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PROPOSAL FOR THE CDCC PROGRAMME ON INTERNATIONAL TRADE



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Among the most outstanding characteristics of the countries of the Caribbean region is the subordination of their economies to external trade. It can therefore be said that the smaller a nation the more open it is to the outside world. In addition, the export structure of the CDCC countries shows that the greater part of their exports consist chiefly of primary and agricultural products, the prices of which are subject to sharp fluctuations and of which the commercialisation and production are still controlled by enterprises of multi-national character.

Notwithstanding the above, the efforts accomplished within the region are worth mentioning, not only in the field of integration but also in the application of policies of import substitution and other aspects of the economic development of the countries in question, including aspects related to greater State participation in the control of external trade and of financing from external sources.

In this context, and in the light of the above, it would be of the greatest interest for the region:

- a) To carry out studies designed to reveal the various configurations of expansion and diversification of commercial relations, not only among the CDCC countries but also with other countries of the Latin American area, aimed at increasing trade relations in the region;
- b) To outline a code of conduct for multi-national enterprises which would have as its goal the limitation and gradual elimination of the influence exercised by such enterprises in the region;
- c) To carry out studies on the balance of payments of each of the countries of the region, for the purpose of discovering their capacity to absorb external financing in the past and possible new sources of such financing, as well as to discover activities in the financial and monetary sphere;

- d) To examine, especially, the import variable, with a view to analysing both the influence of imported inflation and products capable of being substituted.

Within these studies, the following aspects must be emphasised: identification of products with possibilities for increasing intra-regional trade, clarification of extra-territorial obligations and undertakings, i.e. those arising out of the General Agreement on Tariffs and Trade (GATT) and/or association between some of the countries belonging to some of the regional sub-groups with countries or economic communities, such as the European Economic Community, the British Commonwealth of Nations, the United States of America, the United Kingdom, Canada, etc. The purpose would be to make clear any possible obstacle to the development of trade in the region. In addition, the goal is to formulate proposals aimed at diversifying external trade, to outline a possible co-ordination and simplification of the various customs systems and other procedures, and also to improve infrastructure. These proposals must be analysed on the basis of specific problems affecting the traditional exports of the area, and the need to maintain or seek to obtain favourable treatment for such products.

In addition to the above-mentioned studies and mandates within the framework of the CDCC, attention will be concentrated on the expansion of intra-Caribbean trade and possible strategies for negotiations and diversification of trade relations between the CDCC and third countries. In this context, the efforts of the CDCC countries within the framework of other organisations, such as the Latin American Economic System (SELA) and the Group of Latin American and Caribbean Sugar-Exporting Countries (GEPLACEA) will be taken into account. The overall goal would be to delineate the concrete actions which the members of the CDCC could adopt for the purpose of promoting their mutual trade.

It is also necessary to draw attention to the uncertainty prevailing with regard to the behavioural patterns of the external sector of the region, given the magnitude of events in the sphere of the world economy and the rapidity with which they follow one another. Nevertheless, such aspects as currency earnings or balance of payment surpluses or deficits are features essential to the anticipation of some aspects of the behaviour of the external sector of the countries of the region, and these features can to some extent be made explicit by means of a model

for forecasting the external trade of the CDCC countries. This model can be useful for the formulation of a short-term strategy in the external sector, and although very general, it can provide indications for the simulation of payments in the CDCC countries. The model to which we refer is explained below.

Model for Forecasting External Trade for Countries of the Caribbean Development and Co-operation Committee (CDCC)

Introduction

Within the framework of the CDCC and in matters relating to International Trade, it is of the highest importance to possess adequate means of knowing external trade trends, means which permit, in the narrow sense, the formulation of trade policies within the ambit of the countries and, in the broad sense, the proper adaptation of such policies in the region as a whole.

It must be borne in mind that even at the present time the possibilities of trade relations among the CDCC countries are not at all known, and that as far as relations between these countries and the Socialist bloc are concerned there are no reliable data.

In addition, in the matter of the construction of a world trade network, these countries constitute a relatively similar group and are treated in an exogenous or residual manner or are purely and simply excluded from the network. This leads to the conclusion that it would be desirable to perfect, in step with the efforts to gather understanding and knowledge of the past evolution of trade and its future projections, projection methods capable of furnishing ideas on the future of the trade of the countries making up the Committee.

An adequate knowledge of the external trade of the CDCC countries is important because of the fact that these countries show structures of production and external trade characterised by considerable openness to the outside world, since it is in the outside world that the majority of economic impulses and incentives to growth originate. These countries show a double dependence vis-a-vis the industrialised countries,

in that on the one hand they depend on the latter for their supply of capital goods and manufactured products with a high content of very sophisticated production techniques, and on the other for market outlets for their agricultural products, the consequence being interdependence between imports and exports. In other words, import of capital goods and manufactured products depends on exportable surpluses, while export earnings depend on the evolution of prices of exportable products, which in the long term has not always been favourable and which is characterised in the short term by considerable fluctuation.

Without any doubt, the insufficiency of export earnings is counter-balanced by the flow of bi-lateral or multi-lateral aid, but this compensation brings with it certain limitations. For example, the technical limitations are reflected in the dependence of trade balances in relation to capital balances. On the other hand, the political limitations amount to the dependence of the recipient country in relation to the donor country, whose intentions are not often disinterested. In addition, as developing countries the CDCC countries are aware of the growth of their external debt, as well as of the instability of their export earnings.

The countries of the Caribbean have been unanimous in preferring trade guarantees to capital movements and international donations. It is sufficient to repeat the slogan "trade, not aid" proclaimed by the developing countries in GATT. This slogan reveals both a surge of self-respect and a lucid economic analysis of the situation of these countries, for the reason that external trade is for them the best means of accelerating their economic take-off to the point of self-sustaining growth; and in the final analysis, for the reason that the products upon which their exports are based, i.e. primary products, basic products, crude oil, etc. have strategic importance in the world trade system both for the developed and relatively less developed countries.

These universally familiar considerations demonstrate the importance of forecasting of external trade of the CDCC countries. It would therefore be desirable to analyse, by means of an examination both theoretical and practical, the forecasting techniques in use which show the links existing between the external trade of these countries, their internal growth and the evolution of world trade.

## 2) THEORETICAL FRAMEWORK

The external trade of the CDCC countries is characterised, as is that of other developing countries, by a certain ambiguity. On the one hand, external trade is a measure of external dependence, but on the other hand, external trade contributes more intensively than in the case of other countries to the growth of small nations such as the CDCC countries. As for long-term capital movements and external aid, it can be stated that their contributions depend among other things on the recipient country's capacity for absorption of capital, on the multiplier effect of aid, on the existence or non-existence of leaks, and on the amount of return flow....<sup>1/</sup>

Considering trade exchanges above with all other factors held constant, one may conclude that the fundamental facts tend to be predominant in the orientation of the analysis; these facts are: the instability of export earnings which jeopardises the regular financing of the imports necessary for the maintenance of growth, and in addition, the other significant fact would be the complexity of the mechanisms of import substitution.

### 2.1 THE INSTABILITY OF EXPORT EARNINGS

The instability of export earnings has its origins principally in the insufficient diversification of exportable products and in the fluctuations of export prices. These causes bring about negative effects in the maintenance of a high growth rate, since they sometimes slow or reduce economic growth.

The excessive concentration of exports has been revealed not only by studies carried out by ECLA, but also at the level of studies in individual countries. This concentration can be manifested in a very limited range of products, or else in the limitation of export markets to a small number of countries. Barbados, Belize, Cuba and the Dominican Republic in particular depend to a great extent on their sugar exports. Jamaica depends largely on its bauxite exports while the Bahamas and Trinidad and Tobago depend on their exports of petroleum and petroleum derivatives. As for the destination of exports, it may be observed

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<sup>1/</sup> For greater detail see OHLIN, G. "Les Politiques du Commerce Extérieur", Dunod, Paris, 1966.

that the most important markets for the exports of the area are the United States and Britain. Without any doubt, even should up-to-date information permit an analysis of whether exports have been diversified, there remains the factor of concentration of external trade of the CDCC countries, which increases their vulnerability.

On the other hand, price fluctuations and deterioration of terms of trade reinforce the instability of export earnings of countries such as those of the CDCC. In the short term, the quoted prices of basic products undergo considerable annual variations. On the one hand, food and agricultural products for industrial use experience the immediate influence of the King effect and the delayed action of Robertson or Lumberg type out-of-phase fluctuations. On the other hand, industrial products show a close relationship between their quoted prices and the current economic circumstances of the developed countries. Notwithstanding the above, part of the fluctuations can be dampened by international agreements on basic products, just as by the action of regional emergency funds, subject to the serious limitation that a large number of exportable products cannot be stored.

In the long term, prices at the export stage do not seem to keep pace with world prices, and above all with prices of imported manufactured products. This is the well known thesis of the long term deterioration of terms of trade of developing countries, which is in the final analysis generally expressed as an obstacle to the internal growth of these countries. This is the result of the inverse relationship existing between the instability of exports and the level of investment in developing countries. When revenue from exports is too unstable, the level of investment is low and vice versa. It is well known that economic take-off cannot occur without the achievement of a minimum level of investment; it can be deduced that instability of export earnings appears rather as an indirect obstacle to growth in small countries such as those of the CDCC. In addition to all this, it must be pointed out that links also exist between economic growth and imports, or rather, between growth and the import substitution mechanism.

#### The Complexity of Import Substitution Mechanisms

The process of import substitution can be defined as the complex of mechanisms by means of which a country replaces certain categories of imports, particularly



imports of manufactured goods by local manufactures. It should be pointed out that it is much easier to replace imports of consumer goods, or semi-processed products involving a widespread technology, or especially, those goods of which a shortage would not result in a restriction of growth. On the other hand, the replacement of strategic products or very sophisticated capital goods is much more difficult, given that no government would accept the risks of a lengthy interruption in the supply of such products; nor would any government accept either a rise in price or a drop in quality of products such as fertilizer, insecticides, crude petroleum, or equipment for ports, railways or energy-producing enterprises. This means that the replacement of such products requires overall planning.

The direct and indirect effects of a process of import substitution can be described as follows:

- a) Reduction of imports and increase in national production through the installation of the replacement industry;
- b) Transfer of production factors to the newly created industry and re-distribution of capital and jobs among the various sectors;
- c) Re-distribution of income, linked to these transfers;
- d) Improvement of the trade balance, as long as other categories of imports do not increase and exports are maintained at previous levels;
- e) Possibility of using the surplus either for the accumulation of foreign exchange, capital transactions or new imports;
- f) A possible need to import equipment because of the installation of new industry;
- g) Possible reduction in the production of other sectors of the economy if the factors of labour and capital are more productive in the new industries;

- h) Possible reduction in the production of the export sector, either because of the mechanism cited in (g) above or because of a rise in the prices of the inputs and/or the factors of production in these sectors, which manifest themselves in higher export prices.

As can be appreciated, a process of import substitution is not very easy to design, given the intervention of different factors which affect the overall economy in different ways. The reason for this is that such a process may have positive effects in each of the sectors, while having a negative overall effect on the economy. In order to have a better overall view, one must possess a deep knowledge of the manner of diffusion of the different impulses among all the sectors, and be able to determine the key industries which can have advancing and retarding effects in all the sectors. Nevertheless, the economies of the CDCC countries are marked by a disarticulation between the modern and traditional sectors, which is an obstacle to the rapid propagation of economic impulses. Given these causes, the policies of import substitution put into effect by these countries have not produced the advancing and retarding effects necessary for the achievement of the desired development goals.

These two basic characteristics of the external trade of the CDCC countries - instability of export earnings and difficulty of implementation of a process of import substitution that might permit greater internal autonomy - are not generally integrated into techniques of projection, which are usually based on or copied from the techniques used in developed countries.

#### Export Perspectives for the CDCC Group of Countries

These can be extrapolated in two ways: the first consists of taking a given primary product and carrying out a study of its market prospects. In this regard, econometric studies on the world market for natural rubber, tin, peanuts, jute, etc. can be cited. These apply the most important developments to the export possibilities of the countries producing these primary products. The second method consists in starting from the needs of the customer countries and deducing the exports of the developing countries from the relevant imports of the industrialised countries.

In point of fact both methods are almost identical, in the sense that both are based on the postulate that the economic activity of the major industrialised countries constitutes the dynamic element of the world economy. These countries represent the dominant sector, while the producers of primary products are satisfied only to react in one way or another to the economic impulses of the industrialised countries.

In a study<sup>2/</sup> on the growth of developing countries and the development of their external markets, these principles were applied. The author projected to 1975 the exports of the sterling area, with the help of variables almost exclusively characteristic of the demand in developed countries: Population level and population growth (for food products); variations in the level of industrial activity, perspectives of evaluation of real income and its distribution. In the same way, for the projection of exports of developed countries, export earnings are forecast as a function of hypotheses about the maintenance of their percentage of the market relative to the total imports of customer countries for a given category of products.

As far as food products are concerned, the import content of the final demand of the developed countries plays an important role in the evolution of these parts of the market.

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<sup>2/</sup> MAIZELS, A.B. "Exports and Economic Growth of Developing Country" Cambridge University Press 1968.

### Export of Manufactured Products

These are labour-intensive, low-wage products of which the industrialisation was initiated either by national capital or by multi-national enterprises. At the present time, almost no projection studies exist in this field, except those carried out by the International External Trade Centre (ITC). Without any doubt, it is very difficult to obtain projection information, because of the many specific forms this information must take in order to be operationally useful (range of products and countries, relaxation of its very simplistic hypotheses concerning the production function, possibility of reversibility of factor intensities, etc.) Nevertheless, an effort must be made to acquire a general projection for this type of product.

The prospects for exports which have been detailed by developing countries such as those of the CDCC exhibit a general picture containing the most detailed projections available for each country.

### The Principle of Projection

The techniques which have been adopted to project the components of external trade of developing countries are scarcely different from the method described in the previous pages. These projections and the models very often used are not adapted to the situation of developing countries. Nevertheless, in a United Nations study<sup>3/</sup> there can be found a method of forecasting imports which seems relevant and contains various phases.

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<sup>3/</sup> UNO: "A Study of Long Term Economic Projections of World Economy" 1964.

- I Breakdown of imports into two or three large groups: equipment, intermediate consumption goods, and goods destined for final demand;
- II Determination of the imported value of the last two categories by means of a regression on the GNP, the GDP or such and such a component of the final demand (consumption or family income);
- III Determination of the finance capacity of total imports by means of the following relation:

$$CFM = \frac{PX}{PM} X + \frac{EI}{PM} + \frac{E2}{PM} + \frac{1C}{PM}$$

X = Volume of actual exports

PX and PM = Unit price of exports or imports

E1 = Balance of utilisation of services

E2 = Revenue from external factors

1C = Net long term capital inflows

This relation is no more than an accounting identity based on an extension of the notion of import capacity (trade relations). From it can be obtained a maximum group of products capable of being related to payments for imports, without disequilibrium in the balance of payments. If CFM is known it is then possible to determine, by difference with the projection of intermediate and final consumption goods, the value of imports as a proportion of the value of capital goods. It is also possible to deduce on the basis of the forecasts made in II above, and to add on, the value of imported capital goods. This model has been used to a considerable extent in Latin America, with certain adaptations.<sup>4/</sup>

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<sup>4/</sup> Llinas de Toledo F. "Un modelo destinado al análisis del Sector Externo de las Economías en Vías de Desarrollo". Economía aplicada, Paris 1969, No. 1-2, Pág. 113-124.

Elements for the Projection of the Balance of Payments  
of the CDCC Countries

Until now projection techniques have shown the strong relations existing between the external sector of developing countries and the conditions of internal growth of those countries. It is therefore possible to state that it is at the overall level of the balance of payments that these relations are most clearly perceptible: external capital and direct investment of foreign enterprises are elements which exercise a determined influence on the conditions of internal production, especially in the export sector.

It is our criterion that a model of external trade projection for the CDCC countries must be the simplest possible, since it cannot be forgotten that in these countries statistical systems are not highly developed. The proposed model was developed by the economist Diarassorba<sup>5/</sup>, and we present it in modified form without altering its content. This model is important because it relates the different accounts of the current and capital account balances, and can be integrated with the significant aggregates of internal growth. Its structure is made up of seven (7) equations:

i) Trade Balance Equation Bc

$$Bc = prX_t - M_t$$

XeM = Value of imports in local currency

Pr = Relationship of export prices to import prices;  
the equation thus expresses the capacity of  
imports to be financed by exports.

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<sup>5/</sup> Diarassorba C.V.: "Elements of a Balance of Payments  
Projection for under-developed countries".  
Ivory Coast Journal of Economic and Social  
Research. No. 1, Ivory Coast, 1970.

ii) Equation of Services

Because of the frequent absence of a national merchant fleet and because of the mass of services acquired abroad, the balance of the service account is always negative in developing countries. The generally accepted hypothesis is that the service account represents a fraction of the total import of merchandise<sup>6/</sup>, or  $S_t = sM_t$

iii) Capital Earnings Equation

This account contains the following items: repatriation of profits of foreign countries and sums paid as interest on long term private foreign capital. Taking into account that capital earnings are minute, the flow of expenditure  $F_t$  can be related to the variations of the GNP,  $Y_t$

$$F_t = jY_t$$

iv) Equation of Current Account Balance

$$B_{cc} = B_m - S_t - F_t = prX_t - (1+s)M_t - jY_t$$

v) Equation relating imports to National Economic activity of the CDCC Countries

$$M_t = m_0 + mY_t$$

m = Marginal propensity to import

m<sub>0</sub> = Irreducible imports

$$Y_t = C_t + I_t = c_0 + cY_t + kY_t$$

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<sup>6/</sup> The author adopts a position that is subject to criticism, since he relates the service account to total exports.

- co = irreducible domestic consumption
- c = marginal tendency to consume
- k = mean rate of investment
- $M_t = m_o + mco + m(c-k)Y_t$

vi) Equation of long term capital movements

If long term capital outflow is accepted as minute, the balance on capital account is essentially composed of capital inflow, which is admitted to depend on the profitability of national investment

$$K_t = rI_t = rkY_t$$

- r = mean rate of profit of domestic I

vii) Equation for balance of payments equilibrium  $B_p$

$$B_p = B_c + K_t = prX_t - (1+s)M_t + (rk-j)Y_t = 0$$

This last relation permits the determination, for given values of all parameters, the following:

- a) Imports realised for a given quantity of exports at a level of the national product

$$M_t \text{ less than or equal to: } a_1 X_t + b_1 Y_t$$

$$a = \frac{pr}{1+s} \quad b = \frac{rk-j}{1+s}$$

- b) Exports required to finance, without disequilibrium of the balance of payments, a given quantity of imports required for internal economic activity.

$$X_t \text{ greater than or equal to: } a_2 Y_t + b_2$$

$$a_2 = (j-rk+m) \frac{1+s}{c+k} (pr)^{-1}$$

$$b_2 = (1+s) (m_o+mco) (pr)^{-1}$$

It is our belief that a model as simple as the one set out here is capable of providing a very general set of indicators on the simulation



of the external payments of the CDCC countries, but one from which deductions can be made. For better application of the model and to maintain continuity, if the model is accepted by higher authority, teamwork is necessary between the officials responsible for Economic Affairs and Statistical Services and a Research Assistant. The latter is required to undertake certain research tasks essential to the proper functioning of the work we have proposed.

