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THE CARIBBEAN AND HEMISPHERIC FREE TRADE

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INTRODUCTION

There is now a new phase of globalization of trade, production and finance which is rapidly sweeping away national barriers to the movement of goods, services, capital and finance. Genuine global production cannot be undertaken efficiently if there are national impediments. Global corporate integration is the fundamental economic development behind the dismantling of national barriers (e.g. tariffs, quotas, exchange controls) and the movement to regional groups within which there is a common market for capital and goods. The institutional dimension of this is a resurgence of global corporate integration through mergers which denationalize ownership¹ and which require multi-country market integration. Global corporate integration is one of the driving forces behind regional economic integration because the latter facilitates the minimizing of differences arising from national variations in monetary policy, taxation and regulatory regimes. The process of globalization has impelled a deepening of the integration process in the European Community (EC).

The Uruguay Round of the General Agreement on Tariffs and Trade (GATT), which seeks to further liberalize trade and invest-

GATT would be the institutional and regulatory framework for global trade liberalization. The difficulties experienced in the Uruguay Round negotiations indicate that this round could end in a partial resolution. There is the distinct possibility that the disintegration of GATT negotiations could provoke a proliferation of bilateral trade arrangements, and intensify the tendency to form trade blocks² and regional trade arrangements which raise protectionist barriers to exports from other groups and countries.

Against this background, the severe economic crisis of Latin America and the Caribbean during the 1980s compelled a re-examination of economic policy. The region responded to the economic stagnation with reorientation of economic policies to focus on economic reform, stabilization, and structural adjustment in an attempt to initiate a private-sector led, market-driven, outward-looking growth strategy. An important aspect of this for most Latin American countries and many Central American and Caribbean countries has been a substantial reduction in tariffs and the removal of quantitative trade restrictions.

In recent years, Latin America and the Caribbean have assumed increased importance as export markets. The region accounts for only 14 percent of U.S. exports,³ but this is larger than exports to Japan and to the newly industrialized countries (NICs) of East Asia. Latin America has been a market in which there has been steady increase in demand.⁴ Exports from the United States increased by 70 percent since 1986 growing from \$31 billion in 1987 to over \$54 billion in 1990. The U.S. share of the region's imports has grown from 46 percent to almost 55 percent.⁵ Some observers believe that Latin American and other developing countries are replacing Europe and Japan as the major source of growth in U.S. exports.⁶

A dramatic process of democratization has also blossomed simultaneously in several countries throughout the region. The United States wants to tangibly support democratization in the region and to rehabilitate economic growth, especially where this is taking the form of private-sector led growth strategies. The United States is anxious to stabilize the region because of concerns about security, drug trafficking and illegal migrants.

² The establishment of a common market in the EC in 1993 will set in motion countervailing responses by the United States and Japan leading to a global economy of "managed trade" and "Quasi trading blocks." See Thurow, Lester. *Head to Head: The Coming Economic Battle Among Japan, Europe and America*. New York, William Morrow and Company, 1992.

³ In 1987, Latin America and the Caribbean accounted for 14 percent of total U.S. exports and 13.6 percent in 1990. See *U.S. Exports to Latin America and the Caribbean: A State-by-State Overview 1987-1990*. Washington, U.S. Department of Commerce, International Trade Administration, and U.S. Agency for International Development, March 1992, p. 7.

⁴ President Bush has stated that a "prosperous Latin America is a natural market for U.S. goods and services. Strengthening our neighbors' economies will result in more exports." See text of Remarks by the President in an address to the Council of Americas Dinner. Washington, Office of the Press Secretary, White House, April 23, 1992, p. 4.

⁵ World Bank. *World Development Report 1990*.

⁶ Brownstein, Vivian. *The Economy Comes Back*. *Fortune*, July 13, 1992, p. 60.

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¹ National ownership of major corporations is giving way to globally diffused ownership leading to the "irrelevance of corporate nationality." See Reich, Robert B. *The Work of Nations*. New York, Alfred A. Knopf, 1991. Chapters 11 and 12, particularly.

There has been a resurgence of interest in regional trade liberalization, regional integration, and cooperation. This momentum actually preceded the Enterprise for the Americas Initiative (EAI), although the Enterprise complimented and may have accelerated this process.⁸ On March 26, 1991 the presidents of Argentina, Brazil, Paraguay and Uruguay signed the Treaty of Asunción, which has as its goal the establishment of a Southern Common Market (MERCOSUR) by December 1994. These countries have already reduced tariffs on trade among themselves, and are discussing the establishment of a common external tariff (CET). The Andean Common Market Pact was signed by Bolivia, Columbia, Ecuador, Peru, and Venezuela in May 1991. Subsequently, a number of measures have been taken to eliminate restrictions and to standardize various regulations. Within the framework of the Andean Pact, Columbia and Venezuela signed a partial free trade agreement (FTA) covering 6,000 goods and which came into effect on February 6, 1992. The group has pledged to establish a common agricultural policy and to harmonize exchange and fiscal policies.

Existing regional integration schemes such as the Caribbean Common Market (CARICOM) and the Central American Common Market (CACM) have regained momentum. The CACM was originally established in 1961, and by 1969, nearly 95 percent of trade had been granted duty free status. However, the CACM collapsed during the 1970s because of political and ideological differences among the governments. In July 1991, the CACM countries agreed to reestablish the common market. El Salvador, Guatemala, and Honduras have signed an agreement to establish a free trade zone by January 1993. The CACM plans to negotiate a FTA with Mexico by 1996 and to join a North American Free Trade Agreement (NAFTA) as soon as possible. The CARICOM was established in 1973 as further integration of these economies which had previously traded in the Caribbean Free Trade Association. During the 1980s, intraregional trade declined sharply due to severe economic recession in several member countries and the collapse of the regional payments facility. In 1984, CARICOM members agreed to establish a CET which at present is partially implemented. On July 2, 1991, CARICOM and Venezuela signed a FTA with free entry to the Venezuelan market with reciprocity phased in over five years.

While the new impetus towards regional free trade is a welcomed development, the viability of geographic groupings is threatened by the uneven pace of liberalization among the countries. A recent illustration is Bolivia's contemplation of seeking full membership in MERCOSUR because its tariffs are lower than other Andean Pact member countries.⁹ The efficacy of regional arrangements and bi-

the proliferation of agreements. Numerous bilateral agreements have been initiated and are in various stages of negotiation and implementation, e.g., the Colombia/Venezuela FTA and the Mexico/Chile FTA. The overlapping legal frameworks could very well inhibit trade, as they complicate the conduct of trade and confuse traders.

ENTERPRISE FOR THE AMERICAS INITIATIVE AND THE NORTH AMERICAN FREE TRADE AGREEMENT

The U.S. economy has had a persistent trade deficit, and there is a growing perception that protectionism and unfair trade practices by Japan and other trading partners have been a principal contributor. The further integration of the EC in 1992 and its collective intransigence in the GATT negotiation, particularly over agricultural subsidies, has been interpreted by the U.S. government as protectionism to maintain a trade bloc.¹⁰ The difficulties experienced in expanding exports to the Asian NICs has compounded the feeling of being embattled in a world compartmentalized by protectionist trade blocs. In 1987, the United States and Canada concluded a FTA; and, in June 1990, Mexico and the United States announced their intention to negotiate a comprehensive bilateral FTA, which was later expanded into the trilateral NAFTA by the inclusion of Canada. The difficulties experienced in completing the negotiations of the Uruguay Round of GATT have aroused fears that the negotiations could end in disarray or fail to resolve key issues of the agenda. The formation of the NAFTA and the Enterprise for the Americas Initiative (EAI) may serve both trade liberalization¹¹ and as a negotiating tactic¹² by providing a regional option which the United States will fall back on if it is not able to achieve its objectives within the GATT negotiations.¹³

The EAI, which was launched in June 1990 by President Bush, consists of three components:

1. Trade Liberalization with the aim of creating a Western Hemispheric Free Trade Agreement (WHFTA) through a series of free

¹⁰ The creation of a common market in the EC in early 1993 is widely felt to be detrimental to U.S. exports. Many estimates suggest a small decline in exports because of trade diversion. See: U.S. Congressional Budget Office, *How the Economic Transformations in Europe Will Affect the United States*. Washington, D.C., December, 1990, p. XV and p. 9-38. It should be noted that one study projected a positive impact because trade creation would exceed trade diversion. See: Hufbauer, Gary C. *Europe 1992: An American Perspective*. Washington, D.C., Brookings Institution, 1990, p. 22-23.

¹¹ It has been suggested that the United States could use the creation of FTAs with individual countries to press for multilateral free trade. See Dornbusch, Rudiger W. *Policy Options for Freer Trade: The Case for Bilateralism*. In Lawrence, Robert Z. and Charles L. Schultze, eds. *An American Trade Strategy: Options for the 1990s*. Washington, Brookings Institution, 1990, p. 106-133.

¹² Douglas Seay has argued that regional free-trade agreements could "demonstrate forcefully to the EC and other protectionists that America has the option of establishing its own free-trade system and that countries that pursue protectionist policies risk exclusion from these and other markets." See: *A Seven-point Strategy to Push Europe to Free Trade*. Heritage Foundation Backgrounder, No. 839, July 8, 1991, p. 13.

¹³ The U.S. Government has maintained that the EAI/NAFTA and the GATT are complementary. At a seminar on "The United States and Argentina in Relation to the Enterprise for the Americas Initiative" at The American University on June 12, 1991, Myles Freschette, Assistant U.S. Trade Representative for Latin America, the Caribbean and Africa stated: "Some have interpreted the Enterprise for the Americas Initiative as a U.S. contingency plan for a failure of the (GATT) Round, or as an indicator of a trading system breaking down into blocs. In truth, the opposite is the case: The EAI and the Uruguay Round are complementary."

⁷ For a recent review of regional trade liberalization schemes in Latin America see: U.S. International Trade Commission. *U.S. Market Access in Latin America: Recent Liberalization Measures and Remaining Barriers*. Washington, June 1992.

⁸ Some observers date the liberalization momentum to as early as 1986. See: Organization for Economic Cooperation and Development and Inter-American Development Bank, 1991. *Free Trade Areas, the Enterprise for the Americas Initiative and the Multilateral Trading System: 12 Strategic Options for Latin America in the 1990s*. Bradford, Colin J. Jr., ed. p. 259.

⁹ Kendall, Sarita. Bolivia puts Andean pact in doubt. *Financial Times*, July 7, 1992.

trade agreements commencing with NAFTA. Succeeding agreements would depend on the readiness of countries. The United States has repeatedly stated that it sees the process of creating hemispheric free trade as taking many years, at least a decade and probably longer,¹⁴ recognizing that trade on a completely reciprocal basis cannot be achieved within a short time-frame. In May 1992, President Bush indicated that an FTA with Chile would follow the completion of NAFTA.¹⁵

2. Promotion of private investment flows by: a) the creation of an investment sector loan program within the Inter-American Development Bank to provide resources to support privatization efforts and to create an environment which promotes increased entrepreneurship; and b) the creation of a Multilateral Investment Fund of U.S.\$1.5 billion to be capitalized between 1992 and 1996. The fund would furnish financial and technical assistance to support privatization, private enterprise development, and business infrastructure.

3. Reduction of the stock of external debt by reducing debt owed to the U.S. Government. This involves two strategies: a) For concessional and P.L. 480, or food aid loans, a portion of the debt stock will be reduced with interest on the remaining portion payable in local currency. Interest payments will fund environmental projects. b) The debt owed to the U.S. Export-Import Bank or to the Commodity Credit Corporation will be reduced through a sale of the debt on the secondary market.

CARIBBEAN TRADE

The Caribbean (excluding Cuba) consists of very small economies, many of which are microstates. In fact, even if the entire region is aggregated, it is small, with a total population just over 19 million¹⁶ spread over 197,000 square miles in 16 independent countries. The gross domestic product (GDP) of the region (excluding Cuba) is only \$22 billion.¹⁷ The smallest microstate is St. Kitts and Nevis, which has a population of 42,000 in an area of 104 square miles. These economies are so minute that they have to be differentiated from the conventional concept of small economies such as Singapore, which has a GDP of \$28 billion, or Hong Kong, with a population of 5.7 million.¹⁸ In these circumstances small size is an additional constraint on development, which is reflected in the size of the market, narrow range of resources, and lack of economies of scale.

The Caribbean's trade and capital flows, both foreign investment and loans (concessional and commercial) are concentrated on the United States. Over 50 percent of the region's trade is with the United States. Caribbean exports to the United States amounted to

\$4.8 billion in 1990, having grown by 24 percent since 1987.¹⁹ Exports from the United States to the region grew even more rapidly, by 33 percent between 1987 and 1990, when the total reached \$5.6 billion. This level of exports provides an estimated 110,000 trade related jobs in the U.S. economy.²⁰ This makes the Caribbean one of the few regions where the United States has a favorable trade balance, and one which has grown steadily, as exports have increased.²¹ Canada is the region's second most important trade partner; the region imported U.S.\$1.9 billion from Canada in 1990 and total exports amounted to U.S.\$1.1 billion.²²

Most of the region's exports enter the United States, Canada, and the EC under the respective preferential arrangements of the Caribbean Basin Initiative (CBI), CARIBCAN, and the Lome Convention. This means that many of the exports from the region have not faced competition in the global market place, and for some leading exports, like sugar, bananas, and garments, prices may be uncompetitive. This is particularly true in the CARICOM countries, which have always exported within preferential trade arrangements, starting during the colonial period when they were confined to the British market by mercantilist restrictions. Upon independence in the 1960s, most exports continued to have preferential access to the British market and to the EC under succeeding Lome Conventions. In 1984, the United States extended preferential market access under the Caribbean Basin Economic Recovery Act (CBERA), the centerpiece of the CBI. This provides duty-free entry into the United States for nearly all products from eligible countries. Several items, however, which account for a significant percentage of U.S. imports from CBERA-eligible countries, are excluded from the program. These items include most textiles and apparel, canned tuna, petroleum and petroleum products, most footwear, handbags, luggage, gloves, leather wearing apparel, and watches and watch parts of Communist country origin. Canada's CARIBCAN and the EC's Lome convention arrangement provide one-way market access for exports from the CARICOM countries.

The adjustment to the removal of preferential treatment for exports would be severe on Caribbean economies, particularly the English-speaking countries which have been the beneficiaries of such arrangements for over three-hundred years. The dislocation would be compounded because free trade would also have a dramatic impact on producers for the national market, especially the manufacturing sector, which developed behind high levels of protectionism. The manufacturing sector has been insulated from exposure to competition from imports as a deliberate strategy of nurturing import-substitution industrialization by protectionism.

¹⁹ U.S. International Trade Commission. *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers: Sixth Report 1990*. Washington, September 1991.

²⁰ Calculations are based on the assumption that every \$1 billion of U.S. exports supports 20,000 jobs. Assumption based on testimony of Ambassador Carla A. Hills, United States Trade Representative before the Trade Subcommittee of the Committee on Ways and Means, U.S. House of Representatives, Washington, May 14, 1992, p. 2.

²¹ Although small in amount, exports to the Caribbean are important to U.S. economic growth as total U.S. exports are estimated to have accounted for over 40 percent of U.S. economic growth since 1986. See: U.S. Department of Commerce. *North American Free Trade Agreement: Generating Jobs for Americans*. May 1991, p. 3.

²² Statistics Canada, International Trade Division.

¹⁴ Testimony of Ambassador Julius Katz, Deputy U.S. Trade Representative before the Committee on Finance, U.S. Senate, April 24, 1991, p. 6.

¹⁵ The White House. Statement by Press Secretary. May 13, 1992.

¹⁶ World Bank. *World Development Report 1990*.

¹⁷ U.S. Library of Congress, Congressional Research Service. *The Caribbean: A Primer on the Region's Independent Nations*. Washington, CRS Report 90-445F, September 14, 1990, p. 19.

¹⁸ World Bank. *World Development Report 1990*.

The Caribbean's movement towards free trade requires a change in the entire historical basis and structure on which production and trade have been conducted. The profound adjustment has two elements: 1) liberalization of the trade regime governing imports; and 2) internal economic reform and structural adjustment to create a genuine market economy. This process has been going on since the late 1970s in countries like Jamaica, Guyana, Trinidad and Tobago, and the Dominican Republic. These countries have implemented a series of International Monetary Fund (IMF) stabilization programs and World Bank adjustment programs to increase growth, reduce the balance of payments deficit, and control inflation. The liberalization of trade regimes has varied throughout the region, but is well-advanced in Jamaica, the Dominican Republic, and Costa Rica. But the imminence of the NAFTA and the concomitant erosion of benefits of the CBI confront the Caribbean with the need to accelerate the completion of the adjustment process in preparation for competition in the global marketplace without the advantages of preferential treatment for their exports.

The question which immediately confronts the Caribbean countries is whether they want to move quickly towards free trade by participating in the NAFTA, or whether they will wage a rear-guard action to preserve preferential trade arrangements. They must decide quickly whether they want to meet the criteria to qualify for participation in NAFTA and the EAI. There has to be a detailed process, weighing the costs and benefits, to determine whether more costs are associated with participating than with staying outside of the process. Given that the EAI encompasses trade in services, investment, and intellectual property rights, meeting the eligibility criteria implies a particular growth strategy which not all governments in the region are at the moment inclined to pursue. This strategy is an outward-looking, private-sector led, market-driven growth strategy which involves privatization and liberalization. Governments should pursue this type of growth strategy only out of conviction not out of expediency.

Can Caribbean economies meet the eligibility criteria in their entirety in the foreseeable future? This will be especially difficult question for the micro-states of the Eastern Caribbean to resolve, and may require a much more extended adjustment period than the more developed economies of the region.

To be considered an acceptable partner for the negotiation of a free-trade agreement with the United States, the following criteria have been outlined by the Bush Administration:²³

1) elimination of tariffs on substantially all the trade between the parties to the agreement. (This would include trade from all other countries already included in the customs union.); 2) phase-out of non-tariff barriers; 3) inclusion of services in the agreement; 4) provision for standards for the treatment of investments, guaranteeing the principle of national treatment of investors. (There should be no inclusion of "trade-distorting performance require-

ments on the part of investors.); 5) inclusion of a dispute settlement mechanism; 6) assurance of the protection of intellectual property rights; 7) inclusion of special provisions, if necessary, to handle trade in and access to natural resources and natural resource-based products; 8) inclusion of a variety of operational, technical, and security provisions such as rules of origin and public health safety exceptions and safeguards; 9) monitoring of government actions that could undermine the basis of the agreement, such as provisions covering subsidies, state trading, trade restraints justified on balance-of-payment grounds, and the use of foreign exchange restrictions and controls; 10) a stable macroeconomic environment and market-oriented policies as certified by the IMF, World Bank, and Inter-American Development Bank; 11) displayed commitment by these countries to a multilateral trading system, assessed by the extent to which their positions concur with those of the United States in the GATT Round of Negotiations.

Whether the Caribbean economies are able to take advantage of access to the larger hemispheric market to expand exports depends not only on the policies of governments, but on the readiness and ability of the private sector to compete effectively. Even where Caribbean economies have a comparative advantage it could, as in the past, be offset by the lack of a competitive advantage by locally owned firms. The expansion of exports will depend on a combination of both comparative and competitive advantages. The state of preparedness varies considerably, reflecting economic and psychological factors. In the larger, more advanced economies, e.g. the Dominican Republic, Jamaica, Trinidad, and to a lesser extent Barbados, some firms and financial institutions have become Caribbean multinationals or are branching into the United States, Britain, and Cuba; and there are entrepreneurs whose horizons are hemispheric and even global. In fact, it is the outgrowth of the national market and the process of corporate integration which, like in the EC, is driving the resurgence of regional trade liberalization, including that of CARICOM. In the micro-economies, the private-sector firms are economic minutiae, family-owned and managed, and almost wholly and profitably confined to commerce rather than production, except in the traditional agricultural exports such as bananas. Even a trans-island merger movement would not make them viable, but there is no reason why they cannot be worthwhile joint-venture partners with foreign investors. Apart from infrastructure, all other inputs including technology can be purchased. The difficulties are not insurmountable, but there must be both a recognition and a willingness to compete. Like every process of adjustment, this begins with a change of mind, outlook, and attitude.

THE COMPATIBILITY OF OVERLAPPING TRADE ARRANGEMENTS

The movement toward free trade in the hemisphere raises numerous questions concerning the compatibility of overlapping trade arrangements:

1) What is the compatibility of NAFTA and the EAI with existing trade arrangements such as the Lome Convention and CARIB-CAN? For example, in accordance with Article 174 [2(a)] of the Lome Convention, "African, Caribbean and Pacific (ACP) States . . .

²³ Katz, Julius, p. 7; and U.S. House of Representatives, Washington, *Enterprise for the Americas Initiative Act of 1991*, H.R. 964, 102nd Cong., 1st Sess., February 19, 1991.

shall grant to the [European] Community treatment no less favorable than most-favored-nation treatment."²⁴ This means that any trade concession extended to the United States by CARICOM must also be extended to the EC.

2) What is the compatibility of NAFTA and the EAI with CARICOM? Does CARICOM's CET conflict with the requirements of the EAI? CARICOM's CET has been perceived by some in the U.S. government as protectionist and not compatible with hemispheric-trade liberalization.²⁵ Similar questions also would confront the Central American Common Market.

3) What is the future of the CBI? Is it to be superseded by NAFTA and eventually the EAI? Will it be upgraded to give similar provisions or will it remain as is? Within the long-term vision of a hemispheric free-trade area, CBI benefits will naturally be lost. In the short-term, it is still to be determined how the CBI will operate alongside the EAI.

IMPLICATIONS OF DELAYED ENTRY TO NAFTA/WHFTA

It is unclear what the sequencing will be in the creation of a hemispheric free trade area. There are two alternative scenarios. One scenario is the creation of NAFTA first, with countries later negotiating free trade agreements with the NAFTA countries. However, there are no clear criteria indicating the sequence of steps, the ordering of countries, or the schedule. There is a growing worry that securing a free trade agreement with, or joining NAFTA, is going to be difficult because the "Big Three" may lose interest in further expansion, or may want to wait for a period in order to evaluate NAFTA's progress.²⁶ Moreover, expansion may face political obstacles; since existing U.S. trade law prevents the extension of FTA benefits to third countries, it will be necessary for the U.S. Congress to renew "fast track" authority for agreements subsequent to the NAFTA.²⁷ This uncertainty has spawned a "hub and spoke" development, with Mexico as the central node of catenation. Consequently, there is now a diplomatic stampede to negotiate, even in principle, a FTA with Mexico to get into NAFTA through the "back door." This jockeying could become unsavory and might be detrimental to the spirit of regional cooperation intended by the EAI.

A second scenario, one frequently mooted, is that NAFTA would constitute the core of the EAI with expansion by "docking" or "accession" by additional countries. Any "associate status" or accession would have to be included as a clause in the NAFTA agree-

application for accession would have to be submitted to the process of congressional approval. For the sake of order and equity, it would be necessary to establish and enunciate a clear set of criteria for eligibility into NAFTA.

It has been suggested that the United States should not wait until the NAFTA has been ratified by Congress before starting negotiations with the other countries which are ready.²⁸ The United States has stated that it simply does not have the resources to negotiate simultaneously with all or several countries. This is difficult to understand given the size of the bureaucracy and the large fiscal budget. In fact, it might be relatively easy to negotiate free trade with CBI countries since the program already embodies substantial unrestricted entry to the U.S. market.

While the question of when to participate depends on the United States and the outcome of the NAFTA negotiations, Caribbean governments must decide whether to seek to participate immediately or whether to delay participation until later. If they wait, there are costs involved. For example, if there is a lag in creating a "level playing field," like Mexico getting free entry for certain products that are now restricted under CBI II, then there will be: a) *trade diversion*, reduced CBI exports to the United States because of relatively higher tariffs or barriers than Mexican exports; b) *diversion of investment and associated technology* from the Caribbean to Mexico as investors opt to install new productive capacity in Mexico and existing industries in the Caribbean, like the garment industry, seek to relocate.

Should the Caribbean proceed as individual countries, or should there be collective participation? If collective participation is available and feasible given the differences in readiness, what collection of countries should proceed? Should this be CARICOM or some wider version of the Caribbean? Collective participation may prove difficult because it involves measures which deal with national policy regimes, e.g., investment codes and intellectual property rights.

DIFFERENT LEVELS OF DEVELOPMENT

How is the treatment of different levels of economic development to be accommodated within FTAs? Indeed, are they going to be accommodated? In fact, this was one of the most contentious issues in negotiating the framework agreements even though they are non-binding, and only commit the signatories to further dialogue. In negotiating the U.S.-CARICOM framework agreement, the United States was not prepared to accommodate any reference to different levels of development, and the whole agreement could have foundered. The difference was resolved by using the term "undiversified economies," which deals with the fact that Caribbean economies have a structural vulnerability to external events and are in urgent need of structural adjustment because of their very narrow range of production and exports. Since then, the United States has

²⁸ *Miami Report III. Recommendations for a North American Free Trade Agreement and for Future Hemispheric Trade.* Miami, University of Miami, North South Center, 1992, p. 14.

²⁴ Fourth ACP-EEC Convention signed in Rome on December 15, 1989. *The Courier*, No. 120, March-April 1990, p. 166.

²⁵ Malpass, David, U.S. Department of State, Statement before the Joint Economic Committee, Congress of the United States, April 2, 1992. It should be noted that no CARICOM country is regarded by the USTR as having barriers to U.S. exports. See: U.S. Trade Representative, 1991 National Trade Estimate on Foreign Barriers, Washington, March 1991.

²⁶ Ambassador Carla Hills has warned that "The U.S. Congress will want to see the positive results of the North American Free Trade Agreement before authorizing the Administration to launch new free trade agreements with other trading partners in the region." *Trade, the Americas, and the World.* Address by Ambassador Carla H. Hills, U.S. Trade Representative before the Organization of American States Conference of Trade Ministers, Washington, October 29, 1991, p. 4.

²⁷ Hufbauer, Gary Clyde and Jeffrey J. Schott. *North American Free Trade: Issues and Recommendations.* Washington, Institute for International Economics, 1992, p. 41.

continued to maintain that there can be no accommodation of different levels of development in a "mature relationship." Some flexibility will be necessary since any regional arrangement aimed at integration and/or trade liberalization must accommodate development heterogeneity, at least initially, including different levels of development, coexistence of a variety of growth strategies, and structural adjustment at varying stages of completion. Indeed, this development heterogeneity is recognized and reflected in CARICOM and the EC, and was conceded by the United States when it granted developing-country status to Israel in the U.S.-Israel FTA.

If the NAFTA and the EAI are to be consistent with the GATT, as several senior officials of the Bush Administration have stated, then the principle of "differential and more favorable treatment for developing countries" will have to be explicitly recognized as it is in the GATT.²⁹ Article VI notes the special characteristics and importance of trade of developing countries and the need to promote growth and facilitate diversification; paragraph 8 states: "The developed contracting parties (countries) do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less developed contracting parties (countries)."³⁰

Reciprocity can have a range of connotations that cannot be reduced to equivalence, but which can consist of conditional or modified "most favored nation" treatment. Asymmetrical adjustment is one way to recognize and compensate for differences in the levels of development. The notion of differential treatment is deeply entrenched in the smaller, less developed countries which receive longer adjustment periods even within CARICOM. It will be difficult to disabuse these countries of this tenet of their philosophy of development, but there can be little opposition to the concept of phasing out differences in obligations over a long period, perhaps 20 years. Clearly, it would be difficult at the outset of an FTA to enshrine special and differential treatment in perpetuity. Instead, there should be specific criteria for graduation to nondiscriminatory status. In practice, the United States has espoused "graduation" by disqualifying certain advanced developing countries from the Generalized System of Preferences.³¹

Should reciprocity be complete and asymmetrical or partial and relative, and should it commence immediately or be phased in over a period of years? The Caribbean's apprehension of immediate and complete reciprocity derives less from the inability to undertake policy measures and institutional changes than from the social and economic costs of structural adjustment. This is a valid concern because in these economies, structural adjustment implies both resource allocation, from extinct to emerging or growing sectors, and resource creation, for the installation of new or upgraded produc-

ive capacity. There are risks and difficulties involved in improving quality, quantity, and price in order to survive and compete in the vast hemispheric market, with a range of competitors including some of the giant, multi-national corporations, whose assets and sales dwarf the GDP of the combined Caribbean countries. Daunting as this appears, it can be accomplished because the fragmentation of the production process into smaller, discrete processes provides opportunities, and there are specialized niches in the international division of labor which can be filled by relatively small-scale operations.

ADJUSTMENT PERIOD

The period of adjustment is critical and can be general, sectional, or product specific. Product or sector specific adjustment periods, if sufficiently long, would allow these small, "undiversified" economies to implement orderly economic reorganization. Caribbean fears may be exaggerated, since in some areas in the U.S.-Canada FTA, the phase-in period is as long as 10 years. In addition, only a limited number of products would require prolonged adjustment periods or exemptions because production is concentrated on a narrow range of goods and services, and exports consist in many cases of a few primary products. Sensitive products could be handled by "snapback provisions," similar to Article 702 of the U.S.-Canada FTA³² which permits, under specified conditions, the imposition of a temporary duty on fresh fruits and vegetables. There could also be safeguards such as Article 1101 of the U.S.-Canada FTA,³³ which allows that during the transition period (which ends December 31, 1998), either country may respond to serious injury to domestic producers resulting from the reduction of duties under the FTA by restoring tariffs for a period of no longer than three years. Such action may be taken only once in each industry, and the exporting country is entitled to compensation. An FTA does not have to preclude the invoking of Article XIX of the GATT. The United States and Canada continue their rights under the GATT provision;³⁴ however, in taking global actions, they agree to exempt each other except in cases where imports from the other country "are substantial and are contributing importantly to serious injury or threat thereof . . ."³⁵ To meet this condition, imports from the United States or Canada must be at least five to ten percent of total imports and an important, though not necessarily the most important, source of injury.

LAGS IN CREATING A LEVEL PLAYING FIELD

The time lag between when NAFTA would go into operation and when other countries follow or attain similar access is important

²⁹ Office of the U.S. Trade Representative. *The United States-Canada Free Trade Agreement*. Washington, January 1991.

³⁰ *Ibid.*

³¹ Morici, Peter. *Transition Mechanisms and Safeguards in a North American Free Trade Agreement*. Paper presented at a conference on North American Free Trade: Economic and Political Implications. Washington, D.C. June 27-28, 1991. Richardson, J. David. *Adjustments and Safeguards*. In Peter Morici, ed., *Making Free Trade Work: The Canada/U.S. Agreement*. New York, Council on Foreign Relations Press, 1990. p. 68-69.

³² *Ibid.*

²⁸ Yusuf, Abdulqawi A. Differential and More Favorable Treatment: The ATT Enabling Clause. *Journal of World Trade Law*, v. 14, no. 3, 1980. p. 488-507.

²⁹ However, in Article XXXVII the developed countries only committed to implement Article XXXVI to the fullest extent possible and to accord high priority. See: Dam, Kenneth W. *The GATT Law and the International Economic Organization*. Chicago, University of Chicago Press, 1970. p. 443-446.

³¹ Jackson, John H. *The World Trading Systems Law and Policy of International Economic Relations*. Cambridge, Mass., MIT Press, 1989. p. 278.

relocation of new and existing productive capacity could result, as well as a diversion of investment away from the Caribbean. Some decisions on investment in the Caribbean have been on "hold" since NAFTA negotiations commenced.³⁶ Investment diversion is a real danger because Mexico already has certain competitive advantages: a) lower transportation costs; b) lower wages than most Caribbean countries; c) cheap energy; and d) a market size which can yield economies of scale that Caribbean economies would find difficult to realize. Location would give Mexico an advantage in the Western and Southwestern United States, while the Caribbean should be able to compete in the South and the east coast of the United States where, in fact, most of the nation's population centers are located.

Approximately 33 percent of trade with CBI countries enters the United States duty free under normal tariff rates and will not be affected by NAFTA.³⁷ The U.S. Trade Representative's Office has estimated that based on the initial U.S.-tariff offer in NAFTA negotiations, \$4.5 billion, or 60 percent of U.S. imports from CBI countries in 1990, would be put at a competitive trade disadvantage as soon as NAFTA begins to be implemented. In addition, a further \$5 billion, or 7 percent of dutiable CBI imports, would be subject to declining preferential margins over NAFTA.³⁸ According to a recent study by the Association of American Chambers of Commerce in Latin America (AACCLA), at least 37 percent of Jamaica's exports to the United States are not covered by either the CBI or the Generalized System of Preferences (GSP). Nearly all of this represents textiles and textile products which would be threatened if import barriers on Mexican goods are lowered. In addition, a further 10 percent of Jamaica's exports to the United States enjoy a tariff advantage over Mexico,³⁹ which could be lost. The products which would be adversely affected are rum, other alcoholic beverages, and orange juice. The AACCLA estimates that about 34 percent of the exports of the Dominican Republic could be vulnerable to Mexican competition.⁴⁰

The NAFTA may provide entry of products excluded under the CBI (textiles, sugar, leather goods, and garments) and put the entry on a much more secure footing because NAFTA would be a contractual agreement in the form of a treaty. The CBI, on the other hand, is not a treaty and, therefore, is subject to unilateral dispensation or withdrawal of benefits, and provides a much less secure basis of market access and, as a result, a more insecure investment environment.

³⁶ Thurston, Charles W. Japanese Investors Looking at Mexico. *Journal of Commerce*, April 30, 1992.

³⁷ *Impact on Other Latin American Economies of a Mexico-U.S. Free Trade Pact: A Preliminary Analysis*. Association of American Chambers of Commerce in Latin America, Washington, October 1991, p. 8.

³⁸ *Ibid.*

³⁹ *Ibid.*

⁴⁰ *Ibid.* p. 7.

Increased debt relief will be necessary if trade is to be stimulated. Commercial bank debt, which is obviously a major concern for the region, has not been addressed in a new or substantive way. Passing reference is made to encouraging the application of the Brady guidelines and is a reflection that U.S. banks are not as exposed to Latin American debt as they were a few years ago.

Some form of aid will be necessary to strengthen physical and social infrastructure that would allow these countries to support and harness private sector entrepreneurial energy and to take advantage of whatever export opportunities might open up. Trade liberalization and debt relief are not substitutes for development assistance, but are complementary because an efficient and expanding private sector requires a competent public sector. Extra demands will be placed on the public sector due to resource reallocation that is inherent in a process of adjustment. To effectively support the revamping and improvement in private sector activity, the public sector will have to be transformed and reoriented. This will necessitate additional resources at the very time when liberalization of the trade regime may engender short-term dislocation in revenue-raising capacity. This is a particular anxiety in the microeconomies of the Eastern Caribbean where fiscal revenue is based largely on import duties. Reduced tariffs and import duties would cause the expenditure capacity of the government to be truncated by the erosion of the traditional tax base, and this would require an overhaul of tax administration.

Development capital (venture capital, equity investment funds, Section 936 funds) is needed to create new productive capacity and export production. There is now a paucity of private-capital inflows to the Caribbean associated with the reconstruction of East Germany and Kuwait, the use of significant resources to assist the Soviet Union and Eastern Europe, and the United States having its own economic difficulties. In this sort of capital shortage, where savings as a proportion of GNP decreased in both the industrialized and developing countries during the 1980s, there is a need to create a component which provides venture capital, equity investment, and development bank financing. One possibility is the restoration of Overseas Private Investment Corporation (OPIC) guarantees for projects funded by Section 936 funds. This question is critical because the problem is not just resource allocation for efficiency, but the need to create new economic capacity and therefore a need for resource creation to enable these countries to take advantage of the trade opportunities.

Since 1984, 789 companies have invested \$2.2 billion in CBI designated countries employing 142,016 full-time jobs and generating \$1.3 billion annually in foreign exchange earnings.⁴¹ Costa Rica, Guatemala, Panama, El Salvador, and the Dominican Republic attracted two-thirds of the companies and accounted for 92 percent of foreign-exchange earnings, 87 percent of full-time employment, and

⁴¹ U.S. Department of Commerce, Latin America/Caribbean Business Development Center, Caribbean Basin Division. *1990 Caribbean Basin Investment Survey*. Washington, February 1991, p. 7.

78 percent of the assets.⁴² For these countries, the main reasons for investing were access to the U.S. market under the CBI, host country investment incentives, and the cost of labor. There is a need for the United States to establish investment incentives that would enhance the region's ability to attract more private capital, even if Caribbean economies succeed in establishing the macroeconomic climate to maximize domestic investment and recapture capital flight. The need to assist the market-induced investment flows derives from the trend towards increasing concentration of foreign investment among the industrialized countries and the paucity of foreign investment in the Caribbean. The U.S. economic recession, following the adverse impact of the Gulf War on tourism, has been a further dampener to the region's economy. The need for investment incentives is urgent to encourage greater use of loans from the Section 936 funds.⁴³

ACTION AGENDA

Whether the world economy moves towards the liberalization of trade or the formation of trading blocs, the Caribbean cannot count on the continuation of existing preferential trade arrangements. The Caribbean must recognize that the developed countries no longer feel obliged to provide preferential trade arrangements and aid to a region of economies with minute markets, no indispensable raw materials, and limited strategic importance. The region must be prepared to adapt to the elimination or erosion of preferential trade regimes (e.g., the extension of CBI-type trade benefits to the Andean countries with the passage of the Andean Trade Preference Act approved on November 26, 1991, and the proposed extension of benefits of the Lome Convention to Central America and perhaps to the rest of the developing world). The Caribbean must prepare a strategy for its survival and development in the new world economic and political context. Therefore the Caribbean must:

- 1) Formulate a growth-promoting adjustment strategy to enable Caribbean economies to survive in a global economy which is undergoing rapid and profound changes, including those represented by the EAI.

- 2) Undertake an economic evaluation of the costs and benefits of participation in, or omission from, hemispheric free trade. The complete and careful analysis of all aspects of the EAI, the terms and conditions of participation, and its implications for the immediate and long-run future, is a prerequisite for arriving at decisions of such paramount importance and the establishment of objectives.

- 3) If the decision is to participate, then the Caribbean must decide what kind of EAI it wants or needs and ensure, as far as possible, that the EAI is compatible with existing trade agreements such as CARICOM, the Lome Convention, and CARIBCAN.

The Caribbean must not be a passive participant but must be active in shaping the EAI. The Caribbean must seize the opportunity afforded by the unique nature of the U.S. political process and the consultative institutional mechanism of the trade and investment framework agreement with the United States to shape the EAI before it is written on tablets of stone. It is incumbent on Caribbean governments to become active participants in the political process of shaping the EAI by their lobbying efforts and diplomatic initiatives in the United States to help shape the outcome of the Enterprise. This could most effectively be done by collective action on the basis of the wider Caribbean, that is, the traditional Caribbean together with Central America. It is possible for small, vulnerable economies, which are a particular genre of economy with their own peculiar constraints and specific development problems, to argue successfully to receive special consideration and even priority treatment. Time is short; the Caribbean must act now to convert the Enterprise for the Americas Initiative, into an Enterprise of the Americas Initiative.

⁴² Ibid.

⁴³ Flax-Davidson, Ron H. Tax-Exempt Investment for the Caribbean Basin Initiative Region. *The International Lawyer*, v. 25, no. 4, Winter 1991, p. 1021-1029; U.S. Library of Congress, Congressional Research Service. *The Possession Tax Credit (IRC Section 936): Background and Issues* by David L. Brumbaugh. CRS Report 88200E. Washington, March 11, 1988.