Dominica	Grenada	St. Kitts	St. Lucia	SVG
25%	2.0	2.8	2.7	2.3	3.0	2.4
50%	6.0	5.7	5.5	4.7	6.0	4.8
100%	11.7	13.6	14.6	11.1	13.4	12.2

At a 25% tariff reduction the lowest effort (2% of GDP) is required by Antigua and Barbuda and the highest (3% of GDP) in St. Lucia. If the Tariff reduction is 100%, the lowest effort (11.1% of GDP) is required in St. Kitts-Nevis and the highest effort (14.6% of GDP) is required in Grenada.

In the earlier part of this section mention was made of the serious distortions and inefficiencies in the fiscal regime that require immediate attention. Furthermore the need for higher levels of public sector savings will not be met unless adjustments are made that will stimulate faster growth in and expansion of the economies of the region. Major reductions or total elimination of tariffs at this stage will further complicate and retard this process.

CONCLUSION

The country studies suggest that adjustment/transformation of the OECS economies to face the changes in the new global economy are far from easy. The economies are still experiencing the shocks of the recent changes in the global economy coupled with the effects of natural disasters. The growth rate of the OECS economies have fallen well short of the average of 6% experienced during the latter half of the 1980's. All of the traditional export sectors have experienced lack lustre performance in the 1990s, especially traditional commodity exports and manufacturing. Communications and financial services have been the fastest growing sectors and have served to prop up the weak growth performance.

However the authorities are aware of the difficult choices that they would have to make, and are formulating responses to the challenges they face. The emerging regional economic development strategy provides a vision and identifies strategic responses to the current crisis. The Medium Term Economic Strategy Papers (MTESPs) largely reflect the thinking at the regional level, which has been cemented by national consultations on the OECS Strategy.

The competitiveness studies of agriculture and agro-processing sectors have identified some areas that have potential for export and the analysis of the service sectors discussed some approaches to the development of a competitive service sector. The manufacturing sector faces some major challenges since it produces under a variety protective arrangements. The phasing out of these arrangements would spell disaster for the manufacturing sector as currently constituted.

The studies suggest that the OECS countries should seek to negotiate a more liberalised trade regime in services since they stand to reap more benefits through wider market access. The OECS market in services is already fairly open and a more liberalised services regime would give the countries reciprocal access where they currently offer non-reciprocal entry into the market.

The fiscal situation of the six countries surveyed has weakened significantly. Most of the countries have experienced rising fiscal deficits, mounting public debt and escalating debt service obligations as they seek to carry out structural reforms to make their economies more competitive. High outlays on economic and social infrastructure and human resource development in the face of declining concessional official aid flows have forced the countries into rapidly increasing commercial debt and higher risks attendant on non-traditional foreign currency loans, notably the Chinese ruan and Kuwaiti dinars. The prospect of emerging from the present fiscal difficulties is restricted by the inefficiencies and distortions in the tax system and major defects in the allocative efficiency of the budget system as well as the structure and cost of the public debt.

One of the major issues the OECS countries would have to face is the fiscal implications of adapting to the liberalised global environment. As a result of the heavy dependence on import duties the revenue adjustment would be quite significant. The simulations of the revenue changes required provide some estimates of the tax effort that would be required to replace import duties. Many of the OECS countries are actively considering the implementation of a value-added tax to broaden the revenue base. This may be an opportune time for regional co-operation in the implementation of the VAT. It would also help to remove the disadvantage that OECS exporters face vis-à-vis their regional counterparts whose exports are zero-rated.

All the countries surveyed have made progress in the implementation of the CARICOM CET. However, only St. Vincent and The Grenadines has fully implemented it. Two other countries, Dominica and Grenada, have implemented Phase III while the other three are still at Phase II. Most of the countries have reported that regional tariff adjustments have been carried out with minimal loss of revenue. In most cases, the shift to third country goods has resulted in increased revenue yields. All countries have agreed to move to the final stage of the CET; but have requested studies to evaluate the revenue impact, especially those countries which are still at Phase II. With respect to Article 56 items, only Dominica has replaced its licensing regime with tariffication. The volumes and values of the commodities involved have been low and consequently revenue loss has been minimal.

Generally, tax structures in the region are basically consistent with WTO rules. However, there are five major areas of concern. In at least two countries there are differences in the application of taxes to nationals and non-nationals, notably the embarkation tax. In Antigua non-nationals are asked to pay personal income tax from which nationals are exempt, and higher rates of property tax. This appears to be discriminatory and in violation of the principle that no tariffs or taxes or regulatory restrictions should be applied to non-nationals belonging to MFN countries that do not apply to nationals. The aliens landholding license also appears to violate this principle. The removal or leveling of these taxes would not result in any significant loss of revenue. However, there are critical social implications deriving from deregulation of land transactions, one of which is the alienation of the poorer segment of the communities from lands required for basic shelter and small farming that could arise if a price/demand spiral occurs. In addition, there are a number of pseudo tariffs, notably the customs service charge, stamp duties on customs entries and foreign exchange levy on foreign currency payments. The customs service charge and the stamp duty on customs entries are both recoveries of administrative costs; but together they exceed the allowable limit. The customs service charge is a particularly high yielding tax (with rates ranging from 3.0 to 4.0% of CIF except for Dominica where the rate has been reduced to 1.0% of CIF). The absorption of this tax into the consumption tax could be inflationary and could lead to contraction in domestic output, especially given the fragile base of domestic industries.

In the context of global trade liberalisation, the elimination or major reduction of customs tariffs and other border taxes and charges takes on much greater significance than it did in the process of regional integration. For one thing the size of the adjustment required will be at considerable cost to the revenue. In an efficient market, import tariff reductions serve to reduce tax evasion, increase disposable incomes and consumption, and to stimulate increased import volumes through price elasticity of demand that result in an overall increase in revenues. However, the market structure of the import trade in the region favours windfall profits to business without significant reductions in prices, thus suppressing compensating growth in demand. Moreover, low value added industries and import substitute industries suffer from changes in the relative price structure of imported goods with the lowering of tariffs in the absence of effective exchange rate mechanisms. It should be noted that such industries may not respond sufficiently to exchange rate adjustments because of the high import content of their production inputs.

As shown in the *Simulations* on the effects of tariff reductions in the country studies, total elimination of tariffs could result in revenue losses as high as 12.0% of GDP. A one-off elimination of import tariffs would present enormous difficulty in finding suitable, alternative sources of revenue. A one-off switch from import duty and other existing border taxes to consumption tax without restructuring the tax system would result in exceptionally high rates of tax on domestic production and imports equally and a fall in demand for domestic goods.

All the above accentuate the need for a major package of reform to remove inefficiencies and distortions in the tax system, strengthen tax management, improve budgetary resource allocation and control, effectively manage and contain the public debt and stabilise the fiscal account.

The scale and scope of the reforms needed demands proper sequencing of the move towards trade liberalisation. It should be noted that trade liberalisation by itself will not remove market distortions and inefficiencies if those distortions and inefficiencies arise from internal structural deficiencies. It is, therefore, important to decide beforehand at what pace and in what sequence liberalisation should take place. A weak and unstable fiscal structure with rising fiscal deficits and mounting public debt is not a good foundation on which to proceed. Further progress towards trade liberalisation should be phased over a reasonable period of transition to allow sufficient time for fiscal stabilisation and to complete transitional arrangements for moving towards full tariff elimination. Given the weak institutional strengths of most countries, considerable international support will be needed to carry out reforms. Accelerating the pace of reforms would be counter-productive in a situation of low absorptive capacity.

RECOMMENDATIONS

The OECS face the task of preparing for negotiations on several fronts and at the same time ensuring an adequate implementation strategy is pursued with respect to the new convention. In this regard, two sets of activities are required. First, a set of measures at the macroeconomic and sectoral level that would reposition the economies to take advantage the post negotiation arrangements. Second, reorganisation at the local level to prepare effectively with the negotiations. The following steps should therefore be taken:

MEASURES TO REPOSITION THE ECONOMIES

INSTITUTIONAL STRENGTHENING AND TRADE REFORM

- Improve the transparency and predictability in the administration of incentive measures.

- Support the establishment of one-stop shops to speed up investment and to improve communication between established and incoming manufacturers and Government agencies.

- Improve the efficiency of all public sector agencies, especially those whose operations have a bearing on the efficiency of the private sector.

- Establish and/or strengthen, as appropriate, Small Enterprise Development Units in our islands to stimulate the growth of the small business especially in export related activities.

- Establish institutional arrangements comprising public and private sector actors to promote effective backward and forward linkages between the tourism, manufacturing and agricultural industries.

- Enact appropriate legislation to operationalise Protocol II of the revised Treaty of Chaguaramas, to permit the free movement of skills within the OECS.

- Identify and develop strategies for securing dedicated air and ocean transportation services for moving OECS products;

- The OECS countries should move purposefully on the tariffication exercise that is now in progress and establish a programme for the eventual reduction of the tariff levels.

- OECS countries should upgrade their customs procedures to make them consistent with their obligations under the international trade agreements in which they are contracting parties.

- There is a need to assess the impact of a position advocating a slower pace of FTAA agriculture trade liberalisation with the needs of regional agriculture/agri-produce exporters in extra-regional markets.

- The countries could take advantage of their new-found duty-free treatment under the CBI by entering into a more aggressive export/investment programme. Initial attention will focus on using the apparel provisions of the new law to regain the region's competitive position vis-à-vis Mexico.

- A comprehensive tax reform programme to rationalise and simplify the tax system and improve tax administration and planning so as to increase personal savings and improve the responsiveness of investment to growth in savings.

- Public sector reform to restructure government operations to make them more responsive to strategic plans directed towards sector policies and programmes and to rationalise the recruitment, compensation and use of manpower in the public service.

- Budget reform to rationalise government spending and improve accountability so as to improve efficiency, increase savings and effectively manage the public debt.

- A study to assess the revenue and price effects of trade liberalisation and to establish if necessary transitional arrangements for moving towards complete tariff elimination.

- Develop a phased approach towards the elimination of tariffs so as to minimise disruptions in revenue flow.

The Post Lomé Arrangements

- Measures for addressing potential slow disbursement rates would be important and should be identified very early to ensure adequate performance that would avoid the loss of resources from rolling programming and the abolition of carry-overs from this convention. In this vein, support for capacity building in project formulation and implementation would be critical. With no real increase in EDF indicative allocations expected, the latter initiatives would be important.

- The EU should be asked to explain the detailed formula used for calculating resource allocations for the National Indicative Programmes in the Compendium of Reference Texts. Criteria for resource allocation should be transparent and take into account the peculiarities of small island developing states.

- The OECS private sector would need to equip itself to meaningfully participate in the Business Forum and dialogue. It may also wish to focus on the specific conditions of small domestic firms and the types of lending that are most appropriate for them to take advantage of the new Investment Facility.

- Capacity building would be important for many civil society groups to allow them to meaningfully participate in the policy dialogue and manage EDF resources.

- The OECS should review the new Convention with a view to determining where clearer strategies, guidelines and criteria need to be inserted in the Compendium of Reference texts.

Areas such the calculation of public deficits and export earnings, performance criteria, etc should receive some particular attention.

- With the emphasis on poverty reduction, it would be useful for the OECS to link the programming process under the new Agreement to the national implementation process of the UN Social Summit Declaration and Plan of Action to ensure that the countries are not faced with more uncoordinated and incoherent demands from the donor community.

- The OECS would need to explore integrated approaches to market-based commodity management system in light of the imminent phase out of STABEX and the new mechanisms for the management of export price volatility.

Agriculture

- develop infrastructure, especially in rural areas (feeder roads, water and electrical supplies);

- where necessary, implement land reforms which, taking account of local conditions, lead to equitable patterns of ownership, promote more efficient land use and give farmers an incentive to improve productivity;

- enhance the capacity of marketing entities to play a lead role in market-led diversification and the expansion of linkages with the agro-processing sectors;

- strengthen livestock extension and veterinary services;

- increase small ruminant production;

- promote utilisation of local available feed-stuff and by-products;

- build new slaughtering, meat marketing and processing facilities;

- design formal and informal training courses to equip farmers with farm management business skills;

- continue to identify new markets for non-traditional crops and assist farmers to take full advantage of these new marketing opportunities;

- institutionalise an irrigation and non-potable water policy and programme and encourage farmers to invest in suitable irrigation technologies

- strengthen national pest control programmes in collaboration with regional organisations;

- provide training to extension officers and farmers in sustainable agricultural farming and animal husbandry methods;

- speed up the implementation of measures to restructure the production and marketing arrangements for bananas;
- establish low interest credit and revolving funds schemes for farmers;
- speed up the use of STABEX resources made available to assist with the restructuring of the banana industry in particular and the agricultural sector in general.

The Manufacturing Sector

- determine the products to be pursued, guided by considerations such as comparative advantage, links to tourism as the potential leading sector and the nature of demand in rapidly expanding export markets including CARICOM;
- determine the appropriate skills required for the production of the mix of products and the delivery of these skills throughout the formal and informal education system, through appropriate changes in the school curricula and plant and in collaboration with the private sector. (Where skills are not available, acquiring them from another country might be necessary);
- establish and/or strengthen as necessary, national and regional Standards Bureaus, to guide our manufacturers towards the attainment of ISO product and service standards;
- implement an assistance programme to facilitate the reengineering of import substitution firms towards production for the export market;
- encourage manufacturers through various incentives to upgrade the skills of their employees, to improve the technology level of new investments and to increase automation;
- reorient national skills-training programmes towards the utilisation of modern technology;
- examine the feasibility of replacing the existing incentives regime with a system of tax credits tied to performance criteria such as training expenses, investment in physical capital and for expenses for export market development, employment generation, investment, product line, export share and domestic market share;
- encourage banks and other financial institutions to provide a mix of equity and loan funds so as to reduce the overall interest burden of infant industries;
- improve access to and develop market intelligence in consumer taste, information on the activities of existing and potential competitors, the quality of labeling required;
- promote the development of relatively large firms with sufficient regional capacity to undertake the marketing of products in which the region has a comparative advantage.

Services Sector

- OECS authorities should give consideration to offering regional telecommunications licenses for companies to operate all of the countries. This would provide opportunities for companies to take advantage of a larger market and give them the capacity to implement new technologies more readily. Such regional licenses could be auctioned off since they would be more valuable than the sum of national licenses.

- Given the new environment, in which the market is expected to operate, an elimination of concessions to telecom service providers is essential. In the past, there may have been some justification for the granting of concessions, since both the government and the local private sector were not in a position to undertake the large capital outlays that were needed. With the new technological advances, large-scale investments in small communities may no longer be required and therefore government would be in a position to collect the necessary taxes without much debate.

- The encouragement of the service sector would also require the prompt implementation of the proposals to change the region's incentive regime to take account of the special characteristics of the service sector. It is important that these incentives be regional in scope, rather than national, in order to encourage the development of strong regional enterprises, which are just as necessary for international competitiveness in services as they are for goods.

- The indigenous financial institutions in the OECS may need to come together and pool their financial and human resources to mount a credible competitive response.

PREPARATIONS FOR NEGOTIATIONS

POST LOMÉ NEGOTIATIONS

- The timetable (September 2002 for post-Lomé (Phase 2) negotiations as well as the preparatory period up to 2008 for agreement is short. Maximum use must be made of the time to put in place the negotiating capacity as well as the regional arrangements regarding the single economy and market;

- The various reciprocal and non-reciprocal scenarios that face the OECS have to be examined. It would be instructive to work out transitional and adjustment paths with all the necessary trade adjustment support and development assistance along with the required safeguards. In this context, it would be helpful to consider how EU financial and technical assistance could in the future best support trade adjustment and competitiveness building over some desirable transitional period. OECS countries have already indicated a strong interest in non-reciprocity in trading relations even with larger regional developing countries. It would therefore be important for them to see what Lomé-equivalent preferences under GSP would be needed. The present EU GSP comes up for renewal in 2004 and the OECS may wish to ensure that this alternative possibility is thoroughly examined along with all the other available trade options;

- Post-Lome proposals for trade and the development of export services must be developed to take account of the current impact of the General Agreement on Trade in Services (GATS) on future negotiations with the EU.

- The OECS countries have been strong on the non-reciprocal line even with larger neighbouring developing countries. The extent to which this line is sustainable and needlessly retards the necessary adjustment measures has to be examined. It may be possible for the OECS as non-LDCs but vulnerable small states to obtain transitional paths (beyond the normal 10 or 12 years) that could be longer than the other non-vulnerable non-LDCs ACP countries. Different transitional speeds under Article XXIV would create administrative problems for the rules of origin but this be a price that have to be paid to mitigate adjustment costs for some and meet market access requirements for others.

- It would also be critical for the OECS to develop a capability to negotiate simultaneously in the WTO and with the EU since many developments in the Post-Lomé negotiations will depend on new WTO arrangements. The present multilateral round will be important for providing some umbrella cover to either of the options proposed or some new sui generis arrangement. The securing of waivers as well as possible changes or clear interpretations of Article XXIV would be important as well as new measures for special and differential treatment in the WTO.

- Future negotiations with the EU will deal with trade in services. Given the expected increase in the importance of services to the OECS, the development of services would require agreements, inter alia, on freedom of movement of natural persons, mutual recognition and accreditation, and rights of establishment. OECS countries should try to develop negotiating capability in the following services: tourism-related services, including airline reservations, entertainment, culture, health and sports; telecommunications-based services; financial services; environmental services; and business services, including accounting, legal and marketing.

- Despite the importance of the tourist industry for the OECS, there is inadequate attention to it in the new agreement. New proposals for post-Lomé negotiations are needed that would embrace not just marketing arrangements, but also the all-important areas of air services and the further development of environmental and cultural heritage tourism in the OECS. It is also of critical importance to take account of the current impact of the General Agreement on Trade in Services (GATS) on future negotiations with the EU.

- Finally, while pursing the above, the OECS will also have the task of securing the best arrangement for the banana industry. It will also have to prepare itself to negotiate in many trade-related areas where new forms of preference are important.

FTAA NEGOTIATIONS

- The OECS will have to prepare itself to negotiate in many trade-related areas where new forms of preference are now important.

- The constraints facing OECS countries to conduct trade negotiations must be clearly articulated and measures taken through capacity building and cooperation in multilateral fora. The OECS must seek to take advantage of promised EU assistance in this area.

- Focus attention on market access/entry issues aimed at the elimination of tariff and non-tariff barriers to agricultural exports.

- Given the highly protected and non-competitive nature of regional agriculture, there is a need to identify scope for trade-offs in the negotiations between sensitive disciplines such as agriculture and services, investment, IPR, among others.

- CARICOM needs to seek continued protection for its agri-food market, especially because high tariffs remain the only WTO-compatible instrument to safeguard the sector and the OECS position should concur with this.

- Prioritise technical and financial resources for the development of a comprehensive agriculture negotiation strategy to cover all trade regional, hemispheric, and multilateral negotiations, a la the suggested format of an Agricultural Trade Negotiation Unit with regional and national scope.

- Focus on seeking to ensure that some form of special consideration be negotiated for smaller economies, in line with some of the features of the multilateral Special Agricultural Safeguard, for example.

- Develop a strategic negotiating linkage between multilateral trade initiatives supporting preferential arrangements for agriculture (e.g. WTO use of waivers under the enabling clause) and the commitments under the FTAA.

- There may be certain tourism-related services like restaurants and water sports which countries would like to reserve for local participation and these may need to be addressed in the negotiations.

- OECS countries should try to ensure that the principle of one standard, one test, acceptable everywhere, is adopted where appropriate. The concerns of exporters regarding the conduct of multiple tests for the same product based on destination renders this issue of major significance.

- Supply-side constraints among the OECS countries themselves and the increased significance of non-tariff measures precluded countries from benefiting from the market access opportunities that have emerged. Matching technical and financial assistance to the areas where market access concessions have been granted based on strategic interventions throughout the "commodity chain" is an approach worth considering.

- CARICOM producers have continued to seek a CARICOM-wide sugar quota, which would allow reallocation among its members in the event of temporary shortfall by any one of their members. Quota transferability to CBI beneficiary countries after quotas have reverted to the "common pool" is consistent with the way in which the sugar programme already operates. In fact the US undertook to explore the legal implications of this request during bilateral discussion (CARICOM/US Trade and Investment Council) in 1999. A single CARICOM sugar quota would be consistent with the region's efforts to create a CARICOM Single Market and Economy.

- The OECS should seek to have rums excluded from the "zero to zero" proposals as this could be significant to the countries which are currently in the process of developing brands under the "Four Island Classic" label, as it would offer them some protection in developing market share.

- OECS countries should negotiate a transition period over which they move towards trade liberalisation. This could be sequenced taking account of the structural adjustment imperatives and the time needed for the phasing out of tariffs and the removal of WTO non-compliant taxes and charges.

ANNEX

Revealed Competiitve Advantage Indicators: Traditional

Bananas	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
St. Lucia	7.172	7.402	51,848	0
Dominica	7.269	6.617	18,981	0
St. Vincent	7.114	6.608	20,187	0
Antigua	4.182	5.844	0	1
Grenada	5.171	4.670	1,916	0
St. Kitts	1.869	1.943	0	30

Sugar&Hone	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
St. Kitts	5.046	4.801	10,460	732
Antigua	-0.303	-0.480	0	1,553
St. Vincent	-1.453	-1.096	0	1,608
Grenada	-3.137	-1.385	0	1,990
Dominica	-2.587	-4.032	9	1,306
St. Lucia	-5.987	-4.411	11	3,320

Cocoa	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
Grenada	5.717	5.754	3,001	0
Dominica	0.869	1.556	26	15
St. Lucia	0.590	0.822	103	0
St. Vincent	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

Netmeg	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
Grenada	9.006	9.154	3,582	0
St. Vincent	3.733	4.957	170	4
St. Lucia	1.450	0.462	0	5
Dominica	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

Copra	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
St. Lucia	-0.779	2.232	13	0
Grenada	2.732	-	0	0
Dominica	-	-2.416	0	20
St. Vincent	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

Citrus	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
Dominica	2.841	2.786	755	0
Antigua	2.541	2.515	0	23
St. Vincent	-0.455	0.367	73	0
St. Lucia	2.899	-1.534	19	0
Grenada	-	-	0	0
St. Kitts	-	-	0	0

Source: Generated by IICA, Policies and Trade Programme, 1999

Revealed Competiitve Advantage Indicators: Non-Traditional Exports

	Tannia		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-9	1994-96	1994-96
Dominica	9.067	9.371	351	0
St. Lucia	-	-	0	0
St. Vincent	-	-	0	0
Grenada	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

	Yams		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-96	1994-96	1994-96
Dominica	7.096	7.680	433	0
St. Vincent	6.013	6.104	98	0
St. Lucia	-	2.057	3	
Grenada	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

	Plaintains		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-9	1994-96	1994-96
Dominica	7.828	6.993	774	0
St. Vincent	7.032	4.645	81	0
St. Lucia	4.360	2.872	24	0
Grenada	6.374	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

	Taro		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-96	1994-96	1994-96
Dominica	6.989	6.642	516	0
St. Lucia	-	-	0	0
St. Vincent	-	-	0	0
Grenada	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

	Coconuts		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-9	1994-96	1994-96
St. Vincent	6.095	5.825	132	0
Dominica	5.558	5.736	113	0
Grenada	4.268	2.481	2	0
St. Lucia	0.677	2.462	8	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

	Avocados		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-96	1994-96	1994-96
Dominica	4.607	4.732	245	0
St. Lucia	1.330	2.267	39	0
St. Vincent	-	-	0	0
Grenada	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

	Cinnamon		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-9	1994-96	1994-96
Grenada	4.003	4.262	42	
Dominica	3.727	4.207	87	0
St. Lucia	-	-	0	0
St. Vincent	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

	Mangoes		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-96	1994-96	1994-96
Dominica	3.373	4.077	171	0
St. Lucia	3.491	3.862	257	
St. Vincent	3.092	3.365	90	0
Grenada	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

	Ginger		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-9	1994-96	1994-96
Dominica	3.925	3.931	62	0
St. Lucia	3.684	1.134	2	3
St. Vincent	-	-	0	0
Grenada	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

	Pumpkin		Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-9	1994-96	1994-96	1994-96
Dominica	2.913	3.073	171	0
St. Vincent	1.950	2.442	37	0
Grenada	1.295	1.474	6	0
St. Lucia	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

Source: Generated by IICA, Policies and Trade Programme, 1999

Revealed Competiitve Advantage Indicators: Non-Traditional Exports

Sweet Potatoes			Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-93	1994-96	1994-96	1994-96
St. Vincent	6.780	6.798	443	0
St. Lucia	0.999	1.742	5	0
Dominica	-	-	0	0
Grenada	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

Papayas			Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-93	1994-96	1994-96	1994-96
St. Lucia	-	0.555	2	0
Dominica	-	-	0	0
St. Vincent	-	-	0	0
Grenada	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

Pineapple			Average, US$'000	
	RCA10	**Index**	**Exports**	**Imports**
	1991-93	1994-96	1994-96	1994-96
St. Lucia	0.552	2.885	95	0
Dominica	-	-	0	0
St. Vincent	-	-	0	0
Grenada	-	-	0	0
Antigua	-	-	0	0
St. Kitts	-	-	0	0

Source: Generated by IICA, Policies and Trade Programme, 1999

Agro-Processing

Beer	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
St. Lucia	2.423	3.307	3,949	517
St. Vincent	0.603	1.647	287	153
St. Kitts	-0.016	0.457	0	87
Grenada	-1.945	-1.065	0	343
Antigua	-2.404	-1.419	0	933
Dominica	-2.938	-2.554	0	1,316

Non-alcoholic Bev.	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
St. Kitts	1.292	1.414	1,000	1,150
St. Lucia	-0.412	-0.641	383	2255
Antigua	-1.323	-1.246		490
St. Vincent	-1.695	-1.569	0	380
Dominica	-2.743	-2.695	0	947
Grenada	-	-	0	0

Oil and Fats	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
St. Kitts	1.538	1.503	633	752
St. Lucia	1.221	0.605	614	1,195
Antigua	-0.298	-0.077	0	993
St. Vincent	-2.362	-0.390	0	762
Dominica	-1.164	-0.467	627	2,473
Grenada	-5.013	-1.023	0	1,329

Rice	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
St. Vincent	1.160	1.816	6,439	3,733
St. Kitts	-1.043	-0.620	0	443
Antigua	-0.869	-0.773	0	850
Dominica	-1.195	-1.304	0	659
St. Lucia	-1.257	-1.421	0	1,964
Grenada	-1.950	-1.527	0	942

Wheat Bran	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
St. Vincent	4.658	4.699	245	0
Grenada	3.937	3.600	35	0
St. Kitts	1.267	-	0	0
Antigua	-	-	0	0
Dominica	-	-	0	0
St. Lucia	-	-	0	0

Wheat Flour	RCA10 Index		Average, US$'000 Exports	Imports
	1991-93	1994-96	1994-96	1994-96
St. Vincent	5.496	6.030	8,869	0
Grenada	2.586	2.659	1,212	548
Antigua	-2.175	-2.198	0	1,167
St. Kitts	-2.540	-2.555	0	1,010
St. Lucia	-3.241	-3.214	0	3,870
Dominica	-3.646	-3.737	0	2,441

Source: Generated by IICA, Policies and Trade Programme, 1999