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**TRADE LIBERALISATION, TRADE PERFORMANCE AND
COMPETITIVENESS IN THE CARIBBEAN**

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TRADE LIBERALISATION, TRADE PERFORMANCE AND COMPETITIVENESS IN THE CARIBBEAN

Introduction

The Caribbean is at a crossroads in its development. It is grappling with what is the best development model to catalyse structural transformation, competitiveness of its production and exchange, long-term growth, high and good quality employment of its workforce and overall high living standards within a framework of equity and sustainable management of environmental resources. The earlier period of import substitution industrialisation (ISI), although it led to spurts of growth, was unable to sustain high growth and economic dynamism in the region. This stemmed in part both from the logic of the model and also its mode of implementation. From the point of logic, the model failed to give sufficient weight to the beneficial effects of trade and openness as potential drivers of growth and economic change. Meanwhile, in terms of implementation, unlike some of the Asian tiger economies, which changed specialisation to goods and services at the frontier of world demand, the Caribbean continued to specialise based on static comparative advantage in traditional commodities such as sugar, bananas, rice, bauxite and petroleum products, with very little value added and product differentiation. Therefore, the use of some of the good aspects of the ISI model such as cultivating dynamic infant industries, that would grow up into mature cutting-edge activities capable of capturing and maintaining competitive market share on regional and international markets was little realised.

Since the neoclassical counter revolution of the 1980s, there has been a roll-back of development economics and specifically ISI strategies of development in the Caribbean and many regions of the world. The old approach has been replaced by a new one based on open markets and liberal economic policy for catalysing growth and economic adjustment. Coined the 'Washington consensus', the new paradigm was built on trade and financial liberalisation, privatisation, fiscal and monetary prudence, flexible labour and input markets and a stable correctly valued exchange rate¹. With the new model, trade liberalisation, long a cornerstone of liberalism has re-emerged as a champion pillar for accelerating structural change, improved trade performance and the competitiveness of economies. Importantly, for small economies such as those of the Caribbean, the model is essentially an export-led growth model and open trade is seen as key to its success. In fact, along with the information and communications revolution and liberalisation of finance and capital flows, trade liberalisation is a major plank of the current phase of globalisation.

¹ An overvalued exchange rate was deemed an important imbalance in the economy that could lead to misallocation of resources between activities, facilitating rent-seeking and also dampening exports by weakening price competitiveness.

Caribbean economies adopted liberal² trade policies in the latter 1980s and 1990s often as conditionalities for accessing finance from the International Monetary Fund (IMF) and World Bank in the wake of macroeconomic disequilibrium. Later, due in part to the dominance of the new model, countries have been persuaded of the key role of open trade and integration into the world economy as a driver of growth and development. The key logic is that for small open economies, the size of the domestic market is simply too small to capture the benefits of economies of scale, necessitating exports and production is too specialised, thus making a wide range of imports necessary for growth. To facilitate an orderly integration, the Caribbean Community (CARICOM) has adopted an open regionalism model premised on concentric circles of liberalisation beginning with the regional market and moving outward to the international market as a strategy for galvanising competitiveness. Specifically, the export-led growth model has shifted the emphasis towards exports rather than import-substituting activities as the catalyst for growth and for alleviating the foreign exchange constraint of the region. In this regard, the hope is that trade liberalisation through its many potentially beneficial effects will stimulate dynamic systems of production and exchange, increase market share in activities that face price and income elastic demand in world markets and thereby provide a major impetus to higher living standards in the region.

This study provides an analysis of links between trade liberalisation, trade performance and competitiveness in the Caribbean. The study takes an eclectic approach, borrowing from different strands of theory and empirical findings, where necessary. Nevertheless from a broad conceptual frame of reference, an effort is made to analyse the structural, institutional and market (demand and supply) factors that impinge on trade performance and competitiveness outcomes in the region. This approach, it is believed, provides the most relevance for analysing the real world situation in the Caribbean, where the underlying structure and logic of the economy, complemented by institutional arrangements, hold the potential for thwarting or catalysing improved production, exchange, competitiveness and structural transformation.

The study seeks to encourage debate on a number of issues and puzzles relating to trade liberalisation and trade outcomes and competitiveness. These issues include:

- (a) What are some of the key drivers of ex-ante and ex-post competitiveness and how do these relate to standard specialisation based on comparative advantage?
- (b) What are the structural and institutional requirements for transformation that would secure dynamic competitiveness?
- (c) Why have some of the most faithful liberalisers been some of the worst performers in terms of growth and trade performance?

² For a number of Caribbean economies, the adoption of liberal market policies was based partly on faith in the capacity of these policies to deliver high growth and improved living standards and partly on conditionalities imposed on countries that adopted IMF and World Bank-type economic reform and structural adjustment programmes such as Jamaica and Trinidad and Tobago.

(d) Is this failure simply a matter of sequencing of reforms and institutional and other constraints or is there a problem with trade liberalisation itself?

(e) Is there a need for Caribbean economies to adopt a more balanced economic model and a strategic mixture of export-led and domestic import competing led growth?

(f) Is there a role for strategic industrial policy in the Caribbean and what is the role of the State in such a strategy?

The study is divided into six sections. The opening section introduces the study by providing a broad context to trade liberalisation and competitiveness. Section I outlines the underlying rationale for trade liberalisation, noting the established benefits and some drawbacks. Section II will examine the Caribbean experience with trade liberalisation in terms of how the process was undertaken. Section III evaluates the link between trade liberalisation and trade performance, especially the opportunities and constraints from the process. Section IV provides an analysis of the relationship between trade liberalisation and competitiveness of regional producers. Finally, Section V highlights some recommendations and policy issues for consideration.

I. The rationale for trade liberalisation

As with a number of critical issues in economics, trade liberalisation has been met with pro and counter claims. Broadly, trade liberalisation entails the progressive removal of restrictions on trade and the replacement of quantitative restrictions, such as quotas, with tariffs; the reduction of these; lower variance in the levels of protection across sectors and activities; and increased market orientation and transparency of trade policy.³ Although it is often difficult to draw the line between them, trade liberalisation is intrinsically linked to economic openness, which is premised on open markets and liberal economic policies in the domestic economy.

Trade liberalisation can benefit a country in a number of important ways:

(a) Improved allocation of resources to activities that optimise social marginal benefits and minimise social marginal costs;

(b) The expanded market consequent on liberalisation provides access to better quality technologies, managerial and organizational skills, inputs and intermediate goods that could facilitate the modernisation and transformation of production and trading structures;

(c) By enhancing the economies' ability to take advantage of economies of scale and scope;

³ See Rajapatirani, S. (1995). "Post-Trade Liberalisation Policy and Institutional Challenges in Latin America and the Caribbean." Policy Research Working Paper 1456. Washington, DC, The World Bank, Latin America and the Caribbean Technical Department, Advisory Group, May.

(d) Improved disciplining effect of domestic competition that forces local producers to move their production systems close to the world standards to survive;

(e) Positive growth and restructuring externalities, including the transfer of know-how, and Schumpeterian creative destruction that allow new dynamic firms to arise to drive growth.

For example, the World Trade Organization (WTO) has estimated that in a model with increasing returns to scale and monopolistic competition, liberalisation was forecasted to lead to a 23.5 per cent increase in world trade in 2005 (see table 1). Under this same scenario, developing countries were expected to realise over 36 per cent increase in trade.

Table 1: Estimated Increase in Merchandise Exports in 2005* Version of the Model

Description	Version 1	Version 2	Version 3	Actual Value of Exports
World	8.6	9.6	23.5	2843
USA	7.5	8.2	21.7	448.2
Canada	5.3	6.1	16.6	134.1
Australia & New Zealand	8.4	9	24	52.3
Japan	7.5	8	18.3	339.9
Developing Economies	13.7	15.3	36.7	906.4
#				
China	6.1	8.4	26.5	85

Source: CUTS International, (1998), "Trade Liberalisation, Market Access and Non-Tariff Barriers", Briefing Paper, April, No. 4

Note:* Excluding intra-European Union trade and including trade in petroleum, and the unit is in per cent, in 1992 (and in \$bn), # including transition economies, Version 1: assumes constant returns to scale and perfect competition, Version 2: assumes increasing returns to scale in industrial sectors and perfect competition, Version 3: assumes increasing returns to scale and monopolistic competition in industrial sectors
Source: Market Access for Goods and Services: Overview of the Results, GATT Secretariat, Geneva, November, 1994.

Nevertheless, objections have been raised to the proposed net benefits of trade liberalisation, particularly for small developing economies which are price takers, which face inelastic demand for their exports in international markets and weak bargaining power in trade negotiations. For these countries, it is argued that import liberalisation, especially when done rapidly often leads to the intense competition and the death of a number of firms in developing countries without the Schumpeterian creation of new firms to take their place. This on average leads to fall in incomes and unemployment and growing levels of inequality. Second, trade liberalisation sometimes leads to a fall in the price of exports relative to imports and this might take place over a fairly long period of time resulting in a structural decline in the terms of trade of some developing countries, as in many highly indebted African countries.

On the domestic front, developing countries often lack the economies of scale and scope to penetrate external markets. Therefore, market access does not imply the ability to capture market share for products and services. In effect, trade liberalisation without measures to increase supply capacity and quality is simply providing market access without countries that might not have any products to trade. This has been acknowledged by the WTO, which has in recent times placed greater emphasis on trade facilitation and capacity-building measures.

II. Trade liberalisation: the Caribbean experience

Most Caribbean countries have undergone fairly wide-ranging trade liberalisation involving significant elimination of quantitative, price and qualitative barriers to trade. Pursuit of this strategy has stemmed in part from the belief that liberalisation will drive competition, efficiency, growth in exports and cheaper imports, especially inputs into the production process. Trade liberalisation in the region has run along two tracks, each influencing the other. At the regional level, integration under the CARICOM Single Market and Economy (CSME) had led to the removal of trade barriers as a strategy for increasing regional trade, investment and production integration.

As in other regional arrangements, regional trade liberalisation began with the elimination of quotas and other quantitative restrictions on trade in goods. The system of import licensing has also been drastically reduced for community goods.

In a strong move towards tariff harmonisation, the common external tariff (CET) was established in 1991, to present fairly uniform tariff levels to countries outside the grouping. Initially, tariffs were to be reduced from a ceiling of 70 per cent to 20 per cent. To cushion the impact of the CET, especially for countries that were heavily dependent on trade tax revenue, the authorities proposed a four-phased reduction in tariffs.

Moreover, a distinction was made between competing and non-competing imports, with the former bearing the highest tariffs and the latter the lowest. Agriculture was also most heavily protected given its vulnerability to external competition, importance to employment and foreign exchange generation. The tariff on agricultural products was set at 40 per cent; while inputs into domestic agriculture attracted a zero (0) tariff.

Importantly, the safeguard mechanism allows the use of extraregional materials where supplies in the region are insufficient or unavailable altogether, without breaching the rules of origin. This is a tacit acceptance of the supply side bottlenecks that are faced by the region. Although the safeguard mechanism has been widely used to source foreign supplies of food, spices and wood products, this has been done mainly by the larger economies such as Trinidad and Tobago and Jamaica, where scale economies permit the development of a more vibrant manufacturing sector. The exception in the Organisation of Eastern Caribbean States (OECS) has been Saint Lucia which has also made wide use of the provision.

A. Liberalisation at the international level

On the external front, Caribbean countries were caught up in the new neo-liberal paradigm that has become the orthodoxy since the 1980s. The cornerstone of this so-called 'Washington consensus' are open markets and the roll-back of the role of the State in the economy. Stemming from these two broad doctrines are secondary principles including trade and financial liberalisation, privatisation and public sector reform, deregulation and macroeconomic policy reform, which conform to the dominant role of the market and the private sector in the economy. It is important to note that outlining these reforms says nothing of their credibility and relevance as a development paradigm for countries. Indeed, many of the market incentives are progressive and do help countries to progress, although, like most policy decisions there are shortcomings that should be addressed.

Caribbean economies can be described as 'reluctant liberalisers'. The region did not readily jump onto the bandwagon of liberalisation when it became fashion in the Organization for Economic Cooperation and Development (OECD) countries in the early 1980s. Indeed, most countries in the region still showed a distinct preference for ISI policies that sought to develop infant industries behind high tariff walls and State incentives such as tax holidays, duty free concessions and accelerated depreciation allowances. In the early stages, ISI delivered commendable growth rates, linked mainly to increased capital accumulation and presaging factors of production into activity. In fact, given the underdeveloped private sector, entrepreneurial opportunities for production and trade were often untapped, providing an opportunity for production by the State in some activities. However, unlike what Sir Arthur Lewis had advocated, the model focused on production of import-competing goods for the domestic market rather than for exports. With the small size of the regional market and the production inefficiencies inherent in production behind protective walls, the ISI model led to a fairly rapid slowing of the growth stimulus. By the 1980s, most Caribbean economies were in macroeconomic disequilibrium evidenced by fiscal and balance of payments current account deficits, high inflation, unsustainable levels of external debt and sluggish growth.

Trade and financial sector liberalisation were core components of economic reform and structural adjustment programmes, as countries were encouraged to adopt an export-led growth model to replace the dirigiste ISI model, which was deemed a failure. The first major plank of the trade liberalisation programme was tariffication⁴ - the conversion of quotas and licensing arrangements to tariffs. Although not a precise science, it is well noted that tariffs are less trade and production distorting than quotas and licensing arrangements. The CET has been a major plank of the more liberal trade regime, with average tariffs falling from around 70 per cent to 20 per cent for most commodities, except agriculture which will attract a tariff of 40 per cent.

Using an index of trade restrictiveness that compares countries according to the extent of trade barriers, the timing and intensity of trade liberalisation, Loser and Gerguil⁵ state that Latin

⁴ Tariffication presented problems of exactly how to convert non-tariff barriers into tariff equivalents, and in a number of cases countries offered inflated equivalents referred to as 'water in the tariff'.

⁵ See Loser, Claudio and Gerguil Martine (1999), "Trade and Trade Reform in Latin America and the Caribbean in the 1990s", *Journal of Applied Economics*, Vol. II, No. 1 (May), 61-96.

America and the Caribbean had moved about 6 points on a 10-point scale during the decade of the 1990s with most countries moving from a restrictiveness level of 10 in the 1980s to 4-5 by 1998. This indicates that the region has liberalised its trading regime substantially in the last decade and a half. Moreover, non-tariff barriers which affected an estimated 40 per cent of imports in the mid 1980s, affected only 11 per cent in 1997.

An important aspect of forced liberalisation has been the erosion of preferential trading arrangements that have long protected Caribbean commodity producers, especially for sugar, bananas and rice. The overhaul of the European Union (EU) preferential trading regime for African, Caribbean, Pacific (ACP) countries and its full replacement with the Economic Partnership Agreement (EPA) will bring to a close a long-standing relation of non-reciprocal trade preferences. Regional producers will no longer benefit from non-reciprocal guaranteed quotas and above world market prices for their commodities, and will be forced to compete based on productivity, efficiency, product quality and prices. This will demand a major restructuring and reform of production systems to make them competitive and efficient. However, there is also the avenue of alternative products such as methanol and fuel co-generation from sugar production which is being explored by Jamaica and Guyana.

III. Trade performance in the Caribbean: opportunities and constraints

A. Intraregional trade

Trade has not provided the catalyst for growth and structural transformation that would have been expected in the Caribbean, for countries that are so heavily dependent on trade. Unlike East Asia where trade has been a major catalyst for growth, the impact of trade on growth in the Caribbean has been limited.

Based purely on past performance, intraregional trade does not appear to provide a sound rationale for integration under the CSME. The reality is that underlying historical and structural patterns has led to a strong extraregional orientation in trade. Indeed, average intraregional imports as a percentage of total imports increased only marginally (by 1.6 per cent) from 15.7 per cent between 1995-1999, to 17.4 per cent between 2000 and 2004. In fact, growth in imports between the two periods was significant only for a few countries, including Guyana (6.89 per cent), Barbados (6.06 per cent), Dominica (3.5 per cent) and St. Vincent and the Grenadines (3.4 per cent). Growth rates for the other countries were 3 per cent or less with some countries, such as Trinidad and Tobago and Grenada, actually experiencing negative growth rates. This was very modest growth compared with other trading blocs.

Similarly, average intraregional exports increased by less than 2 per cent from 26.68 per cent between 1995-1999 to 28.35 per cent between 2000 and 2004. The regional market for exports became more important for a number of countries over the two periods, including Barbados, Guyana and some OECS countries such as Dominica and St. Vincent and the Grenadines, reflecting in part the relative loss of market share on the international market. A number of the banana-producing OECS countries have lost market share with the erosion of

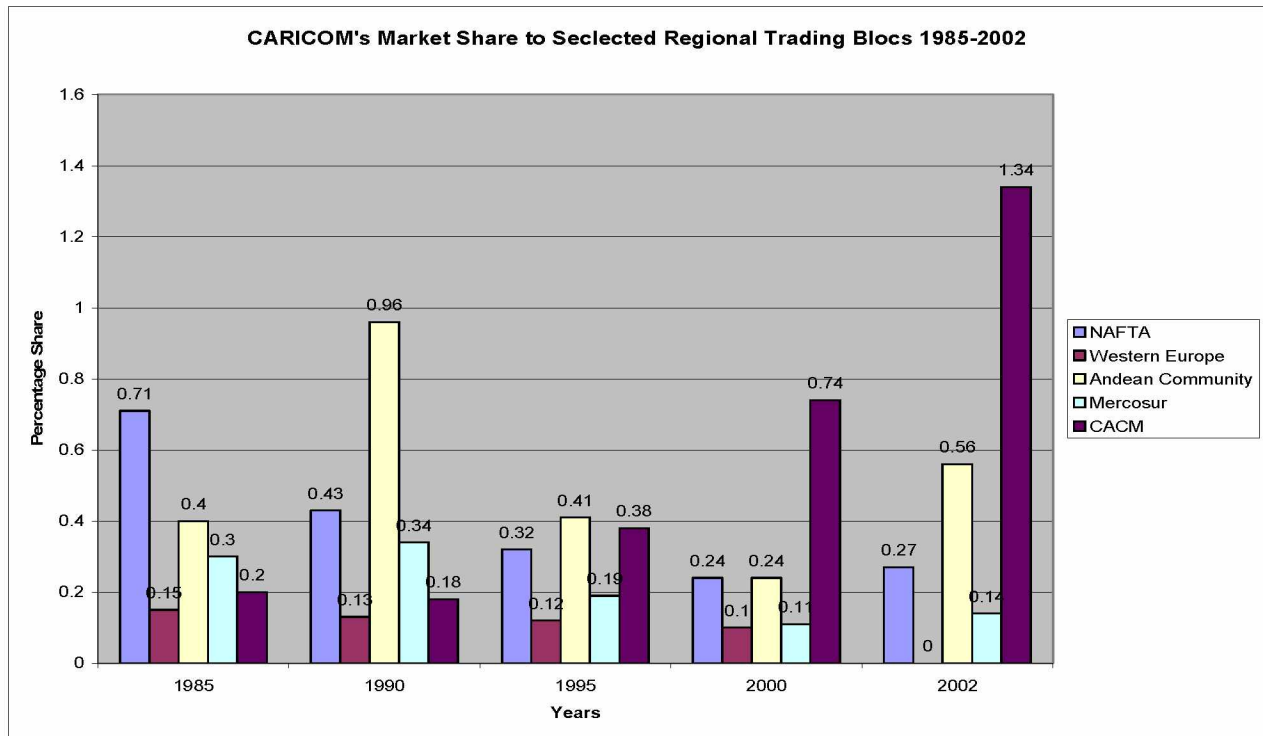
preferences, which could account in part for the increase in the relative weight of regional exports in their total exports, which means that they have not gained any absolute increase in market share on regional market.

Given the importance of extraregional trade to growth and development in the Caribbean, a multifaceted approach using various indicators to measure trade performance could provide insights for improving trade policy and focus.

B. Extraregional trade performance

An outstanding feature of Caribbean extraregional trade is its level of concentration by region and product composition. With the declining importance of traditional agricultural commodities, including sugar, bananas and coffee in the region's trade structure and the relative growth in importance of North America in the world economy, Caribbean trade has shifted towards that region at the expense of Europe. The high concentration of exports is shown by the fact that exports to principal destinations in the west, including the North American Free Trade Area (NAFTA) and Latin America, declined only slightly from an average of 84.7 per cent of total exports between 1995-1999 to 82.4 per cent between 2000 and 2004. The concentration of exports to NAFTA increased over the last decade, with its share in CARICOM exports rising from 48.7 per cent between 1995-1999 to 51.2 per cent between 2000 and 2004. During the comparative periods, exports to the United States expanded from 41 per cent to 44.6 per cent, while exports to both Canada and Mexico registered modest declines. Reflecting CARICOM's lacklustre performance on the Latin American market, exports to the Latin American Integration Association (LAIA) contracted from 4.9 per cent in the first half to 2.8 per cent in the second half of the decade to 2004. Underscoring its weak competitiveness performance, CARICOM was not able to maintain its exports share in any of the sub-groups of countries in the LAIA region.

As figure 1 shows, CARICOM has lost market share in its goods trade in all major markets except the Andean Community and the Central American Common Market (CACM) between 1985 and 2002. Notably, the market share for Western Europe and NAFTA, both of which provide preferential treatment for a range of goods including agricultural commodities and specified manufactured goods, declined from 0.15 per cent to 0.1 per cent and 0.71 per cent to 0.27 per cent, respectively. This implies that although preferences have been useful in maintaining living standards for producers, such as farmers and small manufacturers in the region, the failure to restructure these production systems to raise their price and quality competitiveness relative to external competitors have led to an erosion of regional market share in them.

Figure 1: CARICOM's Market Share to Selected Regional Trading Blocs 1985-2002

Source: Competitive Analysis of Nations (2002) and WITS (2005)

The production composition of trade is critical for the region, as it indicates patterns of structural change and diversification that are critical to competitive market penetration.

C. Factors explaining trade evolution and patterns

A country's trade pattern and growth are influenced by a number of factors including natural resource endowment, geography (distance from and socio-cultural affinity with trading partners), trade barriers (tariffs and non-tariff barriers (NTBs)), transport costs and other factors, including membership of regional integration arrangements, preferential trading arrangements, among others. In analysis for OECD countries, Baier and Bergstrand⁶ find that income growth explains 67 per cent of the growth in world trade, tariff reductions 25 per cent and transport cost reductions 8 per cent. Although the main factors driving trade and the relative weights might be different for developing countries, such as the Caribbean, the three factors listed are expected to be quite important.

⁶ See Baier, Scott, L. and Bergstrand, Jeffrey, H., (2001), "The Growth of World Trade: Tariffs, Transport Costs and Income Similarity, *Journal of International Economics*, Vol. 53, Issue 1, February, PP 1-27

In the Caribbean historical links and preferential arrangements arising out of those links with Europe in particular, have long explained many of the trade in traditional commodities, notably sugar, bananas, rum and rice.

1. Trade balance with the EU

The balance of trade provides a crude, but useful indicator of trade performance in the post-liberalisation period. The average merchandise trade deficit for CARICOM increased by over 117 per cent between 1995-1999 and 2000-2004, from an average of US\$301.3 million between 1995 and 1999 to US\$655 million between 2000 and 2004. The trade deficit expanded in all member States with the exceptions of Guyana, Jamaica, Belize and St. Vincent and the Grenadines. Both Guyana and Jamaica recorded average merchandise trade surpluses over the period, although the surplus declined sharply in Jamaica in the latter period, but much less so for Guyana. In contrast to its dynamic trade position with the United States, Trinidad and Tobago registered a sizeable average trade deficit with the EU over the two periods. Indeed, its average trade deficit increased by over 108 per cent between 1995-1999 and 2000-2004. Trinidad and Tobago's imports of capital and intermediate goods from the EU have increased sharply over time, in keeping with the rapid growth in industrial capacity in petrochemicals and ancillary industries. Trinidad and Tobago continues to dominate the regional export market with over 65 per cent of total exports. An important qualification is that although the goods' trade balance provides a broad picture, for largely service-based economies such as many of the OECS countries and Barbados, the evolution of the services account provides a better indicator of external performance.

D. Trade in services

Trade in services has assumed increasing importance in the world economy with the liberalisation of this trade, especially the removal of regulations, granting of national treatment to foreign service providers and the easing of restrictions on the movement of natural persons. In fact growing trade is in part a reflection of the increasing importance of services as a drive of output and growth in most countries. In developed countries, in the decade and a half since 1990, the share of services in GDP has risen 65 per cent to 72 per cent, while in developing countries, the services sector has increased from 45 per cent to 52 per cent of GDP over the same period⁷. Similarly, services account for 70 per cent of employment in developed countries and 35 per cent in developing countries. Interestingly, since 1990, growth in services exports from developing countries (8 per cent) has outpaced that of developed countries (6 per cent). Also notable is that Africa and Latin America and the Caribbean only account for a relatively small share of service exports, 10 per cent and 15 per cent, respectively, while the lion share is accounted for by Asia. This points to room for the further development of trade in services in Latin America and the Caribbean and Africa.

⁷ See UNCTAD, (2007), "Trade in Services and Development Implications", Trade and Development Board, Commission on Trade in Goods and Services, and Commodities, Eleventh Session, Geneva, 19-23 March, 2007.

The General Agreement on Trade in Services (GATS) provides four modes of trade in the delivery of services:

(a) Mode 1: Cross-border supply - where the service is delivered from one country to another, but the supplier does not move to the recipient country, for example, the purchase of consultancy and software services over the internet and telephone calls.

(b) Mode 2: Consumption abroad - this entails the consumer moving to the supplier country to consume the service, therefore, the supplier does not move, for example, demand for tourism services by visitors.

(c) Mode 3: Commercial presence - this is where the service is established in another country by the establishment of a commercial presence, for example, a branch of a company. Therefore, the service supplier moves to the recipient country.

(d) Mode 4: Movement of natural persons - which is the where the supplier moves as a 'natural person' to provide the service, for example, nurses moving abroad and consultants.

In terms of the various modes, countries have been largely comfortable with modes 1 to 3, but have for the most part resisted mode 4, the movement of natural persons. This relates to social and institutional resistance to foreigners migrating to their countries by residents and leaders and has nothing to do with the inherent logic of persons providing services as workers, consultants, etc., rather than under some other mode. Indeed, Winters (2002) had noted that if developed countries were to allow temporary entry for foreign workers from developing countries, equal to 3 per cent of their current workforce, this would generate welfare gains (in real income) that exceed those from full merchandise trade liberalisation with developing countries.

It is well known that most Caribbean economies have effectively leapfrogged from agricultural economies to service-based economies without the development of an effective manufacturing sector. Therefore, given the vital importance of services in production and trade, the performance of this sector provides a useful barometer of the prospects for growth and development in the region. Indeed, a number of Caribbean economies, particularly OECS economies, now view themselves as transitioning to high value added service economies built on tourism, financial and Information and Communications Technologies (ICT) services.

Traditional development theory had noted the pivotal role of manufacturing production and the transition from agriculture to manufacturing as a means of reaping the benefits of technological progress, innovation, increasing returns to scale and increasing wages and living standards of workers. In this light, it is now accepted that a high quality service sector can play the role that the traditional manufacturing sector played in driving sustainable growth, creating linkages with other sectors and acting as an anchor for competitive integration into the world economy. Indeed, many of the smaller economies in the region have no choice but to depend on services such as tourism, off-shore financial services and informatics, where feasible, to provide this catalyst for growth and development, as these are the apparent areas of competitive advantage.

E. Service supply

Supply side considerations are critical to the regional services sector. The reality is that most regional services, including transport, business, health and education services, have been largely non-tradable for a long time. In effect most services have long been considered domestic services. This no doubt stemmed in part from exploitation of early comparative advantage in agriculture, minerals and low cost manufacturing.

The reliability and quality of regional supply of services is crucial to the capturing and maintaining of sustained market share on regional and international markets. Reflecting their intangible nature, trade in services is highly influenced by confidence in the quality and consistency of the offer.

The services sector is by far the largest sector in CARICOM, accounting for more than two thirds of total output and employment in the region. However, the region accounts for only half of one per cent of international services trade. This underscores a mismatch in that although services are critical to region (largely service intensive) economies, high factor intensity in the sector has not translated into internal and external competitiveness.

IV. Trade liberalisation and competitiveness in the region

The concept of competitiveness evolved from the business science literature and has been championed by forerunners in this field, especially Michael Porter. Although it has some relation to comparative advantage, unlike the latter, competitiveness is much less grounded in a logical economic framework. Indeed, economist Paul Krugman, viewing the concept as providing impetus for the pursuit of strategic trade policies in a winner and loser end game, see it as a dangerous obsession.⁸ Indeed, to set off the bounds of the concept and the factors that drive it, clear and internally consistent theory of competitiveness needs to be developed. This is critical since the subjective nature of the concept makes it quite normative and weakens its usefulness as a scientific economic concept (Rapkin and Avery, 1995). Nevertheless, Rapkin et. al proffer that competitiveness is a useful political economy concept for gauging the relative structural gains from trade and integration among States.

Standard trade theory is anchored in comparative advantage and modifications in the Heckscher-Ohlin and later the incorporation of increasing returns in New Trade Theory does not provide a full understanding of patterns and gains from trade among countries. Comparative advantage based on specialisation according to what a country does best depending on its factor endowment, fails to explain much international trade such as trade based on learning by doing and increasing returns. However, although these dynamic gains are accounted for by the new trade theory, it does not actively include the domestic economic environment, institutions and overall attractiveness or aggressiveness as indicators of the patterns and gains from trade.

⁸ See Krugman, Paul, (1994), "Competitiveness: Myth or Dangerous Obsession", Foreign Affairs, 1994.

Competitiveness, while not ignoring the crucial importance of trade theory as an explanation of much trade, includes other factors that are crucial in explaining trade and market position.

International competitiveness refers to the ability of a country's firms and producers to capture and maintain market share and incomes on regional and international markets. Competitiveness is usually marked by an improving trade balance in specific commodities and activities, which is built on domestic productivity, innovation and product/service quality, after sales service delivery and competitive prices. There has long been a debate on the real contribution of trade liberalisation to improved competitiveness in economies at different stages of development.

The orthodox view is that trade liberalisation by subjecting domestic firms to more intense competition, fostering learning by doing and innovation, should enhance the ability of domestic firms in regions such as the Caribbean to penetrate and maintain market share regionally and internationally. Although this view is based on sound theory and has much to recommend it, there are a number of factors, including the mode and sequencing of trade liberalisation and also the extent to which liberalisation is supported by complementary policies that could constrain or raise the competitiveness benefits from the process.

A. Trade competitiveness analysis

The Competitive Analysis of Nations (CAN) software allows us to compute a broad competitiveness matrix to group countries by their market structure in a given import market. The indicative typology shows for which products market share is increasing, decreasing or remaining static and therefore provides a suggestive gauge of market restructuring. A product (e.g. rum) of a given country (e.g. Barbados) to a given market (e.g. the EU) whose market share is increasing in the imports of the given market, is said to be a Rising Star. This is in effect an increase in market share in a dynamic product. An increase in market share in a product that is declining in importance in the imports of the partner country is called a Declining Star. Meanwhile, a fall in market share in a dynamic commodity (one in which the percentage of imports is increasing) is termed a Missed Opportunity. Finally, a decline in market share in a stagnant commodity is called a Retreat.

Table 2 below shows that CARICOM had market share gains mainly in stagnant commodities in the first period (1985-1990) and second period (1990-1995). The market share gains increased dramatically from 34.78 per cent to 65.34 per cent of total exports in the two periods. In the third period (1995-2000), market share gains remained fairly stable at almost 65 per cent.

Table 2: Competitive Matrix of CARICOM Exports to North America, 1985-1990, 1990-1995, 1995-2000 at the three Digit level and expressed as a percentage of the final year exports

		Stagnant Commodities		Dynamic Commodities	
		First period	56.16%	First period	43.78%
		Second period	54.92%	Second period	44.84%
		Third period	48.69%	Third period	51.27%
Market Share Gains		Declining Stars		Rising Stars	
First period	34.78%	First period	15.88%	First period	18.90%
Second period	65.34%	Second period	24.02%	Second period	41.32%
Third period	64.93%	Third period	26.60%	Third period	38.33%
Market Share Losses		Retreats		Missed Opportunities	
First period	65.16%	First period	40.28%	First period	24.88%
Second period	34.42%	Second period	30.90%	Second period	3.52%
Third period	35.03%	Third period	22.09%	Third period	12.94%
Source: CAN (2002)					

The adaptability index provides an indicator of the ratio of dynamic commodities to stagnant commodities for each competitiveness matrix- market share, export share and specialisation. For the period 1985-1990, the adaptability indices for the three indicators were 0.77, 0.78 and 0.77, respectively. This means that market share and specialisation in dynamic commodities were both 0.71 times market share and specialisation in stagnant commodities. By the third period (1995-2000) the adaptability indices of 0.92 for both market share and specialisation reveal that the region had improved its competitiveness on the North American market, as its share of dynamic commodities that are in stronger demand had increased relative to non-dynamic products.

Table 3: The Adaptability Index for CARICOM's Exports to North America (1985-1990; 1990-1995; 1995-2000)

	1985-1990	1990-1995	1995-2000
Market share	0.77	0.71	0.92
Country export structure	0.78	0.82	1.05
Specialisation	0.77	0.71	0.92
Market import structure	1.01	1.14	1.14
Source: CAN (2002)			

Table 4 below shows the competitive matrix for Caribbean countries with Western Europe. The picture that emerges over time is quite an unfavourable one. Whereas dynamic commodities represented 46 per cent of exports to the EU market between 1985-1990 and rose to

54 per cent between 1990-1995, by 1995-2000 the market share of dynamic products had plummeted to roughly 29 per cent, just over half of what they were in the second period. The Caribbean has lost market share on the EU market over time, as evidenced by the growth in market share losses from 31.4 per cent of commodities exported between 1985 and 1990 to 58.4 per cent for the period 1995-2000. It is revealing to show the key products for which market share was dynamic or stagnant. The main dynamic products (rising stars) in the first period (1985-1990) were ships, boats and floating structures whose market share increased substantially from 0.91 per cent in 1985 to 20.87 per cent in 1990; alcoholic beverages with a 40 per cent growth in market share to 7.4 per cent; and outer garments and knitted goods. It is important to note that this growth in market share was built partly on preferences for some of these products. By the final period, the export structure had changed importantly, with leading rising stars being gas, natural and manufactured, whose share increased from 0.2 per cent in 1995 to 3.57 per cent in 2000, special commodities and spices. By that time, agricultural commodities such as rice and crustaceans and molluscs were declining stars, in spite of preferential market access.

Table 4: Competitive Matrix of CARICOM Exports to Western Europe, 1985-1990, 1990-1995, 1995-2000 at the three Digit level and expressed as a percentage of the final year exports

		Stagnant Commodities		Dynamic commodities	
Market Share Gains		First period	57.94%	First period	46.10%
		Second period	45.69%	Second period	54.09%
		Third period	71.04%	Third period	28.72%
		Declining Stars		Rising Stars	
First period	68.22%	First period	34.47%	First period	33.75%
Second period	84.30%	Second period	43.77%	Second period	40.53%
Third period	41.30%	Third period	25.94%	Third period	15.40%
		Retreats		Missed Opportunities	
Market Share Losses		First period	23.47%	First period	7.94%
First period	31.41%	Second period	1.92%	Second period	13.56%
Second period	15.48%	Third period	45.10%	Third period	13.32%
Third period	58.42%				
Source: CAN (2002)					

Table 5 below follows Czinkota and Wongtada⁹ (1997) in calculating basic ex-post competitiveness indicators for CARICOM countries for trade in services. For the indicator,

$$\text{Competitiveness} = \frac{\text{Export value} - \text{Import value}}{\text{Export value} + \text{Import value}}$$

Therefore, the indicator crudely measures competitiveness as the services trade balance relative to the total services trade. The value of the competitiveness measure ranges from -1 to +1, with these outer values representing extremes. Sectors and industries that are highly competitive tend

⁹ See Czinkota, M. R., and Wongtada N., (1997). "The Effect of Export Promotion on U.S. Trade Performance: An Analysis of Industry Internationalization", The International Trade Journal, Vol. XI, No.1, Spring, pp. 5-37.

to have a value closer to +1. Indeed, if we view structural competitiveness as the ability to maintain market share over a relatively long period of time, tracking the evolution of this basic competitiveness measure over time provides an initial indication of the pattern of structural competitiveness for given activities such as tourism, financial and other services.

Table 5 below shows the competitiveness indicator for the CARICOM trade in goods by SITC sections. The table shows that between the first and second halves of the periods, the competitiveness indicator worsened from -0.23 to -0.25 indicating some loss of competitiveness and market share in goods exports. In terms of SITC classifications, only crude inedible materials, except fuels (0.55 for 1990-1997 and 0.56 for 1999-2006), beverages and tobacco (0.02 and 0.03) and mineral fuels and lubricants (0.17 and 0.14) showed any real measure of competitiveness. The other products - particularly machinery and transport equipment, animal and vegetable oils, fats and waxes and miscellaneous and manufactured articles, all activities in which the region has little comparative advantage and also major areas of imports - had very low competitiveness indicators. An important issue relates to the capacity of the region to engage in learning by doing so as to be able to produce some of the basic manufactured goods that are imported. Apart from food and beverages, most countries in the region have made very little breakthrough in manufacturing. This reflects in part, weak systems of training in basic and applied sciences, the poor nexus between universities and institutions of learning and practical research and product development organizations, a limited capacity for and focus on reverse engineering¹⁰ of product process and designs to learn how to manufacture established products and a weak emphasis on building up local capacity by foreign direct investors.

¹⁰ It has been noted that Japan and the Asian Newly Industrialised Countries were able to speed up their industrial development by reverse engineering systems that allowed them to manufacture established products from the United States and other OECD countries.

Table 5: Competitiveness Indicator for CARICOM Countries Goods Trade by SITC Sections
(measured as Exports Value -Imports Value /Exports value + Imports Value)

SITC Sections	Y E A R S																	Aver- age	Aver- age
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	1990- 1997	1999- 2006
Total	-0.15	-0.24	-0.22	-0.31	-0.17	-0.22	-0.23	-0.29	-0.32	-0.27	-0.20	-0.23	-0.31	-0.31	0.08	0.15	0.69	-0.23	-0.25
0. Food and Live Animals chiefly for Food	-0.10	-0.19	-0.09	-0.14	-0.02	-0.14	-0.09	-0.07	-0.14	-0.13	-0.13	-0.17	-0.18	-0.26	-0.09	-0.16	0.40	-0.10	-0.11
1. Beverages and Tobacco	0.01	-0.02	0.06	0.06	0.02	0.04	0.06	-0.03	0.06	0.04	0.07	0.08	0.08	0.02	0.10	0.13	0.40	0.02	0.03
2. Crude Materials, Inedible, except Fuels	0.59	0.53	0.49	0.50	0.47	0.60	0.61	0.62	0.62	0.68	0.67	0.70	0.52	0.32	0.73	0.73	0.43	0.55	0.56
3. Mineral Fuels, Lubricants and Related Materials	0.29	0.23	0.29	0.06	0.29	0.17	0.07	0.00	0.00	0.08	0.13	0.11	0.02	-0.01	0.44	0.51	0.90	0.17	0.14
4. Animal and Vegetable Oils, Fats and Waxes	-0.63	-0.72	-0.79	-0.72	-0.70	-0.72	-0.79	-0.76	-0.76	-0.80	-0.80	-0.78	-0.77	-0.78	-0.66	-0.61	-0.37	-0.73	-0.74
5. Chemicals and Related Products, Not elsewhere Specified	-0.23	-0.23	-0.28	-0.28	0.01	-0.03	-0.08	-0.11	-0.24	-0.22	-0.07	-0.06	-0.20	-0.13	0.40	0.35	0.78	-0.15	-0.16
6. Manufactured Goods Classified Chiefly by Material	-0.58	-0.63	-0.60	-0.61	-0.52	-0.48	-0.51	-0.52	-0.55	-0.58	-0.56	-0.52	-0.51	-0.57	-0.23	-0.37	0.33	-0.55	-0.55
7. Machinery and Transport Equipment	-0.92	-0.94	-0.93	-0.93	-0.92	-0.94	-0.93	-0.95	-0.94	-0.92	-0.92	-0.93	-0.95	-0.96	-0.92	-0.91	-0.75	-0.93	-0.94
8. Miscellaneous and Manufactured Articles	-0.43	-0.52	-0.38	-0.37	-0.35	-0.37	-0.43	-0.49	-0.54	-0.58	-0.61	-0.68	-0.78	-0.82	-0.75	-0.75	-0.32	-0.42	-0.43
9. Commodities and Transactions Not Classified Elsewhere	-0.97	-0.98	-0.97	-0.98	0.32	-0.95	-0.59	0.31	0.30	0.17	0.25	0.21	0.37	0.30	0.16	0.06	0.81	-0.60	-0.44

Source: CARICOM Trade Database

Unlike the case for the manufacturing sector, average indicator for services was 0.28, which indicates that the region has some competitive advantage in services, especially tourism and also financial and entertainment services in some countries. Nevertheless, although the region has maintained a measure of competitiveness in services, this seems to have been declining somewhat over time. Indeed, the index slipped from 0.33 in 1992 to 0.27 in 2004. Moreover, it averaged 0.31 between 1992 and 1997, but fell to an average of 0.24 between 1999 and 2004. This, it is suggested, is due in large part to the reduced competitiveness of the tourism sector in a number of CARICOM countries where service quality and value for money has been declining due in part to a limited service range and inadequate investments in product development and marketing.

Financial services have been adversely affected by the OECD Harmful Tax Competition Report, which led the Financial Action Task Force (FATF) to blacklist a number of Caribbean offshore financial centres for purportedly being conducive to money laundering and harmful tax competition.¹¹ These regional jurisdictions had to expend significant financial and institutional capital in terms of strengthened regulation, prudential and accounting standards and information sharing to have the black-listing removed. Moreover, many of them have not returned to previous levels of business. This fallout was manifested in the competitive performance of the sector relative to other active jurisdictions.

At the country level, Antigua and Barbuda and Barbados had the highest services competitiveness indicator at 0.43 and 0.4, respectively, reflecting the relative dynamism of their tourism and financial services sectors. Nevertheless, Antigua and Barbuda has lost significant market share in the lucrative internet gaming sector due to the United States ban on internet gaming. For instance, the number of gaming companies fell from 47 at the end of 2004 to 38 in 2006. Moreover, in spite of Antigua and Barbuda's successful challenge of the decision at the WTO, the United States remains non-compliant with the ruling. Meanwhile, Saint Lucia and Grenada ranked 3 and 4, respectively, with indices of 0.39 and 0.31. Interestingly, St. Kitts and Nevis and Jamaica, both of which are heavily service dependent especially on tourism, ranked 10 and 12, respectively, suggesting that if measures are not taken to strengthen competitiveness, services could become declining stars¹² for them. Surprisingly, Jamaica was ranked below Belize, which is a fairly goods-producing economy.

¹¹ See Butler, Truman, (2001), "David vs. Goliath: An Analysis of the OECD Harmful Tax Competition Policy", University of Georgia School of Law.

¹² See the definition and implication of the notion of declining stars, elsewhere in this section.

**Table 6: Basic Indices of ex-post Competitiveness for the Services Sector in CARICOM
measured by the Trade Balance as a Percentage of Total Trade**

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Average Indices
Antigua and Barbuda	0.46	0.49	0.49	0.40	0.40	0.42	0.42	0.41	0.43	0.40	0.40	0.40	0.42	0.43
Bahamas	0.46	0.44	0.41	0.41	0.38	0.31	0.22	0.33	0.35	-0.69	0.32	0.31	0.29	0.27
Barbados	0.49	0.43	0.44	0.41	0.43	0.40	0.41	0.38	0.38	0.36	0.36	0.38	0.38	0.40
Belize	0.26	0.23	0.22	0.26	0.24	0.23	0.20	0.12	0.06	0.13	0.09	0.12	0.16	0.18
Dominica	0.14	0.15	0.15	0.17	0.21	0.23	0.24	0.25	0.27	0.20	0.19	0.30	0.31	0.22
Grenada	0.36	0.36	0.42	0.44	0.40	0.31	0.27	0.31	0.29	0.24	0.18	0.23	0.25	0.31
Jamaica	0.25	0.21	0.22	0.19	0.16	0.16	0.16	0.17	0.16	0.11	0.09	0.15	0.14	0.17
St. Kitts and Nevis	0.32	0.29	0.35	0.19	0.17	0.19	0.26	0.08	0.13	0.13	0.07	0.15	0.24	0.20
St. Lucia	0.37	0.39	0.39	0.36	0.38	0.42	0.42	0.41	0.45	0.35	0.32	0.38	0.41	0.39
St. Vincent and the Grenadines	0.14	0.16	0.07	0.15	0.25	0.13	0.15	0.31	0.36	0.41	0.42	0.37	0.33	0.25
Trinidad and Tobago	0.07	0.09	0.07	0.24	0.36	0.37	0.44	0.38	0.18	0.24	0.26	0.30	0.39	0.26
CARICOM	0.33	0.32	0.32	0.31	0.31	0.28	0.27	0.29	0.28	0.11	0.24	0.27	0.27	0.28

Source: CARICOM Trade Database

B. Ex-ante competitiveness and the role of domestic factors

Ex-post trade performance indicators such as market share, export concentration and revealed comparative advantage provide some gauge of competitiveness as realised by what is actually happening in markets. However, this is far from the full story, as behind all this is what is happening to domestic production, distribution and marketing systems to enable producers and traders to maintain and grow market share on various markets. These critical domestic factors are the real ex-ante drivers of competitiveness and no discussion of trade performance and competitiveness is complete without an analysis of them. A number of critical factors affect the ability of Caribbean producers to compete effectively on domestic, regional and international markets. Critical among these factors are production costs, product quality and standards, levels of research and development and product innovation, the quality of institutions and the efficiency of the public bureaucracy and the transaction costs involved in doing business.

It is beyond question that average production costs in some segments, agriculture, industry and services, in the Caribbean are uncompetitive by international standards. In agriculture, high costs of production are the bane of most sectors. In the sugar subsector, for instance, the average cost of production for Caribbean countries in 2005 was US\$782. Costs of production ranged from a low of US\$330 in Belize to a high of US\$1212 in Trinidad and Tobago. Underscoring the weak competitiveness of the region in the sector, regional production costs exceeded the world market price by some margin. Alarming, the costs of production in the highest costs producers even exceeded the preferential prices offered on the EU market. The situation is similar in the banana and rice subsectors.

The fledgling regional manufacturing sector has also been buffeted by competitiveness problems that stem from high production costs that result from scale diseconomies, high costs of utilities, labour and transportation. Moreover, average energy costs in the Caribbean are as much as seven times higher than those in the United States and Europe. Although most Caribbean countries are middle or low income countries, and absolute labour costs might not seem high by developed country standards, the fact is that labour costs are quite high by the standards of large developing countries such as China, Indonesia and Brazil. The high costs put the region at a competitive disadvantage with these economies in attracting outsourcing and other forms of Foreign Direct Investment (FDI). In many instances, niche FDI manufacturing in the Caribbean is attracted largely on the basis of proximity to the North American market, which is suitable for just-in-time type production and language affinity. Nevertheless, as transport costs come down and costs considerations become more important there is nothing to stop some of these producers relocating to much cheaper locations such as China and Indonesia.

Even more important than absolute wage levels, is the growth in real wages relative to productivity growth. It is well known that an economy cannot have its cake and eat it, and thus growth in wages must be matched by similar growth in labour productivity to be sustainable. Real wage growth has outpaced productivity growth in most Caribbean countries in the last decade. In the OECS, for example, the World Bank estimated that for the period 1995-2002, public sector real wages grew on average by 2.1 per cent per year, while real GDP grew by 1.5 per cent and average labour productivity by less than 1 per cent.

Related to labour productivity and efficiency is the quality education and training of the workforce. Competitive advantage in the modern world economy is built more on knowledge and innovation than on traditional Heckscher-Ohlin resource-based comparative advantage. As the slow down in the rates of growth after the ISI model for some time has shown, simple factor accumulation from the use of depleting natural resources is insufficient for maintaining high levels of sustained growth. To drive high and high quality growth in terms of the quality of jobs provided, knowledge, innovation and creativity are key, as these factors are subjected to increasing returns, rather than the diminishing returns of traditional factor accumulation. Regional education and training systems have not proven adequate to matching knowledge and skills to the job market. There is also imbalance in the tertiary and technical vocational skills sets acquired by the students, with a balance much favouring business and social sciences at the expense of science and technological skills. This means that in an era when the region needs to restructure and upgrade its production, marketing and distribution systems to meet the imperative of competitiveness, it is lacking in the scientific and technological know-how required for these tasks.

Product quality is a most important factor in competitiveness, particularly for small producers, which confront small volumes in production. High product quality and differentiation allow small producers of selected manufactured and agro-industrial and other goods in the Caribbean to reap high average profits per volume. Where large economies, such as China and Brazil, can compete based on low prices and large scale production, Caribbean economies have to select competitive niches that allow them to maximise quality, product difference and use value.

Historically, the Caribbean was a region primarily of extraction with little value added and research and development input into the production and trading processes. Nevertheless, the expectation was that with independence and growth in living standards, the region would develop a research and development and innovation capacity commensurate with improving levels of development. On the contrary, however, the situation on the ground in the universities, training institutes, standards organizations and firms point to capacities in these critical areas that are below what would be expected of middle income developing countries. There is no magic formula for raising levels of research and development and innovation in a given economy. These vital factors seem to be affected by the levels of skills and training of the workforce, the levels of freedom and entrepreneurship in the society, incentives provided for developing new products and processes and links between universities and training institutes and firms, among other factors. Indications on the ground are that the Caribbean suffers from deficiencies in all these areas. In manufacturing, including electronics and textiles, for instance, regional value added remains low as production often entails assembly-type operations, with little room for creative input from the worker. In addition, these types of operations provide very little room for linkages with other sectors in the economy that could foster the development of a competitive cluster.

C. Efficiency and productivity as drivers of competitiveness

Higher factor accumulation in terms of presaging more labour, capital and natural resources in production and exchange is a limited means of driving growth and competitiveness¹³, especially in a competitive liberal trading environment. Indeed, as Lewis suggested in his labour surplus economy model, as the surplus labour is increasingly absorbed in production, and wage rates continue to rise, firms have to invest in raising the productivity of labour through improved machinery, organization and management. In fact, this also applies to capital or any abundant factor. Competitiveness based on static gains from increased factor accumulation is always short-lived.

Productivity growth is the key to sustained, dynamic competitiveness and long-term, stable growth. Indeed, the history of successful economies is one of continually reinventing themselves by ratcheting up productivity growth through the use of improved technology, managerial, production and coordination systems. Aside from growth in labour and capital productivity, which are essential for competitiveness, growth in total factor productivity is rather vital as it indicates improved value added due to technological progress, improved efficiency in production and organization, improvements in human capital stock, better capacity utilisation and transition to more efficient sectors and activities¹⁴. Table 7 below shows that total factor productivity growth for OECS countries actually slowed in the period of stronger trade liberalisation and market opening. Although crude, the data indicates that total factor productivity in the subregion fell from an average of 3.9 per cent in the 1980s to 1.3 per cent in the 1990s.

Although difficult to account for precisely, the slowdown in productivity growth seems to have been related to the impact of natural disasters that knocked out significant portions of the capital stock in a number of countries. Also, the fallout from these mean that countries could not invest the required resources in education and training to upgrade the human capital base of the workforce, which would have affected worker productivity and innovation. Moreover, structural change on account of the erosion of preferences and weaker demand for some exports in major markets meant that governments had to undertake significant debt to stimulate growth in the face of flagging private investment in the 1990s. With public investment focused on public infrastructure, and obtained at costly commercial rates, there was little stimulus to productive activity leading to a dampening of productivity growth and higher indebtedness. Indeed, debt sustainability is now a critical concern for the OECS and could pose a serious drag on future growth.¹⁵

¹³ Indeed factor accumulation at best only drives static competitive advantage that is readily competed away as new suppliers enter the market.

¹⁴ See World Bank, (2005), "Organisation of Eastern Caribbean States: Towards a New Agenda for Growth", Report No. 31863-LAC, Caribbean Country Management Unit.

¹⁵ The OECS countries are some of the most indebted countries in the world with debt to GDP ratio averaging 101.7% between 2000 and 2006.

Table 7: Total Factor Productivity Growth (Solow Residuals) for the OECS, 1981-2000

		1981-2000	1981-1990	1991-2000
Antigua and Barbuda	GDP	4.73	6.14	3.32
	Labour	0.42	0.32	0.51
	Capital	1.2	1.23	1.18
	TFP	3.11	4.59	1.63
Dominica	GDP	3.53	5.38	1.68
	Labour	-0.11	-0.1	-0.12
	Capital	0.84	0.98	0.7
	TFP	2.8	4.5	1.1
Grenada	GDP	4.62	5.57	3.68
	Labour	0.32	0.26	0.38
	Capital	1.23	1.13	1.34
	TFP	3.07	4.18	1.96
St. Kitts and Nevis	GDP	4.86	5.47	4.24
	Labour	-0.02	-0.33	0.29
	Capital	1.38	2.04	1.31
	TFP	2.45	0.43	2.65
St. Lucia	GDP	5.12	7.62	2.61
	Labour	1.84	1.82	1.86
	Capital	0.9	0.79	1.01
	TFP	2.37	5.01	-0.26
St. Vincent and the Grenadines	GDP	4.13	6.07	2.19
	Labour	0.56	0.64	0.49
	Capital	1.12	1.02	1.22
	TFP	2.44	4.41	0.47
Source: Kida (2004)				

Similar to the OECS, the Caribbean as a whole experienced a slowdown in total factor productivity in the 1990s compared with the 1980s. Growth in total factor productivity for the region as a whole contracted from over 2 per cent in the 1980s to just over 1 per cent for the 1990s. This reflected growth in more inefficient public investment, relative to private investment, specialisation in primary sectors such as sugar, rice and bananas that are based on static comparative advantage and private investments largely in tourism, where it is difficult to raise productivity. All in all then, it can be said that trade liberalisation has not led to expected relative productivity gains that would drive competitiveness and structural change as would have been expected.

Another issue has been the structural heterogeneity at the micro-level with a few leading firms, particularly multinational corporations making significant competitive gains, but with a high liquidation rate among domestic Small and Medium Enterprises (SMEs) that benefited little

from productivity gains by their larger counterparts. Therefore, unlike the predictions of orthodox theory, the post-liberalisation period was marked by increasing productivity divergence rather than convergence.

Apart from narrowing the relative productivity gap with competitors, improved trade performance and competitiveness require careful attention to improved coordination of production and trade, logistics and business services. Logistics as it relates to the management of production and exchange of goods and delivery of services and coordination of these processes is vital to market success. High quality logistics systems help to reduce the down time to complete transactions, speed the delivery of services, while maintaining quality and reduce logjams in marketing. The overall efficiency that results from improved logistics and coordination is critical to tourism, entertainment and professional services growth in the region.

D. General business environment

The overall business environment is a signal determining factor in firm competitiveness. A stultifying business environment raises the firm's transactions costs, diminishes productivity and undermines creativity, initiative and innovation - all keys to competitive production and trade. Table 4 below shows a number of indicators of the business environment in Caribbean countries from the World Bank's Doing Business database. On average the Caribbean did not rank very favourably in terms of the ease of doing business, compared with advanced economies and dynamic emerging economies. In the overall ease of doing business, the Caribbean had an average rank of 70 out of 175 countries, with an average percentile rank of 0.46. Saint Lucia was the best ranked CARICOM country with an index of 27, followed by Antigua and Barbuda at 33, while Guyana at 133 was the worst ranked CARICOM country. Intermediate countries included Belize with a rank of 56 and Jamaica with an index of 50 and, surprisingly, Trinidad and Tobago, in spite of dynamic business growth got a lower rank at 59. The relatively low rank for Trinidad and Tobago stemmed from low scores for contract enforcement (156), registering a property (154) and difficulty in closing a business (151), all rules of the game issues.

It is useful to pit the Caribbean's rank against four relatively small economies for a more relevant comparison than with large developed OECD economies. Of the four economies, the Caribbean compared favourably with Costa Rica at 105, but very unfavourably with Mauritius at 32, Ireland at 10 and Singapore at 1 (the stellar performer). The good performance of these small economies indicate that despite its small size the Caribbean, with the required effort, could upgrade its business and policy environment to strengthen the competitiveness and dynamism of its firms - both import-competing and exporters.

With respect to the different components of the matrix of doing business, a picture of comparative disadvantage relative to best practice emerges for the Caribbean. For example, with respect to the number of procedures entailed in starting a business, the Caribbean averaged 8 procedures, compared with 6.2 for OECD countries and 7.9 for South Asia and 10.3 for the Middle East and North Africa. Three countries, Jamaica, Saint Lucia and Trinidad and Tobago, ranked 45 out of 175 countries, largely due to the surprisingly high rank for Saint Lucia (27).

Table 8: Indicators of the Business Environment in Selected Caribbean Countries

	Jamaica			Saint Lucia			Trinidad and Tobago			Average rank
	2005 rank	2006 rank	Change in rank	2005 rank	2006 rank	Change in rank	2005 rank	2006 rank	Change in rank	
Ease of :										
Doing Business	48	50	-2	27	27	0	55	59	-4	45
Starting a Business	10	10	0	36	43	-7	32	35	-3	29
Dealing with Licenses	95	93	2	11	10	1	83	81	2	61
Employing Workers	24	26	-2	27	29	-2	26	27	-1	27
Registering Property	103	107	-4	45	51	-6	154	154	0	104
Getting Credit	96	101	-5	96	101	-5	41	48	-7	83
Protecting Investors	58	60	-2	18	19	-1	15	15	0	31
paying Taxes	161	163	-2	9	9	0	26	27	-1	66
Trading Across Borders	77	74	3	44	45	-1	22	22	0	47
Enforcing Contracts	45	46	-1	160	160	0	156	156	0	121
Closing a Business	22	23	-1	38	39	-1	151	151	0	71
<p>Note: 2005 rankings have been recalculated to reflect changes to the 2006 methodology and the addition of 20 new countries. Source: World Bank(2007), "Doing Business- How to Reform"</p>										

Table 9: Detailed Break down for Individual Indicators of the Business Environment

Starting a Business (2006)	Jamaica	St. Lucia	Trinidad and Tobago	Average	Region	OECD
Indicator						
Procedures	6	6	9	7.0	10.2	6.2
Time (days)	8	40	43	30.3	73.3	16.6
Cost (% of income per capita)	9.4	25.9	1.1	12.1	48.1	5.3
Min. Capital (% of income per capita)	0	0	0	0.0	18.1	36.1
Getting Credit (2006)						
Legal Rights Index	6	6	6	6.0	4.5	6.3
Credit Information index	0	0	3	1.0	3.4	5
Public registry coverage (% of adults)	0.0	0.0	0.0	0.0	7	8.4
Private bureau coverage (% of adults)	0.0	0.0	31.5	10.5	27.9	60.8
Employing Workers (2006)						
Indicator						
Difficulty of hiring index	11	0	0	3.7	34	27
Rigidity of hours index	0	20	0	6.7	34.8	45.2
Difficulty of firing index	0	20	20	13.3	26.5	27.4
Rigidity of employment index	4	13	7	8.0	31.7	33.3
Non-wage costs (% of salary)	11.5	5	4.5	7.0	12.5	21.4
Firing costs (weeks of wages)	60.5	56	67.1	61.2	59	31.3
Trading across borders						
Indicator						
Documents for export (number)	6	5	5	5.3	7.3	4.8
Time for export (days)	19	9	9	12.3	22.2	10.5
Cost to export (US\$ per container)	1750	1053	693	1165.3	1068	811
Documents for import (number)	7	8	7	7.3	9.5	5.9
Time for import (days)	20	19	13	17.3	27.9	12.2
Cost to import (US\$ per container)	1350	1163	1093	1202.0	1226	883
Source: World Bank(2007), "Doing Business- How to Reform"						

E. The role of the State

The neo-liberal orthodoxy views the State as a mere facilitator of private sector activity. Bounded rationality as applied to the State constrains it to creating an environment that is conducive to private agents optimising production and exchange. In this regard, the State is challenged to efficiency in the provision of public goods, such as defence and security, public health and education and a business-friendly economic environment marked by macroeconomic stability, adequate protection of property rights, a functioning legal and administrative system and a sound social safety net to a measure of equity among different groups. The emphasis in this view is non government failure and the need to provide safeguards to guard against it. However, there has long been a counterview, informed in part by the development process in a number of countries, that an active State that is more involved than simply being an ‘umpire’ and facilitator can help to catalyse equitable development.

Chang (2003) notes that the State can accelerate the process of restructuring, diversification and economic change by acting as an entrepreneur in its own right and also as a conflict manager. In its entrepreneurial role, the State can undertake or directly facilitate, through incentives such as tax breaks, depreciation allowances and other measures, certain large-scale production activities that might not be undertaken by the private sector. Chang noted that countries such as Japan, Korea, Taiwan, France, and one might add China in more modern times, have had relatively strong entrepreneurial States that pursued an active industrial policy aimed at creating dynamically competitive economies with production and exchange at the cutting edge of the technological frontier and adjusting to meet world demand.

In the Caribbean, the State has long been an active and important socio-economic agent. An open inquiry is required in the region as to the specific role and capacity of the State as an entrepreneur in the region. Interesting aspects of this debate would include to what extent is the average Caribbean State equipped to undertake direct production, especially in activities where, although indications point to socially beneficial returns, private investment is not forthcoming? Another is how far can the Caribbean State be categorised as a learning State that can remedy past policy and implementation mistakes.

F. The role of institutions in competitiveness

One of the black boxes that advocates of the benefits of trade liberalisation often fail to consider is the role of institutions in driving the competitiveness of firms and sectors. Rodrik (1997)¹⁶ argues forcefully that the floundering of growth in many developing countries after 1975¹⁷ was not so much due to the lack of openness and integration into the world economy, but to weak institutions for promoting structural change, macroeconomic stability and conflict

¹⁶ See Rodrik, Dani (1997), “Globalization, Social Conflict and Economic Growth”, Prebisch Lecture, UNCTAD, Geneva, October 24, 1997.

¹⁷ Rodrik notes that for 50 countries, growth averaged 3 per cent between 1960-1975, the golden era of post-war growth, and incidentally a period of import substitution industrialization for many. However, after 1975, only 9 countries - seven in East Asia and Malta and Botswana were able to maintain of 3 per cent or more.

management. Rodrik provided a basic formulation of the link between growth, shocks, social conflict and institutions as follows:

$$\Delta\text{Growth} = -\text{external shocks} \times \frac{\text{latent social conflict}}{\text{Institutions of conflict management}}$$

This formulation suggests that the impact of an external shock on growth in an economy is greater where there is more latent social conflict and weaker institutions for conflict management.

The quality of institutions for upgrading productivity and efficiency, such as productivity councils, standards bureaux, business development, entrepreneurship development institutions, marketing, coordination and logistics agencies are vital to fostering competitiveness.

It is well accepted that to be an effective catalyst for competitiveness, trade liberalisation should be well sequenced. This demands that the required institutions are in place to undertake the sequencing and implementation of trade reforms. Without the building up of the institutional capacity first trade reforms are likely to be derailed leading to a low growth impact from trade opening. As Nobel Laureate Douglas North noted, history is characterised by the interaction among three elements - institutions, organizations and individuals. Moreover, in the Caribbean there has been a legacy of weak institutions since unlike active settler communities, like the United States and Canada, absentee plantation ownership in the region was not conducive to building up strong institutions.

As the region accelerates the drive to international competitiveness of its firms and industries, serious attention must be paid to the quality and efficiency of its institutions. At a practical level, the public service must be transformed to dynamic and cost effective bureaucracy. The legislative machinery must enhance the timeliness and quality of the administration of justice and dispute settlement bodies both in commerce and other areas must be strengthened. Importantly, the turn-around time for the clearance of goods in customs must be significantly reduced in most countries and the level of service upgraded.

V. Policy issues and recommendations going forward

Trade is well recognised as an important engine of growth and development. Moreover, free trade by disciplining domestic producers through competition, providing cheaper inputs into production and facilitating the adoption of new and improved technologies, among other benefits, is an established catalyst of improved trade performance and growth through stronger growth in net exports. These well-established and generally accepted principles and outcomes beg the question as to why the period of trade liberalisation and general opening up and market friendly policies in the Caribbean has not corresponded with improved trade performance, competitiveness and economic growth (both in terms of growth rates and volatility of these rates).

There are two schools of thought on the reasons for the relatively poor trade and competitiveness performance in the face of market opening and removal of barriers. The first view is that liberalisation remains constrained and is not fully adequate to the task of unstopping bottlenecks in production and exchange that foster the development of a competitive regional economy. A corollary of this view is that there have been problems with the timing and sequencing of reforms. The argument here is that liberalisation was undertaken without the underlying reform of the institutional and policy framework and the restructuring and diversification of production systems to ensure its success. In effect, supply side bottlenecks continue to constrain competitiveness and growth. Consequently, to a large extent, Caribbean countries have expended significant resources in negotiating market access, without the concomitant development of products to trade.

The second view challenges the first, and contends that there is a problem with the logic of the trade liberalisation theory itself. Therefore, trade liberalisation might not benefit all countries, but the ability to benefit depends on productive capacity, institutions and policy-making. The fact that the average rate of growth of per capita income in developing countries halved from 3 per cent during the period of ISI in the 1960s and 1970s to 1.5 per cent during the heady years of liberalisation in the 1980s and 1990s does not provide much to justify unilateral trade liberalisation. In addition, despite decades of market liberalisation, the average income of developing countries is still only 15-20 per cent of that of developed countries, measured in purchasing power parity dollars (Wade 2006). Therefore, trade liberalisation and specialisation based on static comparative advantage has not led to the anticipated catch/convergence of developing countries with their developed counterparts. This, however, does not provide justification for widespread import substitution. Nevertheless, it suggests that selective industrial policy that targets certain sectors based on empirical studies of actual and potential competitive advantage might be quite relevant for developing countries such as the Caribbean. As noted by Akyüz (2006)¹⁸, developing countries should have the option of using tariffs on a selective basis as needed for industrial upgrading, while remaining subject to multilateral rules. This, he said, could be done by setting a reasonable limit on average tariffs, while leaving rates on individual products unbound.

An important consideration is that proponents of both models provide a useful insight when they note that the failings of either model often stem from the practical design and implementation of the policy measures that they imply and not fundamentally from their logic and conceptual framework. For instance, in the case of ISI, countries often overreached themselves by developing activities in which they did not have the slightest comparative advantage and the failure to promote exports side by side with import-competing production, as was done in the successful Asian Newly Industrialising Countries (NICS).¹⁹ Meanwhile, the export-led growth strategy, fails to give sufficient weight to domestic absorption through

¹⁸ See Akyüz, Yilmaz, Milberg, William and Wade, Robert (2006), "Developing Countries and the Collapse of Doha Round: A Forum, Challenge, November-December.

¹⁹ Incidentally, in the Caribbean, although the Lewis model has been championed as the forerunner of regional ISI strategy, Sir Arthur Lewis highlighted the importance of a balanced growth strategy that includes both an active export drive and import-competing activities, unfortunately, during the phase of ISI, Caribbean policy makers adopted the latter with very little focus on the former, with adverse consequences. Incidentally, the Asian NICS were very faithful to Sir Arthur's thesis and prospered as a result of it.

consumption and investment in import-competing activities as one of the bases for growth and development.

Palley (2006) notes that the current orthodox paradigm, which assigns a key role to trade liberalisation, is built on export-led growth theory and neoclassical economic growth theory. However, he argues that this framework that premises development on export-led growth and capital accumulation is flawed and incomplete. He notes that although this model gets some things right, it also gets some things wrong (sins of commission), and misses doing some things that it should (sins of omission). This missing element in the model, he avers, is the demand side. Indeed, the demand side has been addressed in Thirlwall's balance of payments constrained model, which views the balance of payments as the single most important constraint to growth and development in developing countries. The crux of the demand side argument is that many developing countries such as the Caribbean are largely price takers in international markets, with low price and income elasticities of demand for their exports. This stems from the demand that they face in exporting largely primary commodities or low technology manufactures, which are more easily substitutable, little differentiated and face long-term structural decline in their terms of trade.

The question is what option is left for developing countries such as those in the Caribbean. The first issue seems to be that there is no need to 'throw out the baby with the bathwater', as both the export-led growth model and the ISI model contain completely plausible and logical aspects that could be included in an integrated development strategy. The fact is that the real world is much more nuanced than the 'all or nothing' model often presented by proponents of either one or the other of these models.

In light of the challenging policy issues outlined above a few recommendations are provided. These are meant as suggestive rather than definitive.

Given that the Caribbean is indicated to have benefited from static gains from trade liberalisation due to improved x-efficiency and allocative efficiency, regional producers and policy makers should promote research to identify sectors and activities where there is still good potential for exploiting these efficiencies, and provide incentives for firms to invest in these activities. This is important because accumulation is about continuously exploiting new areas of efficiencies.

Caribbean countries articulate an integrated development model that creates a suitable balance between export-led growth and domestic demand-led growth. The current model with its heavy overemphasis on export-led growth as a driver of competitiveness is unsuitable to the needs of the region. As small, open economies, the region would always need to promote exports to fill the foreign exchange gap. Nevertheless, in economic history, exports are a corollary of domestic production. The region therefore needs to seek out areas of domestic demand such as in agricultural food production, professional services, including business development services, logistics, entertainment and recreation services that remain underexploited and thus tend to result in higher prices than necessary.

On the supply side, the region needs to tackle a number of critical issues to foster competitiveness in a liberal trading environment. Of utmost importance is the need to transcend specialisation based on static comparative advantage. As suggested before, the Caribbean remains locked into plantation economy specialisation with little value added, technological intensity in production and product differentiation. This applies both to goods such as sugar, bananas and rice, but also to tourism (based largely on sun, sea and sand) and enclave manufacturing. Static comparative advantage specialisation in an era of globalisation is simply unviable. This is particularly so for traditional primary production such as sugar and bananas, where preference erosion has made much production largely uneconomic, but also for traditional tourism (marked by limited product differentiation, service development and innovation) and low end offshore financial services.

The Caribbean must plot a strategy to develop dynamic comparative advantage in selected activities that are at the frontier of sustained world demand. This would entail raising value added, productivity and efficiency in traditional sectors, including sugar and rice in countries such as Guyana, where there is still the prospect of viability and transitioning out these activities in other sectors where it is evident that there is little or no hope of competitive production, as has been done in the case of sugar in St. Kitts and Nevis. In the mineral sector including bauxite/alumina, petrochemicals and gold mining, an innovative strategy should be developed to kick start or accelerate downstream activity. This could entail incentives to promote joint venture partnerships built on technology transfer, learning by doing, improvement in technical and managerial skills of the workforce and encouragement of a culture innovation, invention and excellence in production and exchange.

There is the need for a diversification and restructuring fund at the multilateral level to accelerate the beneficial integration of developing countries in the world economy. Caribbean stagnant commodity producers, in particular, can benefit from this fund to embark on new areas of production and trade and to dynamise stagnant production systems, especially for commodities to make them competitive by adding value, increasing productivity and quality, reducing transport and other transactions cost and enhancing after sales service.

Conclusion

In the wake of trade liberalisation and globalisation, competitiveness has become an imperative for Caribbean economies. In fact, the writing was long on the wall for specialisation in static primary production such as sugar, bananas and rice, based on preferences. However, countries persisted because it is always difficult to mobilise a constituency for change in boom times. Countries are now aware that constructing development on pillars of preferences and low value added traditional activities is a lost cause. It is now well recognised that a competitive economy is key to sustaining high long-term growth and development. This has been underscored by the experience of successful economies in Asia and other regions that have been catching up (converging) with OECD countries. The ‘holy grail’ for the region is how to unlock domestic production and trade to build competitive industries/activities and institutions that can promote equitable growth.

Although there is no silver bullet for developing and sustaining competitiveness there are some factors that contribute to it. Ex-ante, the main engine of competitiveness is relative productivity and efficiency in production and exchange. Sluggish factor productivity growth in the region has been a major drag on competitiveness and economic restructuring. Unfortunately, trade liberalisation does not seem to have really accelerated the process of dynamic change. This does not mean, however, that the region cannot benefit from a more open trading regime, as such this holds the potential to stimulate more competition and improved methods of doing business. Nevertheless to realise such gains, the Caribbean needs to get its domestic policy house in order. There is a clear need to raise the technological intensity of production by strengthening the quality of capital, processes, organization and managerial systems at the disposal of workers. In the essential tourism sector, careful attention needs to be paid to product and service development, differentiation and marketing. The region simply cannot continue to rely on sun, sea and sand tourism, but must diversify strategically into heritage, nature, geriatric, health, sports and culture and other branches of tourism. There is also the need to improve product branding to delineate different product groups by costs and quality of service, so that the consumer can know up front what to expect. Importantly, human resource training in the sector should focus on ways to combine technology, organization and management to reduce costs, raise product quality and to innovate to develop new products and combinations of products and services that would be demanded by the consumer.

Critically, private producers need to benchmark their production and exchange systems by international best practices to achieve minimum standards in production, advertising, marketing and after sales services. This would require international certification, such as ISO 9000 and 9001, in manufacturing and some services to boost general acceptability and demand on the international market.

There is also a need to improve the business environment to reduce the transaction costs in setting up and running successful businesses in the region. At present, high levels of corporation tax, poor quality services and long administrative delays, especially in obtaining business licences and clearing goods at customs raise the cost of doing business in many countries of the region.

Careful attention must also be paid to the role of the State in the economy, as market failure is a real problem in the region. Although the State should not overreach itself, selected industrial policies to facilitate growth and competitiveness in key clusters of economic activity might be necessary, especially in the wake of flagging private investment in a number of countries. Nevertheless, the State should promote a business environment that facilitates private entrepreneurship.

At a more generic level, there is need for a more balanced development model that combines export promotion with domestic activity based drivers of growth and competitiveness. Domestic agriculture, for example, holds great potential for acting as a greater growth stimulus with the right incentives and can also help to alleviate the food trade deficit and encourage healthier eating choices. Light manufacturing, agro-processing and domestic services are all underdeveloped and can act as better catalysts for growth and competitiveness.

Regional integration also has a vital catalytic role to play in boosting competitive production and exchange. Although regional trade remains below par, reflecting external orientation, this is not necessarily cast in stone. The regional market holds good potential for providing an incubating testing ground for new products and services, where entrepreneurs can learn the 'tricks of the trade' to penetrate external markets. The larger scale economies of the regional market are also essential for achieving marketing critical mass for various types of goods and services. Importantly, the regional coordination in the area of product/service standards, quality and competition practices are essential to the development of cutting-edge activities that can hold their own in any theatre of competition.

Ultimately, however, improved trade performance and especially competitiveness are not ends in themselves, but means to the ends of equitable growth and development. These key drivers must be leveraged to enable the Caribbean to create more equitable and dynamic societies, with higher living standards for its people.

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