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TRADE AND INVESTMENT FLOWS BETWEEN THE CARIBBEAN AND THE REST OF THE HEMISPHERE IN THE CONTEXT OF THE FTAA

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TRADE AND INVESTMENT FLOWS BETWEEN THE CARIBBEAN[1] AND THE REST OF THE HEMISPHERE IN THE CONTEXT OF THE FTAA

Introduction

The evolution of trade and investment flows between the Caribbean and the rest of the western hemisphere has been influenced by historical incorporation into the world economy and changes over time. The most important historical factor was the incorporation of the region into the international capitalist economy as producers and exporters of primary products and importers of technology, manufactured goods and finance. This pattern of specialisation and exchange led to exports of primary goods such as sugar, bananas and minerals (oil and bauxite). Investment flows followed trade and were driven by profit-seeking, foreign, transnational corporations that were interested in the exploitation of natural resources. This pattern of trade and investment led to a highly volatile growth pattern in the region that was subject to the vicissitudes of terms-of-trade and foreign investment shocks. Over time, the economic base of some countries in the region shifted from primary goods to services, particularly tourism and financial services. This has led to significant foreign investment and trade in these services.

The change from the inward-oriented import-substitution industrialisation development framework to the export-led growth model, along with structural adjustment programmes (SAPs) economic liberalisation, has led to increased opening and reform of the regional economy. These market-opening policies, including trade liberalisation, macroeconomic reforms (such as the control of inflation, fiscal prudence and flexible exchange rates in some countries) and privatisation have led to significant dependence on trade and an upsurge in foreign direct investment inflows to the region in the last decade.

At the subregional level, the ongoing implementation of the Caribbean Community (CARICOM) Single Market and Economy (CSME) has facilitated intraregional trade and investment. This has been manifested in the development of regional firms and a number of mergers and acquisitions to confront external competition. Complementing the CARICOM initiatives have been continued negotiations to establish the Free Trade Area of the Americas (FTAA) by 2005. The proposed FTAA is likely to lead to trade and investment creation in some activities, diversion in others and dynamic optimising benefits in yet others in Caribbean countries. The net impact on the countries will depend on whether trade and investment creation and dynamic gains supersede diversion. From any standpoint, the scenario is expected to present quite a challenge for small Caribbean economies. The region needs to undertake the necessary strategies in areas such as technology adaptation, marketing and human resource development to develop competitive advantage so as to optimise beneficial trade and investment effects.

[1] The Caribbean for the purpose of this paper is limited to the Caribbean Development and Cooperation Committee (CDCC) countries. These countries are Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, British Virgin Islands, Cuba, Dominica, the Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Montserrat, Netherlands Antilles, Puerto Rico, St. Kitts and Nevis, Saint Lucia, Saint Vincent and the- Grenadines, Suriname, Trinidad and Tobago and the United States of America Virgin Islands.

This paper provides an analysis of trade and investment flows between the Caribbean countries and those of the rest of the hemisphere and the implications of the proposed FTAA for the future evolution of these flows. The paper is divided into seven substantive sections: Section I provides an overview of global trade and investment flows, Sections II and III provide an analysis of intraregional and hemispheric trade and investment flows. They account for the salient patterns and trends in trade flows within the Caribbean and between the Caribbean and major partners in the hemisphere, particularly the United States of America. Importantly, it points to the meagre trade between Latin American countries and the Caribbean and highlights the need for policies to boost this trade under the FTAA. Section IV examines the main drivers of trade and investment flows, while Section V is an analysis of the impact of trade and foreign investment on accumulation and growth in the region. Section VI examines the impact of policy measures on trade and investment flows, and finally, the last section provides an analysis of the major potential implications of the FTAA for the future patterns of trade and investment flows between the Caribbean and other members of the future hemispheric grouping.

I. Overview of global trade and investment flows during the 1990s

World trade and investment expanded considerably during the 1990s. World merchandise exports, for example, rose from US$3423 billion in 1990 to US$6,243 billion in 2000, representing an annual average growth of 6.8 per cent (World Trade Organization (WTO), 2001). Similarly, world merchandise imports grew faster, from US$3430 billion in 1990 to US$6507 billion in 2000. Merchandise trade of developing countries also accelerated significantly during the 1990s as a result of the implementation of far-reaching trade liberalisation programmes. Total merchandise exports from the developing countries surged from US$969.8 billion in 1990 to US$2257 billion in 2000. Total imports grew by US$1331 billion to US$2187 billion in 2000. The robust growth in world trade during the 1990s was underpinned by strengthened economic activities in most regions, particularly the United States of America, which provided the motor of global economic expansion.

Among the countries of the western hemisphere, Mexico recorded the fastest growth rate in merchandise trade averaging 15.1 per cent and 15.0 per cent annually for exports and imports, respectively. North America's merchandise imports grew faster by 8.9 per cent compared to 7.3 per cent growth for merchandise exports, resulting in a deficit on the trade account. Latin American countries also recorded deficits on their trade balance, as their merchandise exports recorded relatively slower growth of 6.2 per cent, compared with 9.0 per cent growth for merchandise imports. Continuing expansion in global trade in the 1990s, however, has been facilitated by increased international capital flows, which have financed the current account deficits of many countries.

World (Foreign Direct Investment) FDI flows averaged US$497.3 million between 1994 and 1999[2], more than double the annual average figure for the period 1988-93. In 1999, inflows amounted to over US$865 million, up 27 per cent compared with 1998. The significant growth in FDI inflows in 1999 was spurred by a number of mergers and acquisitions as investors

[2] See UNCTAD, "World Investment Reports, 1999 and 2000", New York and Geneva.

consolidated their positions to compete in international markets. There was a resurgence of FDI flows in the 1990s relative to the 1980s, in response to liberalisation and other market-friendly policies, technological change and attempts by firms to position themselves to compete more effectively. Importantly, FDI proved much more resilient than other types of capital flows (e.g. portfolio and debt flows) during the Asian crisis of the latter half of the 1990s.

Trends in international production that are propelled largely by FDI flows point to a growing integration of the world economy. The ratio of the stock of world FDI flows to Gross Domestic Product (GDP) has increased from 6 per cent in 1982 to 16 per cent in 1999[3]. Similarly, the ratio of global FDI flows to gross domestic capital formation jumped from about 2.5 per cent in 1982 to 14 per cent in 1999. Meanwhile, global sales of foreign affiliate firms were roughly twice as high as global exports in 1999, compared with parity two decades earlier. Underscoring their vital role, the gross product of transnational corporations (TNCs) was estimated at US$8 trillion, about a quarter of the world's gross domestic product in 1997.

Although the overall trend has been accelerated global market integration, there have been significant differences in the pace of integration of individual countries and regions. This has no doubt led to disparities in the benefits derived from investment, production and trade integration. Contrary to theoretical expectations, the bulk of capital flows has been among developed countries rather than from developed countries to developing countries. Instead, developed countries, particularly the United States of America, have been the major recipients and beneficiaries of FDI inflows.

Total foreign investment flows to developing countries posted strong growth in 2000, moving from $246 billion in 1999 to $299 billion in 2000, up some 21.5 per cent. Growth in inflows was spurred by the recovery in both long-term flows, with a maturity of more than one year, and short-term flows. The resurgence of long-term flows is a particularly good sign, given their potential to contribute to productive activity and export. Long-term flows have not attained their pre-Asian crisis levels, though, as investors continue to be cautious and discriminating in their investment decisions. Importantly, FDI declined by 4 per cent, the first such decline in a decade. This decline reflected the tapering-off of mergers and acquisitions and a fall in large-scale privatisation projects. This suggests that the pull-effect on FDI from one-off privatisation and divestment of State enterprises in developing countries is slowing down. Therefore, the ability of Caribbean countries to maintain inflows in the future would depend largely on the restructuring of static production and the development of new activities that are on the upswing of the international product cycle. Activities in the area of information technology, biotechnology and other growth sectors could provide the impetus for vibrant growth in FDI.

II. Intraregional trade and investment

Within the last decade, CARICOM has intensified efforts aimed at deepening and widening the integration process. This was geared to not only increase the quantity, but also the quality of trade and investment. The Common External Tariff (CET) has been standardised and lowered to a range of 0-20 per cent for all the products, with the exception of agricultural

[3] See UNCTAD , "World Investment Report 2000"

products. When the process is completed the unweighted average tariff is expected to decline to 10 per cent, down from 20 per cent in 1991.[4] Non tariff measures have also been substantially reduced. To facilitate the establishment of the CARICOM Single Market and Economy, the countries have prepared a number of protocols, amending the Treaty of Chaguramas. Protocol II, aimed at creating a single economic space in the CARICOM region, makes provision for the free movement of labour, capital and services and the rights of establishment. This and other protocols (III, IV, V, VIII, and IX) have already been signed by most of the Community members. Perhaps the most advanced in terms of implementation is Protocol II. All the member countries, with the exception of Belize, Montserrat and Suriname, have enacted national legislation to implement provisions relating to the free movement of university graduates. Another accomplishment worth mentioning is that many countries now accept forms of identification, other than passports from CARICOM nationals, to facilitate free movement of skilled labour and artists.

Furthermore, the enlargement process has also been given a boost with the addition of Suriname and preliminary steps for the addition of Haiti to the Caribbean Community. In addition, CARICOM has concluded bilateral trade agreements with the Dominican Republic and Cuba. All these measures are aimed at creating a “single economic space”, one in which goods, services and factors of production will move freely across borders.

Notwithstanding all these efforts aimed at deepening economic integration, intraregional trade has not met expectations. Among the countries of the Caribbean Development and Cooperation Committee (CDCC), intra-CDCC exports exhibited a declining trend in the first half of the 1990s. However, this improved significantly in 1995 reaching a high US$1737 million in 1997 before declining precipitously to US$1381 million in 1998. Intraregional imports grew to US$1048 millions in 1993, and then dropped significantly to US$669 million in 1994. Imports, however, recovered and grew for three consecutive years to US$1813 million in 1997, before declining in 1998. The decline in intraregional trade in 1998 could be attributed to the effects of the Asian crisis on commodity prices and weather-related external shocks in some countries.

The overall significance of intraregional trade among CDCC countries has remained small. The share of intra-CDCC imports in total imports declined from 6.8 per cent in 1990, to 5.5 per cent in 1998. The share of intra-CDCC exports consistently outpaced that of intra-CDCC imports during the entire period under review (See Figure 1). Moreover, petroleum products from Trinidad and Tobago account for the bulk of the value of intraregional trade, underlying the relatively weak intraregional trade performance of the other countries. The low level of intraregional trade reflects the highly concentrated nature of Caribbean export, with many countries producing a narrow range of primary commodities, which are near perfect substitutes. This limits the scope for intraregional trade, leaving the subregion highly dependent on extraregional markets.

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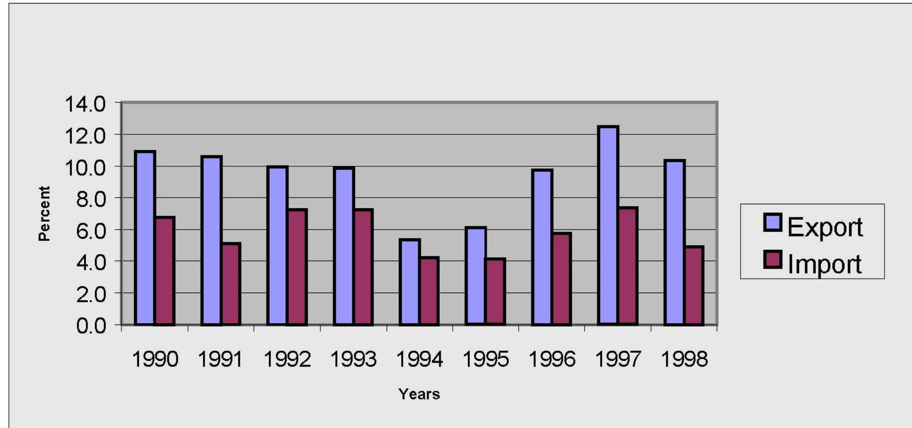
[4] See Inter- American Development Bank, 1999, “ Integration and Trade in the Americas”, Periodic Note, October.

Figure 1

Intraregional exports and imports as a percentage of total exports and imports for the Caribbean for the period 1990-98



Source: ECLAC/CDCC, 2000.

Historically, little attention has been paid to intraregional investment for financing development in the Caribbean. This was reinforced by the fact that, in the past, in spite of the CARICOM Agreement, there were little intraregional capital flows, owing in part to technical and institutional barriers to investment. However, in the last decade, there has been growing cross border investment in the region, particularly mergers and acquisitions, in response to strengthened liberalisation and the achievement of a critical scale of production by some regional firms that enables them to penetrate the regional market. However, mergers and acquisitions also reflect the limits on the scope for organic growth in firms. Also, the 'take-off' position of the leading firms has been influenced by their core competencies in terms of capital base, organizational and management skills.

A significant portion of investment in the Organisation of Eastern Caribbean States (OECS) countries has been from other CARICOM countries, particularly Trinidad and Tobago. In 1997, Caribbean countries accounted for over 59 per cent of investment in the OECS, followed by Italy (28 per cent), France (13 per cent), and the United States of America only 11 per cent. By 1999, out of total investment inflows of $618 million, the United States accounted for almost 50 per cent, while the Caribbean's share was over 20 per cent. This was partly accounted for by a significant increase in investment in the tourism sector. Investment in tourism increased by over 18 per cent between 1998 and 1999, the bulk of which was from the United States of America. Investors from Trinidad and Tobago were the major regional players in the OECS market. Firms from Trinidad and Tobago have invested in a range of activities, including manufacturing, distribution and banking. Firms from Barbados have also strengthened their investment position in catering and other services in the OECS subregion.

It is vital for Caribbean firms to continue to expand within the regional market. This provides an ideal opportunity for regional firms to improve learning and to develop critical mass

to confront foreign competition. Also, it is important to note that no country can foster balanced development by relying solely on foreign investment. There is a clear need for regional firms to develop critical mass to compete in international markets, and the regional market is a good testing environment for this. Moreover, it has been suggested[5] that the return on foreign investment capital for British and United States of America firms during their hey days of overseas investment was of the order of 70 per cent. In effect, therefore, developing countries were providing substantial net returns to foreign multinational firms. There is a clear need for Caribbean firms to increase their size and to strengthen their position in the regional market relative to foreign multinationals, thereby enabling them to better contribute to the development process in the region. Further, where foreign firms tend to engage in natural resource processing, manufacturing and other activities with clearly high profit margins, they neglect important areas, such as air transportation and agriculture. Regional firms with a better understanding of the culture and institutional dynamics of the region need to move into these crucial activities to fill the gaps. This is particularly important in the area of services such as some aspects of the tourism, finance and information sectors.

III. Trade and investment flows between the Caribbean and the rest of the hemisphere

Caribbean countries have sought to strengthen trade and investment ties with the countries in the western hemisphere[6] through formalising bilateral trade and investment agreements. The three largest economies in the CARICOM subregion, notably Barbados, Jamaica and Trinidad and Tobago, have been very active in formalising bilateral investment agreements.[7] Trinidad and Tobago concluded a bilateral investment treaty (BIT) with the United States and Canada in 1994 and 1995, respectively. Barbados also entered into a bilateral investment agreement with Canada in 1996 and Venezuela in 1994. Jamaica signed a bilateral investment agreement with the United States and Argentina in 1994. Other Caribbean countries which have concluded bilateral investment agreements are Grenada in 1986 and Haiti in 1983, both with the United States. All these agreements have contributed significantly to liberalisation of investment regimes in many Caribbean countries. Since some agreements have just been recently concluded, the Caribbean countries are yet to reap tangible benefits from them. The new investment regimes seek to promote foreign investment through the granting of national treatment and the elimination of most restrictions on capital and the repatriation of profits.

[5] See Sweezy, Paul, "The future of Capitalism," in "To Free a Generation," The Institute of Phenomenological Studies, 1968.

[6] This includes North America, Central America, South America and other Caribbean countries, including Cuba and the Dominican Republic.

[7] See Organisation of American States, 1996, "Bilateral Investment Treaties in the Western Hemisphere: A Compendium prepared for the Free Trade Areas of the Americas Working Group on Investment", Washington, DC.

Table 1

Trade and investment agreements between the Caribbean countries and western hemisphere partners

Agreement in force	Date concluded	Trade agreement	Bilateral investment
CARICOM-USA	1984	x	
CARICOM-Canada	1986	x	
CARICOM-Colombia	1994	x	
CARICOM-Dominican Rep	1998	x	
CARICOM-Cuba	2000	x	
CARICOM-Venezuela	1992	x	
Dominican Rep- CACM	1998	x	
Barbados- Venezuela	1994		x
Barbados- Canada	1996		x
Grenada-USA	1986		x
Haiti-USA	1983		x
Jamaica-USA	1994		x
Jamaica-Argentina	1994		x
Trinidad and Tobago-USA	1994		x
Trinidad and Tobago-Canada	1995		x
Source: CARICOM and OAS			

As can be seen from Table 1 above, most of the Caribbean countries have concluded trade and investment agreements with the United States. These agreements were motivated by the important role the United States plays in hemispheric trade and investment flows. Apart from those agreements that are already in place, other bilateral, regional and hemispheric agreements have been proposed or are currently being negotiated which will affect future trade and investment between the Caribbean and other countries in the western hemisphere. Bilateral trade agreements have been proposed between Trinidad and Tobago and Panama and between Trinidad and Tobago and Costa Rica. A trade agreement is also being negotiated between Mexico and Trinidad and Tobago and between Guyana and Brazil.

The United States of America remains the Caribbean largest trading partner in the Americas, accounting for more than two thirds of CDCC's trade with the western hemisphere. CDCC's imports from the United States of America grew considerably from US$5615.3 million in 1991 to US$10513.6 million in 2000.[8] While the European Union (EU) is a significant market for Caribbean exports, the United States, on the other hand, remains by far the largest source of imports for many Caribbean countries. This is partly due to the subregion's geographic proximity to the United States.

[8] Due to the lack of data on CDCC exports and import to and from the United States, we use partner trade data (U.S data) to capture CDCC trade with the United States. As a result of this approach, CDCC exports to the U.S. are valued in c.i.f terms while imports are valued in f.o.b terms, contrary to international convention.

Table 2

CDCC imports from the United States (US$ millions)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
CDCC Total	**5615.29**	**5552.11**	**6156.74**	**6499.63**	**7784.9**	**8088.8**	**9337.9**	**9728.5**	**9402.5**	**10513.6**
Antigua & Bar	74.69	68.1	73.1	64.7	97.2	81.7	85.1	95.8	96.1	138.7
Bahamas	720.94	712.57	704.1	685.35	660.5	725	809.9	815.1	843.6	1064.7
Barbados	166.55	127.76	145.46	161.13	185.7	222.2	281.1	281.1	302.4	305.6
Belize	114.248	116.803	135.5	115.14	100.1	106.6	114.8	119.9	136.1	208.5
Dominica	42.47	33.54	27.4	25.64	26.5	34.1	37.4	52.1	38.6	37.3
Dominican Rep.	1742.7	2098.16	2349.5	2799.5	3016.6	3183.2	3928.2	3977.4	4085.6	4443.4
Grenada	31.55	23.77	23.94	23.48	26.8	35.7	40.6	56.5	66.2	79.2
Guyana	86.13	118.16	122.55	109.78	141.2	136.8	142.5	145.5	145.1	159
Haiti	392.1	216.67	221.3	210.46	550.8	473.6	499.9	547.8	614.8	576.1
Jamaica	962.91	938.46	1112.8	1066.4	1420.9	1490.7	1417.4	1303.7	1294.8	1377.6
Montserrat	8.11	13.26	5.51	6.75	4.3	7.6	16.6	5.2	4	10.5
St. Kitts-Nevis	34.96	31.59	41.67	45.07	43.6	39.2	37.8	44.8	48.5	57.9
St. Lucia	88.59	82.12	98.64	80.57	81	84.3	89.3	92.4	98.1	105.3
St. Vincent & Gren.	43.49	34.89	37.66	38.16	42.2	45	54.4	274.2	92.1	37.3
Montserrat	8.11	13.26	5.51	6.75	4.3	7.6	16.6	5.2	4	10.5
Neth. Antilles	628.84	475.86	522.8	519.97	504.3	527.9	477.1	742.1	603.3	674.1
Suriname	….	….	….	….	189.7	222.5	183.2	187.2	143.7	131
Trinidad &Tobago	468.9	447.14	529.3	540.78	689.2	665.1	1106	982.5	785.5	1096.9

Source: United States of America International Trade Commission (USITC), Various Issues

CDCC imports from the United States have traditionally consisted of machinery, motor vehicles, agricultural and horticultural products and textile and apparels that are used in the offshore assembly operations and re-exported to United States under reduced duty, in the context of the production sharing provisions. Reduction of tariff and non-tariff barriers, coupled with the use of production sharing, have contributed to Caribbean increased imports from the United States of America, a trend which will likely continue with the conclusion of the Trade and Development Act, which gives the Caribbean Basin Initiative (CBI) countries trade parity with the North American Free Trade Agreement (NAFTA).

Table 3

CDCC exports to the United States (US$ millions)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
CDCC Total	**5085.91**	**5437**	**5361.46**	**5893.73**	**6170.5**	**6793.4**	**7552.4**	**7311.5**	**7632**	**9063.2**
Antigua & Bar	3.9	5.44	14.79	5.38	3.1	8.7	5	1.9	1.8	2.3
Bahamas	470.43	585.28	348.2	203.04	156	165.4	165.8	142.5	195.3	275
Barbados	31.48	30.59	34.06	34.49	37.7	41.2	42.1	35.3	58.9	38.6
Belize	45.568	58.83	53.62	50.87	52.3	68.2	77.3	66	80.3	93.8
Dominica	5.7	4.5	5.84	6.93	6.6	7.7	9.1	6.4	23	6.9
Dominican Rep.	2017.1	2372.2	2671.5	3093.9	3397.4	3574.9	4329	4443.1	4282	4384
Grenada	8.09	7.5	8.13	7.3	5.3	3.6	6.5	12.1	19.8	27.1
Guyana	83.63	101.5	90.66	97.85	107.5	109.5	112	135.2	121.8	141
Haiti	284.65	106.9	154.3	58.7	129.8	143.5	188.2	271.8	301.1	297
Jamaica	575.98	598.9	719.67	746.7	846.9	838.6	737.9	753.3	678.9	647.7
Montserrat	2.19	2.46	1.49	1.03	2.1	4.6	5	0.2	0.3	0.2
Neth. Antilles	656.3	645.9	396.5	424.5	288.1	662.5	581.6	307.6	383.3	718.1
St. Kitts-Nevis	15.5	22.8	23.8	21.7	22.4	22.7	29.9	31.9	32.8	36.8
St. Lucia	21.78	28.2	31.34	26.5	35.1	22.3	34.2	22.4	28	22.3
St. Vincent & Gren.	7.51	4.5	4.86	5.44	7.8	6.8	4.3	4.8	8.2	8.8
Suriname	….	….	….	….	100.2	96.6	91.5	106.1	122.9	135.2
Trinidad & Tob.	856.1	861.5	802.7	1109.4	972.2	1016.6	1133	970.9	1293.6	2228.4

Source: United States of America International Trade Commission (USITC), Various Issues

CDCC exports to the United States of America, on the other hand, grew modestly from US$5085.91 million in 1991 to US$7552.4 million in 1997 before declining to US$7311.5 million in 1998. Exports to the United States of America, however, rebounded significantly and reached a high US$9,063.2 million in 2000 (*See Table3*). The fall in exports in 1998 could be attributed to a number of factors. These include the contagion effect of the Asian crisis, which depressed prices of petroleum and primary commodities, reduction in United States sugar quota granted under the Caribbean Basin Economic Recovery Act (CBERA) and natural disasters, particularly the volcanic eruption in Montserrat and Hurricanes George and Mitch, which affected Belize, the Dominican Republic and Haiti, respectively. CDCC's merchandise exports to the United States of America have principally consisted of agricultural products, such as sugar cane and bananas, raw materials, minerals (aluminum ore and concentrates) and petroleum products (mainly from Trinidad and Tobago and the Netherlands Antilles). Caribbean countries have also been diversifying into light manufactures, especially apparel, and this has become a significant export item to the United States in recent years.

Table 4

United States imports under CBERA (1990-98)
('000 US Dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998
CDCC Total	**541,246**	**589,166**	**1,161,286**	**1,040,218**	**1,103,819**	**1,221,922**	**1,387,919**	**1,628,930**	**1,762,356**
Antigua & Barbuda	675	548	324,418	1,110	809	1,683	1,615	521	214
Aruba	4	0	10	21	12	114	138	165	1,779
Bahamas	8,578	10,652	93,324	167,110	45,062	22,855	20,765	25,131	34,914
Barbados	15,198	15,728	15,478	20,177	21,133	23,043	23,088	24,982	20,392
Belize	18,566	5,445	23,732	12,526	13,112	16,676	24,759	34,709	19,706
Dominica	1,330	1,365	1,008	1,293	2,112	2,201	2,504	1,556	1,858
Dominican Republic	311,075	402,507	567,738	657,673	751,028	845,356	932,413	1,136,523	1,294,533
Grenada	2,808	1,307	1,080	144	768	724	1,006	4,070	8,242
Guyana	521	506	1,202	1,246	13,100	17,409	32,284	28,512	24,617
Haiti	63,804	50,053	19,150	33,378	15,770	26,522	30,222	31,193	28,167
Jamaica	60,689	60,080	48,155	76,496	69,316	87,330	95,964	74,515	102,178
Montserrat	0	0	40	271	886	1,488	3,961	4,678	…..
Netherlands Antilles	4,518	5,241	2,963	3,490	3,214	4,468	4,357	3,862	2,775
St. Kitts-Nevis	10,136	5,857	14,172	15,985	17,220	18,776	19,241	24,635	25,428
St. Lucia	3,552	3,195	3,956	4,463	6,077	6,503	7,129	5,262	7,802
St. Vincent & Grenadines	1,518	140	165	233	1,299	2,527	3,579	2,373	3,532
Trinidad &Tobago	38,274	26,542	44,695	44,602	142,901	144,247	184,894	226,243	186,219

Source: United States of America International Trade Commission (USITC), Various Issues

Under the Caribbean Basin Initiative, 24 beneficiary countries in Central America and the Caribbean enjoy duty-free access or reduced rates of duty in the United States of America. The CBI grants zero tariff rate to eight major products, provided 35 per cent value added is in an eligible country. The products which do not enjoy duty preferences from the CBI are: textiles and apparel, certain footwear, canned tuna, petroleum and petroleum products and certain watches and watch parts. However, as an exception to the textiles exclusion, Caribbean countries' apparel exports made wholly from fabric made and cut in the United States enter the United States market under preferential quotas known as the guaranteed access levels (GALs). Certain products, though not eligible for duty-free entry, can enter at reduced rates of duty. These are: leather handbags, luggage, flat goods (such as wallets and portfolios), work gloves and leather wearing apparel.[9] Although the CBI is similar to the United States GSP in many ways, one added advantage of the CBI is that the beneficiary country can satisfy the local-value content requirement when it has 20 per cent local content and the remaining 15 per cent consists of United States-made materials and components.

[9] See United States of America International Trade Commission (USITC), Caribbean Basin Economic Recovery Act: Impact on the United States of America, Fourteenth Report, September 1998, No. 332-227.

Caribbean exports to the United States of America that entered the United States market under the CBI more than doubled, growing from US$541.2 million in 1992 to US$1762.4 million in 1998. The largest exporter under the CBI has been the Dominican Republic, followed by Trinidad and Tobago and Jamaica. The generally weak export performance of most countries clearly highlights the ineffectiveness of CBERA in promoting export-oriented growth and non-traditional exports in the Caribbean Basin countries, in general, and the Caribbean, in particular. Two reasons could be cited to explain the relative ineffectiveness of the programme: (i) the limited number of CBI-country products that benefit exclusively from CBERA preferences, as well as the relatively small margin of preferences the products receive; and (ii) the failure of CDCC countries to effectively diversify into non-traditional exports.

Apart from the GSP and the CBI, Caribbean countries' manufacturing exports also benefit from the United States of America offshore assembly provision, aimed at raising United States competitiveness in response to increased global competition. This has led to the establishment of a major industrial base in the Caribbean, especially in the Dominican Republic, Jamaica and Haiti, involving the assembly of manufactured or industrial components manufactured in the United States, which are re-exported to the United States under reduced tariff. Most of these manufacturing activities are concentrated in textiles apparel. In 1998, for example, CDCC apparel exports under the production sharing programme amounted to US$2747 million, significantly higher than exports under CBERA at US$1762 million. However, three countries account for the bulk of apparel exports under the HTS 9802 programme[10].

Table 5
United States total apparel imports from Caribbean countries 1993-2000
(US$ Million)

Country	1993	1994	1995	1996	1997	1998	1999	2000
Dominican Republic	1435	1593	1758	1775	2235	2358	2355	2451
Jamaica	388	454	531	505	471	422	345	268
Haiti	98	32	76	103	143	225	261	249
TOTAL	1823	2079	2365	2383	2849	3005	2961	2968

Source: United States of America International Trade Commission (USITC), Various issues

[10] These are the Dominican Republic, Haiti and Jamaica.

Table 6
United States apparel imports from Caribbean countries under the production sharing 1995-1998 provision (US$ million)

Country	1995	1996	1997	1998
Dominican Republic	1565	1601	2060	2154
Jamaica	448	437	425	382
Haiti	74	96	134	211
TOTAL	2087	2134	2619	2747

Source: United States of America International Trade Commission (USITC), Various issues

Note: Apparel includes apparel of textile materials, such as cotton, wool, man-made fibre, silk fabric, and non-textile materials, such as fur, leather, and plastics, but non-woven (disposable garments) are excluded.

The Dominican Republic has been the largest exporter of textile and apparel products to the United States under the programme. As can be seen from Table 5, above, the United States of America's total imports of apparel from the Dominican Republic grew from US$1435 million in 1993 to US$2451 million in 2000, accounting for roughly 80.0 per cent of the subregion's exports to that country. Haiti's total apparel exports to the United States, although it remains a small percentage of Caribbean apparel export to that country, have nonetheless grown from US$98 million in 1993 to US$249 million in 2000. Jamaica's apparel exports, however, have been declining through the entire second half of the 1990s. These exports grew from US$388 million in 1993 to US$537 million in 1995 and have been declining since, reaching a low US$268 million in 2000. Around 90 per cent of United States apparel imports from the three countries benefited from 807/9802 programme.

The conclusion of NAFTA with Mexico as a member may have placed the CBI countries at a competitive disadvantage. As a case in point, under NAFTA, Mexico's apparel exports assembled from fabric made wholly and cut in the United States enjoy duty and quota-free access in the United States of America. In contrast, United States import of apparel from the CBI countries made with United States manufactured and cut fabric, although they enjoy preferential quotas under the guaranteed access levels, are subject to duties on the value-added. In addition to duty and quota preferences, Mexican apparel exporters also benefit from generous rules of origin. Furthermore, the devaluation of the Mexican peso during the second half of the 1990s may have also raised the competitiveness of the Mexican apparel export vis-à-vis CBI exporters. According to the United States International Trade Commission (USITC)[11], in the four years before NAFTA became operational on 1 January 1994, United States imports of apparel products from Mexico and the Caribbean Basin countries grew annually at similar rates of 23.0 per cent and 24.0 per cent, respectively. In the post NAFTA period, United States imports of apparel

[11] See, Caribbean Basin Economic Recovery Act, 1995, p.10.

products from Mexico under the production sharing programme recorded a substantial average annual growth rate of 31 per cent, compared with an average annual growth of 16.0 per cent for CBI countries.[12]

NAFTA has had a varied impact on Caribbean countries. Jamaica seems to have been most affected by the competitive position of Mexico. Dominican Republic and Haiti have seen a growth, albeit modest, in their apparel exports to the United States of America. It has been suggested that the relatively high cost of labour in Jamaica, compared with the Dominican Republic, Haiti and Mexico may have partly contributed to the sharp decline in apparel exports. This, coupled with a shortage of labour and the rigidities of labour markets may have prompted companies to relocate to Mexico. Another factor that may explain the differences in export performance between countries is the differences in their response to the competitive pressure coming from Mexico. The Dominican Republic has taken active measures to attract foreign investment[13] into the textile sectors by expanding the free trade zones, offering better tax incentives, and by providing labour training programme as well as streamlining customs procedures. This certainly has contributed to the marked differences in apparel export performance between Jamaica and the Dominican Republic.

To address the asymmetries that have been caused by NAFTA, the United States Government passed into law the Trade and Development Act, which will provide CBI countries with NAFTA parity for certain products, which were exempted from duty-free under CBERA. In addition, the Act provides other trade benefits to CBI countries, including elimination of duties and quotas on certain apparel products made from United States fabrics and yarns. The new agreement is basically an extension of the CBI, to provide preferential treatment for a number of products that were excluded under the former pact. These products include textile and apparel, footwear, handbags and luggage, canned tuna and petroleum products. The prospective benefit to the region stems from the fact that these are products that have already been produced in some countries or which they are likely to produce competitively in the future. The products with the greatest potential for increasing CDCC exports to the United States of America are apparel and petroleum and related products. The Dominican Republic, Haiti and Jamaica will stand to benefit from further elimination of duty on apparel products, while Trinidad and Tobago would benefit from the "NAFTA equivalent tariff treatment" for petroleum and related products. Generally, the new arrangement provides treatment for the Caribbean that is similar to that enjoyed by Mexico under NAFTA.

Caribbean trade with Mexico and Canada remains small in relative terms. Through CARIBCAN, exports of Caribbean Community member countries enter the Canadian market duty-free. Like the United States of America's CBI, certain products such as apparel, textiles, footwear, handbags, methanol and lubricating oils were originally excluded from CARIBCAN.[14] It was not until 1998 that duty-free coverage was expanded to include methanol, lubricating oils,

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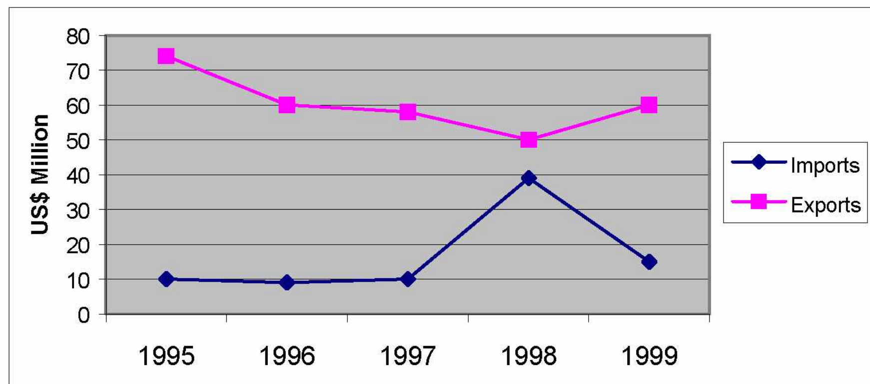
[12] See USITC, Production Sharing: Use of U.S. components and materials in foreign assembly operation, 1995-1998, Publication 3265, December 1999.

[13] The Dominican Republic Government approved, between July and December, approximately US$18 million in business start-ups, of which nine firms were in textile manufacturing.

[14] See UNCTAD, 1998, Generalised System of Preferences: Handbook on the Scheme of Canada, INT/97/A06.

handbags, basket-work and wicker-work. As with United States preferences, Caribbean countries do not seem to have taken advantage of these duty-preferences to the Canadian market. This could be attributed to the limited nature of trade preferences under CARIBCAN, which covers products in which Caribbean countries are not highly specialised. The poor two-way trade performance clearly attests to this. CDCC exports to Canada exhibit erratic patterns, rising from US$425 million in 1995 to US$500 million in 1996 before declining to US$482 million in 1997. It rebounded to US$525 million in 1998 before declining to US$513 million in 1999. This is disappointing given the fact that duty coverage was expanded in 1998 to include products previously excluded from CARIBCAN. Jamaica and Guyana account for the bulk of CDCC exports to Canada, which consist largely of sugar and gold, respectively. CDCC trade with Mexico remains incipient and is accounted for by Trinidad and Tobago. Trinidad and Tobago maintained a positive trade balance with Mexico during the 1995-99 period, with exports averaging US$60.4 million, significantly higher than imports which averaged US$16.6 million (*See figure 2 below*).

Figure 2
Trinidad and Tobago's trade with Mexico 1995-1999



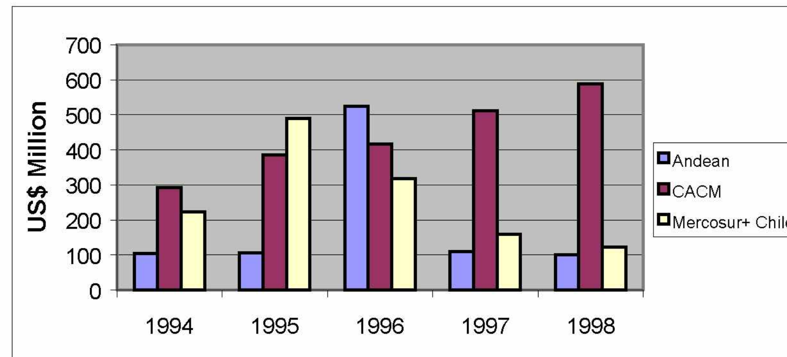
Source: CARICOM, Trade and Investment Report, 2000

CDCC trade with Latin American countries

CDCC trade with the member countries of the Andean Community Grouping - Bolivia, Colombia, Ecuador and Venezuela - has not changed significantly over the 1995-99 period. Except for a huge increase (totalling US$525.2 million) in 1996, CDCC exports have remained relatively static, averaging around US$106.9 million during the period under review. The huge increase in 1996 was attributed to Haiti, whose exports grew, by US$400 million over the value for 1995. Despite the conclusion of the CARICOM-Colombia Trade Agreement in 1995, Caribbean trade with Colombia remained below the level recorded in the pre-agreement period. Although exports to Venezuela recovered from the decline in the latter part of the first half of the 1990s, growth has been sluggish.

Figure 3

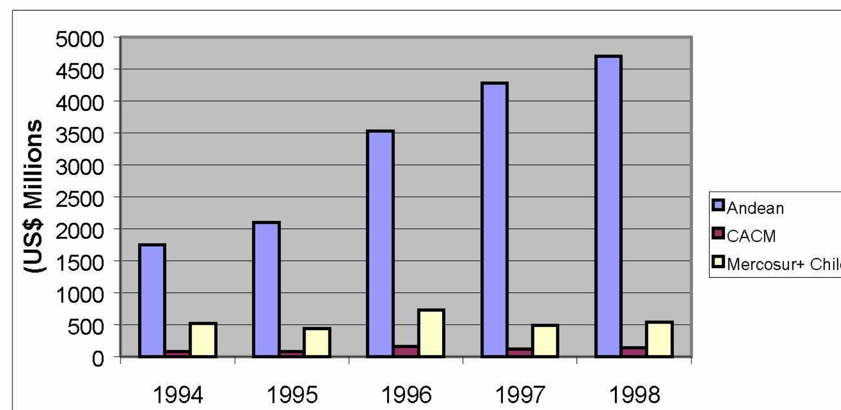
CDCC exports to Latin America 1994-1998



Source: ECLAC/CDCC (LC/CAR/G.592), 1999

Merchandise exports to the Central American Common Market (CACM) countries, however, have seen a substantial increase during the second half of the 1990s, rising by 54.5 per cent from US$381.3 million in 1995 to US$589.1 million in 1998 (the latest year for which data are available). The non-CARICOM CDCC countries, notably the Dominican Republic and the Netherlands Antilles, dominate Caribbean trade with the member countries of the CACM[15]. These countries accounted for an average 57.3 per cent of CDCC exports with the group during the period 1995-98, compared to 42.7 per cent for the CARICOM countries. Trinidad and Tobago remains the largest CARICOM exporter to the CACM countries, particularly Costa Rica. Exports to Costa Rica consist of chemicals and related products, oils and manufactured goods classified chiefly by materials. The modest growth in CDCC exports to CACM stand in sharp contrast to the steady decline in exports to the Southern Cone Common Market (MERCOSUR) and Chile, which decreased from US$490.0 million to US$123.1 million in 1995 and 1998, respectively.

Figure 4
CDCC imports from Latin America 1994-1998



Source: ECLAC/CDCC (LC/CAR/G.592), 1999

[15] The member countries of the Central American Common Market are: Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

The Andean market has been the largest source of CDCC imports from Latin America, accounting for 87.0 per cent of CDCC imports from that region in 1998. Caribbean imports from this integration group more than doubled - growing from US$2099.9 million in 1995 to US$4701.1 million in 1998. Imports from CACM and Mercosur plus Chile remained fairly stagnant during the period under review. Caribbean imports from Latin American countries consist mainly of food and chemicals and related products. In recent times, a number of CARICOM countries, notably Trinidad and Tobago, have initiated trade negotiations with Mexico and Costa Rica and, have expressed intentions to launch negotiations with Panama in the foreseeable future. Close cooperation within the Association of Caribbean States (ACS) has also served to strengthen trade relations between member States of CARICOM and other countries of the wider Caribbean.

As is the case for trade, foreign investment has played a crucial role in production and exchange in the Caribbean from the earliest period of incorporation into the global capitalist economy. Unlike the situation of developed countries where investment quickly became a two-way process (inflows and outflows), in the region there have been little outflows until recent times.

Caribbean countries suffer from a shortage of finance for funding development activities. Net investment inflows, therefore, reflect the excess of domestic investment over domestic savings that is equivalent to the current account deficit of the balance of payments. Capital inflows have played a vital role in offsetting the region's current account deficits. In the last two decades, market reforms, notably privatisation and liberalisation, have led to the transfer of previously nationalised State enterprises into private hands. This has provided the impetus for new foreign investment in these sectors to gain a stake in these industries. Regional governments continue to implement market reforms and to sign on to WTO obligations such as the Trade-Related Investment Measures (TRIMS) in the hope of attracting a greater quantum of long-term developmental investment.

Below average domestic savings levels have reinforced dependence on foreign finance for funding development projects. Savings in the region average around 16-17 per cent of GDP in the last decade, while investment rates have exceeded 20 per cent of GDP. In comparison, in the fast growing Newly Industrialising Economies of Asia, in the last decade, savings have averaged over 30 per cent of GDP. Relatively low savings rates are an important setback, as economists have proposed that the region needs a savings rate of about 25 per cent of GDP, or more, to promote self-sustaining growth and to substantially reduce unemployment (see, for instance, Nicholls, 1995).

Foreign direct investment continues to be the predominant form of foreign investment in the region. FDI entails the acquisition by investors of long-term real assets abroad. This usually entails a significant stake in the management and control of the foreign enterprise (manufacturing enterprise, mines, farms etc). The Caribbean has never been an important recipient of another type of investment inflows, that is, portfolio flows. Portfolio equity investment, unlike FDI entails the ownership of short-term share capital in an enterprise or entity without any real stake in management and control. Portfolio investments are usually financial investments that are motivated by quick returns on assets. Unlike emerging markets, which have

attracted significant portfolio flows, Caribbean equity markets are underdeveloped and have received little attention from portfolio investors. In any case, since this type of investment does not make much of a contribution to development and is highly speculative in nature, resulting in current account instability, the region needs to be wary of such inflows.

Total net FDI flows to the Caribbean increased from around $659 million in 1990 to $3,465 million in 1999 *(see Table 7 below)*. Meanwhile, average annual net inflows expanded from $37 million in 1990 to $197 million in 1999 *(see Figure 5 below)*. Consistent with the resurgence of FDI flows to developing countries, flows to the Caribbean recorded average growth of almost 5 per cent per year over the decade. The relative size, economic structure and the extent of economic reforms led to significant disparities in inflows to different economies. Economic liberalisation, transparency of the investment regime, competitiveness and underlying structural conditions such as the efficiency of customs, infrastructure and legislative systems all played a part in determining the attractiveness of countries to profit-seeking investors.

Table 7

Net foreign direct investment inflows to the Caribbean during the 1990s (US$ millions)

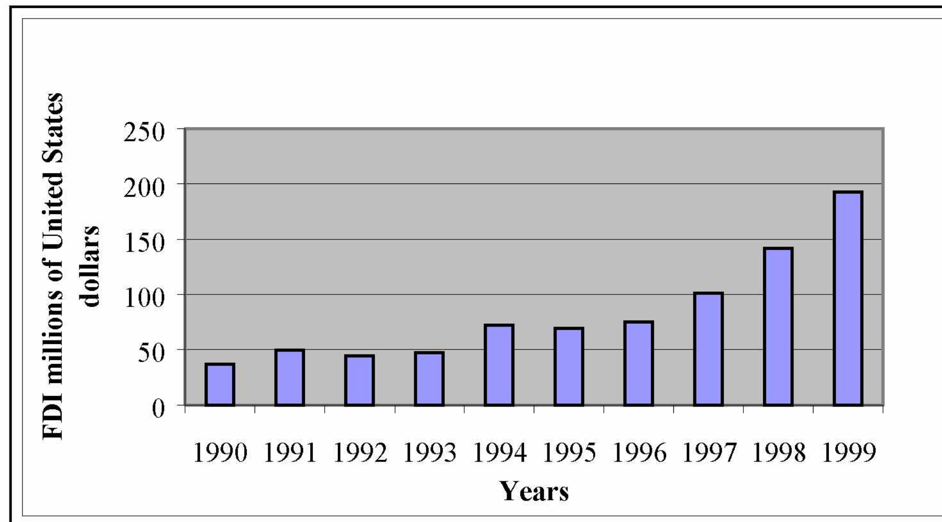
OECS Countries	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**Av. 90-99**
Antigua and Barbuda	61	55	20	15	25	31	19	28	26	12	**29**
Aruba	131	185	-37	-18	-73	-6	84	196	84	392	**94**
Bahamas	-17	-1	40	11	22	10	11	17	147	145	**39**
Barbados	11	7	14	9	13	12	22	18	16	15	**14**
Belize	17	14	16	9	15	21	17	12	18	-7	**13**
Cuba	1	10	7	3	14	9	12	13	30	15	**11**
Dominica	13	15	21	13	23	54	18	21	11	13	**20**
Dominican Republic	133	145	180	225	360	404	394	141	700	1338	**402**
Grenada	13	15	23	20	19	20	18	22	51	43	**24**
Guyana	8	13	147	70	107	74	81	90	47	48	**69**
Haiti	8	-2	-2	-3	7	7	4	5	11	30	**7**
Jamaica	138	133	142	78	170	245	273	137	369	524	**221**
Netherlands Antilles	8	33	40	11	22	10	11	17	151	70	**37**
St. Kitts/Nevis	49	21	13	14	15	20	17	25	34	77	**29**
St. Lucia	45	58	41	34	32	30	23	45	84	87	**48**
St. Vincent/Grenad.	8	9	15	31	47	31	18	42	28	25	**25**
Suriname	-77	19	-54	-47	-30	-21	7	-9	9	5	**-20**
Trinidad/Tobago	109	169	178	379	516	299	320	1000	730	633	**433**
Total	**659**	**898**	**804**	**854**	**1304**	**1250**	**1349**	**1820**	**2546**	**3465**	**1495**

Source: ECLAC, based on national data

Generally, there seems to be positive correlation between the degree of economic liberalisation and FDI inflows. Those countries that undertook the most progressive and wide-ranging reforms and structural adjustment were able to attract more FDI inflows than their less-open counterparts. Indeed, this is to be expected as market-oriented reforms, bilateral investment treaties and the removal of a number of barriers to trade and investment have had a positive impact on capital and trade flows. Notably, FDI inflows to Cuba posted rather strong growth of over 100 per cent per year over the decade. Although the process is nascent, Cuba has undertaken some economic reforms and adjustment, including the partial liberalisation of the trade and investment regime and decentralisation of decision-making since 1990. These changes have provided an important incentive to foreign investors, notably from Spain. In Cuba, FDI inflows were concentrated in tourism, mining, telecommunications and manufacturing, particularly building materials, lubricants, food and tobacco.

Figure 5

Total average net foreign direct investment inflows to the Caribbean 1990-1999



Source: ECLAC, based on national data

FDI inflows to leading reform economies, including the Dominican Republic, Trinidad and Tobago and Guyana, registered particularly strong growth, reflecting strong investor confidence in their policy regimes. Inflows to Guyana grew on average by over 100 per cent, from a fairly low base, and averaged $69 million over the decade. FDI, by sector, in Guyana mirrored the dichotomy between macroeconomic reforms and structural transformation of the economy. Although Guyana has done much to correct macroeconomic imbalances, the economy remains centred on the exploitation of natural resources. Macroeconomic reform has been accompanied by little structural change of static production systems. Therefore, the bulk of capital inflows went to resource-based activities such as bauxite, gold and forestry, along with light manufacturing, including clothing and seafood production.

In the Dominican Republic, FDI inflows recorded rather robust average growth of over 61 per cent per year over the 1990s, while for Trinidad and Tobago, the rate was over 38 per cent. FDI inflows into the Dominican Republic might have been sub-optimal in terms of its contribution to growth and development because the bulk of the flows were to low value-added activities. The reality is that much of the resurgence in FDI inflows to the Dominican Republic was linked to the dynamism in the Free Trade Zones (FTZs), which were engaged in the production of low end textiles and apparel, footwear and electronic goods, medical and electrical products. The greater part of manufacturing FDI in the Dominican Republic has been directed to the FTZs, which are the second largest foreign exchange earner for the country. In 1999, for instance, the FTZs in the Dominican Republic produced annual net exports of over $1.35 billion and employed over 200, 000 workers.

The experience of Trinidad and Tobago was mixed. It reflected growth in both the traditional petrochemical sector and diversification into downstream activities and non-oil manufacturing. In this respect, FDI inflows have led to some dynamic restructuring of specialisation and production. Although the lion's share of flows has gone to the petrochemical subsector, the exploitation of significant deposits of natural gas (that led to lower energy costs) plus the use of improved technology and restructuring of production have led to renewed dynamism in the non-oil manufacturing sector. Output growth and exports have been fairly dynamic in a number of subsectors, including food and beverage, chemicals, printing and packaging and metal processing. To strengthen diversification efforts, government also plans to promote information technology and electronics to capture a sustainable niche in these fast growing sectors. Jamaica also received significant inflows of FDI - an annual average of $204 million over the decade or roughly 12 per cent of the total average for the region. Similar to the Dominican Republic, a large part of the flows to Jamaica were directed to relatively low value-added production in the FTZs.

OECS countries also recorded strong growth in net FDI inflows. Growth in inflows to the subregion averaged over 10 per cent, ranging from about 15 per cent in Saint Lucia to over 27 per cent in Saint Vincent and the Grenadines. As for the other countries of the region, inflows were linked to comparative advantage, specifically tourism, light assembly-type manufacturing and agriculture. Reflecting its importance as a foreign exchange earner, tourism attracted the bulk of FDI inflows. Between 1997-99, for example, almost all of the inflows to Saint Vincent and the Grenadines were to the tourism sector, while for the other countries tourism's share ranged from 50 per cent in Dominica to 83 per cent in Anguilla. In the Windward Islands (where the banana industry continues to be an important export earner and employer) except Grenada, agriculture attracted little or no FDI inflows. The limited scope of the manufacturing sector in the OECS countries was reflected in the limited inflows into the sector. Only Grenada and Dominica attracted any real inflows into that sector over the three-year period.

There was an average upward trend in FDI inflows in the 1990s. Total average FDI inflows increased from $32.5 million in 1990 to over $194 million in 1999. Steady growth was interrupted in only two years, in 1996 when inflows declined to $83.7 million from $98.6 million in 1995 and in 1998.

The origin of FDI inflows to the region continued to reflect the historical factors that have influenced its insertion into the world economy. The United States of America remains the dominant foreign investor with investments in a range of activities. Highlighting the importance of services in 2000, over 80 per cent of United States direct investment to the Caribbean, including Bermuda and the Cayman Islands, was in financial institutions[16]. A significant part of these inflows went to offshore financial institutions. Another 4 per cent was in wholesale trade, almost 4 per cent in other services and about 12 per cent went to the mineral and other sectors, except manufacturing. Importantly, only over 1 per cent was directed to manufacturing activities, including chemicals, industrial and transport equipment manufacture. With the opening up of the telecommunications and other sectors in the region, FDI in services could become even more important.

Fortunately for the region, much of the FDI is in the form of equity capital, some of which is in new 'green-field' activities. For Belize, equity investments accounted for almost 80 per cent of total FDI between 1992 and 1999; while the ratios for Trinidad and Tobago and Guyana were 44 per cent and 16 per cent, respectively. New equity investments are clearly needed, especially in telecommunications, informatics, other services and agro-processing to diversify the economies and to create new bases for employment and foreign exchange generation.

IV. The drivers of trade and investment flows

In the Caribbean, as in most other developing countries, trade complements FDI in some activities, and replaces it in others. Most traditional FDI inflows in primary activities, such as sugar, bananas, tobacco, timber, oil and bauxite, have been aimed at increasing trade in these products. In fact, in earlier decades when the trade regime was fairly restrictive, "tariff-jumping" FDI was often the preferred mode of operation in the Caribbean as in other developing countries (Blomstom and Kokko, 1997). In this respect, patterns of trade and FDI have reinforced the international division of labour and technology - where developing countries specialised in the production of primary products and imported largely manufactured goods. The East Asian Newly Industrialized Countries (NICs) have shown that the division of labour and specialisation could be quite dynamic if countries implement strategies to build dynamic comparative advantage in sectors that are on the upswing of the production cycle.

During this phase of globalisation, FDI has increasingly reflected strategic decisions by multinational corporations and other firms to locate production in countries and regions to capture a number of dynamic advantages. These advantages include skilled labour and high quality infrastructure, including transportation and telecommunications systems. These integrated production systems mean that TNCs actively seek to locate components in the value-added chain in countries where they can maximise competitiveness and profitability.[17]

[16] See US Department of Commerce data 2000.

[17] See UNCTAD, "FDI Determinants and TNC Strategies: the case of Brazil", United Nations, Geneva, 2000.

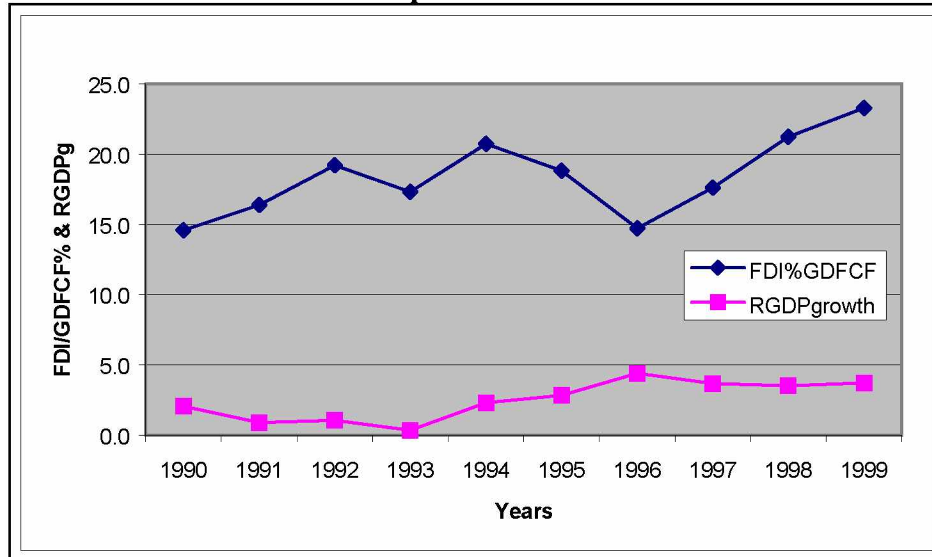
In the Caribbean, much of the FDI inflows have been either of the natural resource-seeking or efficiency seeking type that is motivated by low labour cost. Small markets mean that there is little market-seeking FDI, as in Latin America or strategic asset-seeking FDI that is driven by research and development capabilities, skilled labour and high quality infrasturcture. Since the region as a whole has not developed an adequate technological base or a highly skilled industrial workforce, FDI has often been attracted by natural resources, cheap labour and political stability. The classic case of the cheap labour costs based investment is to be found in the FTZs in the Dominican Republic, Jamaica and Haiti. However, a few countries, including Jamaica, Saint Lucia and St. Kitts and Nevis have been able to enter the market for the outsourcing of somewhat higher value-added component parts. This has entailed the production of parts for aircraft, automobiles and other electronic components under licence or direction from the parent TNC. The advantage for the TNC is that a rigorous system of standards is implemented to ensure that products meet international performance benchmarks and labour costs are a fraction of those costs in developed countries.

V. Trade and foreign investment, accumulation and growth in the Caribbean

In the Caribbean, in particular, foreign investment has long been viewed as an important means to an end - that is, economic growth. However, the extent to which foreign investment contributes to growth and accumulation depends on how far this type of capital contributes to aggregate savings and investment in the region. It has been well established in the literature that growth in investment in productive activities contributes to economic growth. In the context of the Caribbean, the potential growth inducing effects of foreign investment stem not only from the higher levels of finance capital, but also technology transfer, management skills and human resource development. It is useful to ask to what extent economic reforms and growth in foreign investment contributed to real growth in output? FDI stimulates real growth by raising investment rates where savings rates are low, provided the investment is in productive activity. Some indication of the effect of FDI on growth can be provided by an assessment of the contribution of FDI to total domestic fixed capital formation. All other things being equal, increasing ratios of FDI to gross domestic fixed capital formation in the context of rising growth rates might suggest that FDI is acting as a stimulus to growth. However, as Figure 6 below illustrates, FDI as a percentage of GDP and real GDP growth rates have generally moved in opposite directions for the region over the 1990s. The graph is illustrative of the possible lagged effect of investment, but it could also indicate that the period is relatively short, also the real impact of FDI on growth is through aggregate total investment and the impact of FDI might be masked by domestic investment.

Figure 6

Average ratios of FDI as percentage of gross domestic fixed capital formation and average real GDP growth rates for the Caribbean for the period 1990-1999

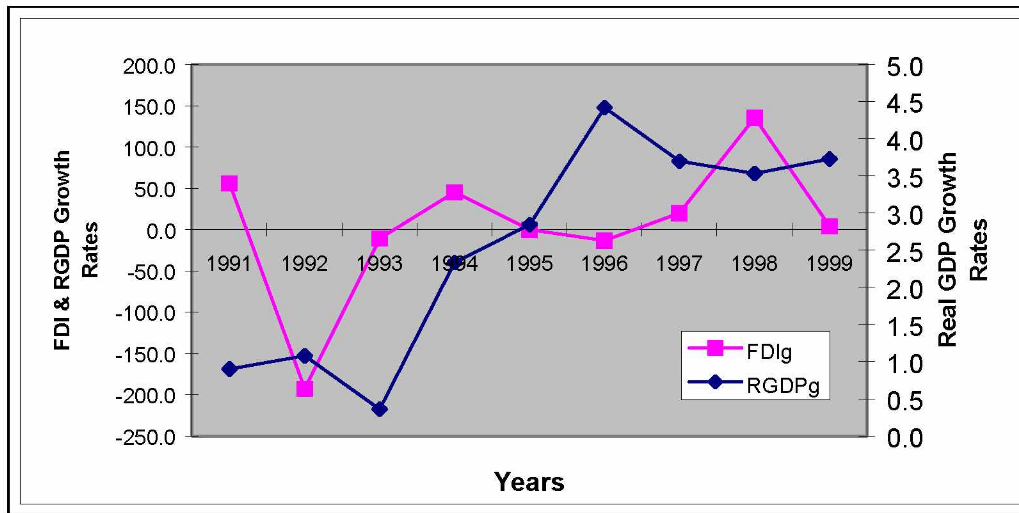


Source: ECLAC, based on national data

Since FDI is quite important for financing productive activity in the region, the relationship between growth in FDI inflows and real GDP growth could provide some indication of the link between inflows and growth. Figure 7 below shows that growth in FDI inflows and growth in real output moved in tandem between 1992 to 1995, but diverged for the rest of the decade. This is just a crude graph and is not intended to provide any indication of causality. However, although it accords with theoretical expectations for the period 1992 to 1995 it is somewhat surprising that it does not for the latter half of the decade when FDI inflows were much higher. This suggests that even though inflows were higher, the productivity of this investment was probably fairly low and the activities that attracted the bulk of the flows were fairly low value added activities. In fact, this was the case for a significant portion of inflows that went to the FTZs in the Dominican Republic and Jamaica.

Figure 7

Growth rates of FDI and real GDP for the period 1990-1999



Source: ECLAC, based on national data

VI. The impact of policy on trade and investment flows

Policy reforms that have improved openness and competition in the Caribbean economy have had a favourable impact on trade and investment flows. Caribbean countries have traditionally used investment incentives to make their environments more attractive to foreign investors. Earlier incentives included the provision of industrial estates, tax concessions of up to 15 years in some countries and accelerated depreciation allowances to import substituting foreign firms. In the last two decades, however, the region has pursued an export-led growth model. Two important planks of this model have been trade and investment liberalisation and market oriented economic reforms. Within CARICOM, the phased tariff reductions under the CET have strengthened trade liberalisation in the region. In addition, quotas and other non-tariff barriers have been eliminated on almost all products. Indeed, the Caribbean has been found to match the average international trend in trade openness.[18]

The region has also implemented a number of measures to improve the openness of their investment regimes. Important among these are the adoption of bilateral investment treaties that guarantee national treatment and the elimination of most restrictions on capital and the repatriation of profits, the use of international arbitration and dispute settlement. Moreover, these policy reforms have remained consistent over time, providing the kind of stability that is conducive to sustained FDI inflows. CARICOM has enacted a joint agreement for the regulation of third country investment. Also, the larger countries, such as the Dominican Republic, Jamaica and Trinidad and Tobago, have made some liberalisation commitments in banking services.

[18] See World Bank (2000), "Caribbean Economic Overview".

OECS countries have made commitments under the General Agreement on Trade in Services (GATS) in hotel construction and management; and also in recreational and sporting facilities and reinsurance, with the exception of St. Kitts and Nevis. Commercial presence is also open to foreign investors in most service areas in an effort to promote FDI in the crucial services sector. Importantly, the countries are pursuing a telecommunications reform strategy to liberalise the sector and encourage competition in the sector. An agency, the Eastern Caribbean Telecommunications Authority (ECTEL) has been created to regulate the industry. This liberalisation has two advantages. First it should lower telecommunications costs and improve service quality, thereby facilitating the development of information-based industries. Secondly, it could lower the cost of production of other activities, for example, tourism and light manufacturing since service costs are a major part of total cost for producers. Even though the trade regime of region is still more liberalised than its investment regime, the latter is catching up fast.

The final text of the FTAA Agreement on Investment will influence investment strategies. Changes in policies and strategies will affect investment flows to the Caribbean. The current draft agreement promotes standard principles and practices, including most favoured nation status, national treatment, arbitration and dispute settlement mechanisms. National treatment stipulates that each party shall grant investors of another party treatment that is no less favourable than that which it accords its own domestic investors. The most-favoured-nation clause obliges contracting parties to grant to investors of other parties treatment that is no less favourable than that granted to its most favoured third party. Of importance to Caribbean States is that Article 1 makes provision for the exemption of certain sectors in smaller economies from some of the clauses of the Agreement. Where these sectors are important exporters, any derogation could provide temporary protection for them to strengthen their competitiveness. However, some analysts are of the view that the region should not focus too much on exemptions, but prepare to face open competition. In a sense, this is an extension of the principle of treating any respite as temporary. This would entail making the necessary structural changes to face external competition for investment in various activities.

VII. Implications of the FTAA for the trade and investment

It is difficult to assess adequately the implications of the FTAA for trade and investment flows between the Caribbean subregion and the rest of the western hemisphere. This stems from the fact that negotiations are still under way and are fraught with uncertainties, partly the result of a slow decision-making process. Moreover, the draft text of the FTAA Agreement is available in the square bracketed format, indicating that divergent views still exist on virtually all the substantive subject areas. However, on the basis of the available draft reports and various ministerial reports, as well as from reading several negotiating positions that have been submitted, inferences could be drawn on the probable implications of the FTAA for trade and investment flows between the Caribbean and the rest of the region.

When finally concluded, the FTAA will establish a free trade area comprising the 34 countries of the western hemisphere (excluding Cuba), thereby progressively eliminating barriers to trade and investment. That means that member countries will be required to eliminate barriers

to trade with partners in the FTAA, while pursuing separate trade policy towards third countries. That means each member country shall grant national treatment to originating goods imported from member countries of the FTAA in accordance with Article III of the General Agreement on Tariffs and Trade (GATT). The FTAA will have far-reaching implications for many countries. As with any trade liberalisation agreement, the FTAA will inevitably create winners and losers.

Traditional trade theories postulate that free trade agreements generally produce two effects: first, they shift the source of trade from the low-cost efficient producers to the lowest-cost Free Trade Agreement (FTA) member country. This is the familiar trade diversion effect. The second effect is to create trade by allowing the high-cost inefficient producers to take advantage of free trade.[19] Now, whether or not the FTAA will be beneficial to member countries depends on the relative strengths of the forces of trade creation and trade diversion. For smaller countries, the benefits from the FTAA are expected *ex ante* to be greater than for larger countries.[20] This is due to the fact that the size of trade flows to be liberalised as a result of the conclusion of a free trade agreement tends to be large, relative to the overall size of a small economy. From this, an *ex ante* assessment of the implications of the Free Trade Area of the Americas for the Caribbean countries would tend to lead to the conclusion that, on balance, the agreement should be beneficial to them. As indicated in the previous section on trade and investment flows, bilateral trade flows between the Caribbean countries and NAFTA, the Andean Community, CACM and MERCOSUR amounted to approximately US$19.5 billion in 1998, with imports amounting to US$14.8 billion, significantly higher than merchandise exports at US$4.6 billion.[21]

The Caribbean countries' trade is heavily concentrated in the United States of America which accounts for more than 50 per cent of the subregion's trade with the western hemisphere. CDCC's exports generally face relatively less protection in the United States and Canada, since they benefit from a combination of MFN duty-free tariffs, various GSP schemes and preferential treatments under special arrangements. For example, around 25.0 per cent of total CDCC exports entered the United States market duty-free under the CBI in 1998. To this must be added another 26.4 per cent of Caribbean Basin countries' exports to the United States that entered under the production sharing programme (HTS 9802), formerly the 807 programme. Given this, it would seem that the benefits in terms of market access into the North American market would not be significant for the Caribbean countries. However, it must be emphasised that only a limited number of products are eligible for duty preferences under CBERA. Some sectors, notably agriculture, textile and clothing, are still heavily protected in the North American market. For example, the post-Uruguay Round average bound tariff on textile and clothing is 12.4 per cent for Canada and 9.0 per cent for the United States of America. The simple average post Uruguay

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[19] See for example Markusen, J. R and Melvin, J.R (1988), The Theory of International Trade, Harper & Row Publishers, New York.

[20] For full discussion of the implications of trade liberalisation for small developing countries see Michael Michaely and Demetris Papageorgiou (1997), " Small Economies: Trade Liberalisation, Trade preferences and growth, A paper presented at the Conference," Caribbean Quest: Directions for the Reform Process", 25-26 June 1997, Port-of-Spain, Trinidad and Tobago.

[21] See ECLAC/CDCC, "Recent Trade Performance of CDCC Countries" (LC/CAR/G.592), Port of Spain, Trinidad and Tobago, 1999.

Round bound tariff for agricultural products is 8.8 per cent for Canada and 9.0 per cent for the United States of America.[22] This, coupled with tariff peaks and other non-tariff barriers, such as domestic support measures, safeguards and phyto-sanitary measures, impede trade, particularly in agricultural products.

Therefore, across the board liberalisation of trade, in general, and agriculture, in particular, would lead to increased trade flows between the Caribbean and the United States and Canada. The potential benefits are expected to be greater for agricultural products. This is consistent with the findings of a study[23] on the impact of the FTAA based on the results of a Computable General Equilibrium (CGE) model, that changes induced by the FTAA would be larger for agriculture than for manufacturing. It further reveals that, in terms of percentage increase in agricultural output, the gains will be greater for small Central American and Caribbean countries, followed by the Andean countries.

The way in which the FTAA might affect trade between the Caribbean and other Latin American countries is very difficult to predict. However, given the currently low level of trade flows between these countries, and also taking into account the recent growth in CDCC trade with Latin America, leads one to conclude that there is room for increased trade flows. Bilateral trade between the Caribbean and Latin American countries faces high trade barriers.[24] Average tariff rates in Latin America and the Caribbean, although they have fallen significantly during the 1990s are among the highest in the hemisphere. For example, average tariff rates were 14.9 per cent, 14.1 per cent and 13.1 per cent for Brazil, Argentina and Mexico, respectively.[25] In addition to this, tariff peaks are also significant in the region. It is estimated that approximately 22 per cent of tariff lines in the CARICOM subregion attract rates above 20 per cent. Therefore, progressive elimination of trade barriers might lead to increased trade flows between the Latin American and Caribbean countries. Already, Caribbean trade with the Latin American countries, although it remains small, has grown during the 1990s. For example, CDCC imports from the Andean Group grew substantially from US$1140.8 million in 1990 to US$4701 million in 1998. CDCC exports to the CACM bloc have also grown from US$105.4 million in 1990 to US$589.1 million in 1998. However, this is accounted for by few countries, most notably Trinidad and Tobago and Jamaica. What this figures show is that the Caribbean countries have been running persistent trade deficits with Latin America. To take advantage of market opening opportunities as a result of the implementation of the FTAA, Caribbean countries will need to continue restructuring and diversifying their production so as to achieve increased dynamic efficiency and competitiveness.

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[22] See WTO, 2001, "Market Access: Unfinished Business", Geneva.

[23] United States of America Trade Representative (USTR), Report of the Quantitative Analysis Working Group to the FTAA Interagency Environment Group, October 2000, at http//:www.ustr.gov/regions/whemisphere/ftaa.

[24] Trade between CARICOM and Venezuela and CARICOM and Colombia may be subjected to relatively low barriers as a result of the implementation of trade agreements between CARICOM and Colombia and CARICOM and Venezuela.

[25] See Robert Devlin, Antoni Estevadeordal and Luis Jorge Garay, 1999, "The FTAA: Some Longer Term Issues", Intal ITD, Occassional Paper 5.

While the literature suggests that the benefits of the FTAA might be greater for the small countries, this might not be the case. Further, it is also true that the adjustment costs to the new emerging hemispheric trading dispensation would be larger for the smaller islands of the Caribbean. Therefore, the actual benefits from the FTAA hinge on whether these countries manage to optimise the benefits from such a free trade area while minimising the adjustment costs. The transitional costs of adjusting to the FTAA would be more formidable for the smaller Caribbean countries, especially the countries of the OECS. This is so for several reasons, including the concentration on a narrow range of primary commodities coupled with the relatively small size of firms involved in production, which make it difficult for firms to change the composition of their products due to the small market. Another factor that compounds the adjustment process in these countries is the fact that they have developed on the basis of trade preferences despite being high cost and inefficient producers. All these preferential trading arrangements will have to be abandoned as they are incompatible with the FTAA. This will lead to the erosion of trade preferences that are presently enjoyed by the Caribbean countries. The FTAA will expose them to increased competition from low-cost efficient producers**.** The adjustment process will have implications for employment and income distribution, with those sectors that become competitive, increasing their employment and profits, while those that remain stagnant losing their market share and employment. Another adjustment cost of the Free Trade Area of the Americas relates to the loss of fiscal revenue as a result of reduction or elimination of duties. Although trade liberalisation may also have revenue implications for larger countries, this problem is more acute in the smaller island countries of the Caribbean due to the heavy reliance on international or trade taxes for budgetary operations. These taxes account for nearly 60 per cent of current revenue for the smaller OECS countries.[26] Added to such costs are the countries' vulnerabilities inherent in small size such as limited diversification; lack of economies of scale due to small markets; higher transportation costs due to small volume; and the perennial problem of natural disasters. All these factors make the adjustment to the new hemispheric trading dispensation excruciatingly difficult for the Caribbean countries.

To help the Caribbean countries adjust to the FTAA, it is extremely important that they are granted derogation from certain obligations and are granted, as well, special and differential treatment in the form of longer transitional periods for implementing their FTAA obligations. Technical and financial assistance must also be provided to enable them to implement the necessary changes required for the FTAA. Without special and differential treatment and technical assistance, the FTAA will inevitably lead to asymmetries in the distribution of gains. Therefore, special and differential treatment should be accorded to the smaller countries in order to enable them to participate in the FTAA and maximise the benefits therefrom.

If special and differential treatment is provided to smaller economies, especially Caribbean and Central American countries, it very likely that those countries which move most quickly to strengthen their competitiveness in textiles, electronics and component parts sugar and cigars will benefit the most from it. Further, special and differential treatment is likely to take one of three forms. These are as exemptions from some of the more stringent trade, investment, competition policy and other measures, or as the granting of a longer phase in periods to implement commitments or, finally, as a combination of both.

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[26] See ECLAC/CDCC, (1999), The Fiscal Covenant: Strength, Weaknesses, Challenges-A Caribbean Perspectives, Port-of-Spain, Trinidad and Tobago.

Special and differential treatment is most likely to take the form of longer phase-in periods. If this is indeed the final outcome, Caribbean countries are likely to gain only a temporary reprieve from the onslaught of full competition from other member countries. In that case, the more competitive activities in the region, including tourism, petrochemical products in Trinidad and Tobago and offshore financial services should be able to withstand competition and maintain market share. Investors are also likely to use the transitional shelter to increase investment in these activities in the hope of pre-empting future competition. The impact on the Caribbean as a whole will depend on the extent to which the FTAA strengthens the openness and competitiveness of the economic environment and also the extent to which the region develops locational advantages based on skilled labour and quality infrastructure. Some Caribbean investors, notably in the banking sector have been trying to strengthen competitiveness in the regional market through cross-border mergers and acquisitions[27].

The pattern of efficiency-seeking investment in the Dominican Republic and Honduras under the CBERA, for example provides an indication of the potential impact of special and differential treatment in the FTAA. CBERA has provided disparate benefits for countries in Latin America and the Caribbean. The Dominican Republic, Costa Rica, Guatemala and Honduras were the main beneficiaries of the CBERA, accounting for over two thirds of United States imports from the region under the trade pact. The main products to benefit include cigars, medical instruments, leather footwear uppers, raw cane sugar and jewellery products. These countries should be able to maintain market share in the United States within the FTAA since they have developed advantages that put them ahead of potential competitors. The extent to which these and new activities are able to withstand more intense competition after the transition period would depend on the extent of adjustment and restructuring of these activities during the transition period. The scenario is similar for the Cotonou Agreement that succeeded the Lomé IV Agreement.

The impact of the FTAA on investment flows to and from the Caribbean will be similar to those for trade in some activities, but different in others. For cost-based investment is likely to follow trade patterns, while market-seeking investment, because it is import-substituting, will not follow trade patterns. It is expected that most investment would tend to be aimed at promoting trade, given the small size of the regional market. Enclave manufacturing of electronic components and machine parts and textiles in the Dominican Republic and Jamaica would continue to be based on production costs. However, if the region can develop competence in the area of skills, infrastructure and administrative efficiency it could attract high quality activities in telecommunications, informatics and tourism. Also, if commendable progress is made in deepening the CSME, this could act as an incentive for investors in the FTAA which would then perceive that there are better opportunities to capture economies of scale, given the expanded size of the regional market.

At the sectoral level, individual sectors will benefit depending on the extent to which they were liberalised before the FTAA. The experience of most integration agreements, including NAFTA and MERCOSUR has shown that those sectors that were least liberalised before the

[27] The Royal Bank of Trinidad and Tobago currently has subsidiaries in a number of other Caribbean countries, including the OECS, Curacao, St. Maarten and Aruba. Its average shareholding in these subsidiaries is over 50 per cent.

agreements tend to benefit most from the FTA (Blomstrom and Kokko, 1997). This is so because the FTA reduces the transactions and institutional costs of operating in these activities. In the Caribbean, sectors such as telecommunications and agriculture are likely to benefit from FDI inflows, since they are not as open to competition as tourism and other activities. Of course the extent to which any sector benefits will depend on its level of adjustment and reform to meet the competition, dynamic changes in demand for its products and the strategy of investors.

In the economic literature, it is well established that similarity in the production and exporting patterns of countries in an integration grouping can be used as a yardstick of trade diverting effects.[28] The more similar the trade patterns of two countries, the more intense the competition between them is likely to be, and the greater the potential for trade diversion, rather than trade creation. Given the small market size in the Caribbean, FDI inflows tend to complement trade flows, since capital flows are geared towards production for the export market. This indicates that trade creation and diversion effects tend to be reflected in similar patterns for investment flows.

The extent of investment creation or diversion from the Caribbean arising from the FTAA will depend on the motive of investors, relative advantages of other countries (in terms of skilled labour, infrastructure, quality control and research and development) and competition. It is beyond dispute that the Caribbean cannot compete with countries such as Mexico, Guatemala and Honduras in the production of low technology and cheap labour goods such as textiles, footwear and assembled-parts. It is likely that the Caribbean may lose market share in investment in these types of activities to its Latin American counterparts. There are indications that Mexico benefited under NAFTA through the diversion of FDI from some Caribbean countries, including Jamaica, in labour intensive textile and other activities. However, with the FTAA providing a uniform tariff structure, Caribbean countries that are able to strengthen their price and quality competitiveness could gain niches in some of these activities.

Countries, such as Trinidad and Tobago, that have undertaken fairly deep restructuring of their production systems are likely to benefit the most from the FTAA. It is quite possible for joint arrangements to be pursued with countries, such as Brazil and Colombia, in the exploration and production of natural gas and petrochemical products. Meanwhile, the OECS, Jamaica and Barbados are likely to deepen their specialisation in services, especially tourism, financial services, telecommunications and other services. This is likely to stem from intense competition in their nascent manufacturing sector, which might not be able to compete, owing to its low relative productivity. With respect to investment flows by regions, it is not anticipated that Latin American countries would become important investors in the Caribbean in the medium term. This is because it would take time to improve transport links, to create the institutional architecture and to bridge the cultural gap.

Also essential to the evolution of investment flows to the Caribbean in the context of the FTAA is the effect the agreement will have on investors from third countries, such as the EU. Important in this respect is that the FTAA could strengthen the perception of credibility of the reform process in the Caribbean. EU, Japanese and other investors might perceive that the

[28] See "Impact of Enlargement on the European Union on Small and Medium sized Enterprises in the Union", EPRC, November, 2000.

FTAA can 'lock-in' the reforms in the region and this could boost investment from these regions. In the event of this, Caribbean countries can benefit from dynamic gains in terms of improved economies of scale, technology transfer and efficiency in production. The scope that the FTAA offers for capturing these dynamic gains is potentially the most beneficial aspect of the Agreement for the region.

Conclusion

The Caribbean's trade and investment still remain heavily concentrated with the United States of America, which account for approximately two thirds of total CDCC trade with the western hemisphere. This has been influenced by the CBI, which grants duty preferences for a number of products originating from the CBI countries. CDCC exports to the United States grew by 17 per cent to US$9063 million in 2000. Exports under the CBI programme grew faster by 51.8 per cent from US$1161 million in 1992 to US$1762 million in 1998, the latest period for which data are available. In addition to the CBI benefits, CDCC exports to the United States also benefit from the production-sharing programme of the United States tariff code 9802. Under this programme, manufactured exports assembled from fabric made and cut in the United States enter the United States market at reduced rates of duty. United States apparel imports from the Caribbean have increased from US$2365 million in 1995 to US$2961 million in 1999. The largest beneficiary from this programme has been the Dominican Republic whose apparel exports grew by 34 per cent between 1995 and 1999. Apparel exports from Jamaica, however, contracted by 35.0 per cent to US$345 in 1999. CDCC trade with Canada and Mexico has not seen a significant increase during the period 1995-99.

Trade with Latin American countries, although it remains relatively small, has increased considerably during the period under review. Of the Latin American integration groups, trade flows are the strongest with the Andean Community. The Andean Community, especially Venezuela, has become a significant source of imports for Caribbean countries. Trade and investment flows between the two subregions remained heavily constrained by relatively high trade barriers. The proposed FTAA is expected to lead to progressive liberalisation of trade barriers across the western hemisphere. This may stimulate trade and investment flows in some activities between the Caribbean countries and the rest of the western hemisphere. However, losses are also expected in others, due to import competition and the failure to adjust to new market realities. The net benefits for the region will depend on whether trade creation and dynamic gains from economies of scale and scope outweigh trade diversion.

There has been a resurgence of investment flows to the region over the last decade. In keeping with the upsurge in world FDI inflows, inflows to the Caribbean increased by roughly 5 per cent per year over the decade. Within the hemisphere, the United States of America remains the dominant foreign investor in the region, followed by Canada. The bulk of the United States investment goes to the financial services sector, reflecting the sharp growth in importance of off-shore financial services, and the overall transformation of most economies from goods-based to services-based economies. However, off-shore financial services are now under serious threat in the wake of the terrorist attack on the United States and calls for enhanced prudential

regulation of these jurisdictions. It is therefore difficult to assess how viable the sector will be by the time the FTAA is implemented.

One of the more important aspects of investment flows has been its failure to contribute significantly to the structural transformation of the region. To a large extent, FDI and other capital inflows have served to reinforce patterns of specialisation in primary production, especially natural resources exploitation in many countries. This differs significantly from the Asian NICS, where FDI inflows helped to propel the diversification of their economies into high-quality, high value added manufacturing of electronic, transport and other products. Market-seeking FDI in the region is inextricably linked to the trade in low value-added manufactured goods, especially from the FTZs and mineral exports (petrochemical products and alumina). Even in the off-shore financial services sector, which has attracted significant United States and Canadian investments, there is a need to create stronger linkages with the domestic economy to enable some of these funds to be channelled into productive activity. At present, the countries benefit almost exclusively through taxes and registration fees. Another factor that limits the contribution of foreign investment to growth and restructuring is the relatively low productivity of investment in the region.

The FTAA, is expected to lead to trade and investment diversion from low value added activities, since the region is likely to become relatively less competitive in these activities. However, if the smaller economies secure special and differential treatment, they might be able to maintain some market share in these activities in the near term. It is vital, however, for them to move quickly to strengthen their competitive position.

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