PROPOSALS FOR THE LIBERALIZATION OF TRADE AND INVESTMENT IN THE ASSOCIATION OF CARIBBEAN STATES (ACS)
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Introduction

Wide-ranging economic reforms, including the liberalization of trade and investment regimes, have contributed to the increased pace of global economic integration. Notable among them were the implementation of the results of the Uruguay Round of trade talks, which included an agreement on trade related investment measures, the continuation of unilateral trade policy reforms and the establishment or revival of numerous trade and integration arrangements. All of these developments have contributed to a more liberalized global trade and investment regime and, in turn, have reinforced global economic integration, as was evident from increasing rates of growth of world trade and investment.

The volume of world trade grew by 8.9 per cent in 1995, or more than double the growth rate of global output, which stood at 3.5 per cent for the same year. In Latin America and the Caribbean, exports of goods grew by 21.6 per cent in 1995 while imports grew by 12.3 per cent in the same year. In 1995, global investment flows grew by 40 per cent to reach a total value of US$315 billion. Most of these flows took place among the industrial countries. Inflows to developing countries amounted to US$100 billion in 1995 and were highly concentrated in Asia. China was the largest recipient of these inflows accounting for 40 per cent of the total. In Latin America and the Caribbean, foreign direct investment grew by more than 5 per cent between 1994 and 1995, to reach an estimated total of US$27 billion with Mexico being the largest recipient in the region and the rest accounted for mainly by Argentina and Brazil. Foreign direct investment originating in developing countries also increased, from US$39 billion in 1994 to US$47 billion in 1995. In Latin America and the Caribbean, outflows of foreign direct investment amounted to US$3.8 billion in 1995, with Brazil and Chile being the largest sources.

The convergence of trade and investment policies and the establishment of more liberalized trade and investment regimes were also evident in the Western Hemisphere. Most countries were undertaking wide-ranging trade and investment reforms and were actively participating in the multilateral trade and investment liberalization efforts, as well as in subregional and hemispheric efforts designed to promote further integration.

Member countries of the Association of Caribbean States (ACS) were also participating in activities aimed at the liberalization of trade and investment, globally. In addition, they were engaged in efforts to further integrate their economies at the hemispheric and subregional levels. The latter efforts were taking place at several levels and reflected in the revitalization of the Central American Common Market (CACM), the Caribbean Common Market (CARICOM), the Organization of

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1 ECLAC: Preliminary Overview of the Economy of Latin America and the Caribbean, 1996.

Eastern Caribbean States (OECS) and the Andean Pact. Notable also were the signing of numerous bilateral and multilateral trade and investment agreements of various types as well as the establishment of the Group of Three and the North American Free Trade Agreement (NAFTA). Most of the countries were also involved in preparations for the negotiations of the Free Trade Area of the Americas (FTAA) which was scheduled for the year 2005. These arrangements had differing objectives, ranging from the relatively simple liberalization of trade on a selected number of goods, to a free trade area which covered most trade in goods and services, investment and incorporated commitments to the protection of intellectual property rights. Some of the agreements sought to achieve deeper integration through the creation of a common market or an economic union. Nevertheless, despite the complex network of hemispheric activities, some ACS member countries do not belong to any particular grouping and have not been involved in any of these developments. However some of these countries, notably Cuba, have signed bilateral agreements with both members and non-members of the ACS.

Since none of these integration or bilateral agreements include all the member countries of the ACS, it is incumbent on it and consistent with its objectives to seek to promote the type of cooperation and integration which involves all its member countries, some of which do not have traditional trade and investment relations. This absence, together with the similarities of the production structures of some of the countries, the existing barriers to trade and investment, the undiversified composition of their exports and the general orientation of their trade towards industrial countries are all responsible for the pattern and level of intra-ACS trade, which has been found to be generally low and highly concentrated among few countries and on a few commodities.

Gradual and progressive economic integration among its member countries, including the liberalization of trade and investment, transport and other related areas is one of the mandates assigned to the ACS. This paper examines the liberalization of trade and investment in the ACS area, identifies some of the probable obstacles to trade and investment and makes some suggestions to encourage the gradual liberalization of trade and investment in the Caribbean basin.

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3 Cuba has signed agreements with Venezuela, Colombia, Mexico, Brazil, Peru and Uruguay.

4 See LC/CAR/G.478 “Intra-ACS trade: An overview of CDCC trade with non-CDCC groupings.”
I. THE LIBERALIZATION OF TRADE AND INVESTMENT IN THE ACS

Most member countries of the ACS have undertaken substantial unilateral trade liberalization programmes as well as liberalization programmes undertaken as part of their commitments to the regional integration agreements to which they belong. Although it was clear that the pace of trade liberalization accelerated towards the end of the 1980s, liberalization programmes have taken many forms and proceeded at different rates, with some countries liberalizing their trade much faster than others. The tariff for Latin America and the Caribbean fell from an average of 40 per cent in 1985 to an average of 15 per cent in 1995. Although the average tariff level in Latin America and the Caribbean has decreased substantially, the countries' individual tariff levels still display wide differences varying from an average of about 19 per cent in Honduras and the Dominican Republic to about 11 per cent in Colombia and Haiti. The level of tariff dispersion in the region has also decreased, from an absolute level of 20.9 per cent in 1985 to 7.9 per cent in 1995. In general, tariffs tend to be higher on consumption goods than on capital goods, with differences amongst the countries with regard to tariffs applied to the various types of goods. For example, the average tariff for capital goods in Colombia was less than 10 per cent while it was more than 10 per cent in Mexico and less than 5 per cent in Central America and the Caribbean.

The liberalization programmes also included the dismantling or lowering of non-tariff barriers which were widely used in the region. Liberalization in this area included the outright abolition of quantitative restrictions or their replacement by tariffs or tariff quotas, which were subsequently lowered or eliminated. It also included the elimination of licensing requirements and import prohibitions or their limitation to a narrow number of goods and the withdrawal of monopolies for the import of particular goods. A number of ACS member countries, for example, Guyana, Jamaica and Trinidad and Tobago had implemented wide-ranging financial liberalization programmes, including the liberalization of payments on both the current and capital accounts of the balance of payments. Exchange rate liberalization had also taken place in some countries. All these measures served to reduce the restrictions on international payments and create an environment conducive to the development of both trade and investment in the area. Privatization programmes have also been widely implemented in a number of countries and this has contributed to the recent increase of foreign investment in some ACS member countries.

In addition to the unilateral liberalization policies implemented by most of the countries, ACS member countries were also party to several integration agreements which invariably included trade liberalization. These agreements included the CACM, the Andean Community, the OECS, CARICOM, the Group of Three and NAFTA. There were also agreements between Mexico and the CACM countries and between the latter and both Colombia and Venezuela. Agreements also exist between CARICOM and both Venezuela and Colombia. Agreements were being negotiated between Mexico and Belize and Mexico and Panama. The Dominican Republic is planning trade links with the Central American countries and negotiations are planned between CACM and CARICOM countries.

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5Inter-American Development Bank: Economic and Social Progress in Latin America and the Caribbean, 1996 Report.
for the establishment of a free trade area. Several ACS member countries have also entered into bilateral agreements with non-member countries. These agreements included Mexico-Uruguay, Mexico-Peru, Mexico-Argentina and Mexico-Chile, Colombia-Argentina and Colombia-Chile, Venezuela-Argentina and Venezuela-Chile.

The contents of these agreements, as well as their approaches to trade and investment liberalization varied. Some identified a specific list of goods in which trade was to be liberalized, others identified the lists of sensitive products to be excluded from trade liberalization, leaving the rest to be liberalized. Other agreements applied only to specific sectors or specific industries, while others were wider in scope and covered trade in goods and services as well as investment.

The liberalization of investment rules and regulations has proceeded both unilaterally and within integration and bilateral agreements. Nevertheless, bilateral agreements have generally given more importance to investment than the integration agreements. They tend to seek to extend most favoured nation status and national treatment to investors from the participating countries although they do not usually contain provisions dealing with investment protection against expropriation, or similar risks. However, protection of investment is generally included in the bilateral investment agreements which ACS countries have with the industrial countries.

All these trade and investment agreements tend to be more liberal than their predecessors and may be better suited to reaping the benefits expected from integration arrangements. These benefits include more trade creation, more competition and more efficiency in the production of goods and services in the participating countries. They also include better possibilities for economies of scale and better prospects for overcoming small size and the human and physical capital limitations which may be hampering economic growth and development. However, the inherent exclusionary effects of the agreements reflected in either their membership or their trade coverage could diminish the overall level of liberalization actually achieved and the benefits which could have accrued to the members.

The proliferation of these agreements may also be introducing distortions into their economies and fostering a sub-optimal allocation of their resources. They also increase the risk of creating rents for those sectors, industries or firms which gain protection resulting from the negotiation of these agreements. In addition, it may be difficult for some of the countries, especially those with limited human resources capabilities, to administer present agreements, let alone negotiate future ones. At the same time, the increasing number of these agreements could also make it more difficult to negotiate an all-encompassing integration agreement, should the movement towards such an agreement be favoured by ACS member countries.

The multiplicity of bilateral agreements can also affect the destination of investment. Investments tend to go to those members of the agreement with the bigger markets and those which are party to the largest number of agreements, since they will presumably be expected to give foreign investors access to a larger market for both exports and imports. Also, membership in any integration
agreement which provides access to a larger market makes the countries involved more attractive to foreign investment.

The liberalization of trade and investment has usually been accompanied by a wide range of trade and investment promotion activities, at the national level as well as at the level of the integration agreements. At the national level, the promotional activities vary among the countries but tend to include the provision of trade information, preferential access to imported inputs, partial or total exemption from local taxes, refinancing systems at preferential rates, credit to exporters, subsidized interest rates and the provision of credit and insurance schemes. Some countries have also introduced export processing zones as a means of promoting exports. These zones provide special incentives for firms investing in them, while absolving the countries from having to change the overall structure of their trade policy regime. In some of the regional integration arrangements, export promotion activities consist of the provision of trade information and the financing, under certain conditions, of the activities of private firms geared towards the penetration of new markets or the development of new products.

Investment promotion has also taken many forms and takes place both at the national level as well as at the level of some integration arrangements. At the national level, investment promotion takes the form of a series of fiscal incentives including import duties exemption on raw materials and equipment brought into the countries for the production of goods. It also includes the exemption from local taxes and licensing requirements. Some countries direct their incentives for investment at specifically targeted industries, i.e., manufacturing, agro-industries, tourism or technology-intensive industries. At the regional level, attempts are usually made to harmonize the incentives offered in the member countries to lessen the negative effects of competition for investment among them.

II. OBSTACLES TO TRADE AND INVESTMENT

The liberalization of trade and investment is now generally accepted as desirable for economic growth and development. Although trade liberalization policies have been widely implemented in the ACS area, there are differences in the approach to that liberalization and the extent of the liberalization attained, as well as the commitment to the pursuit of the liberalization process. The contribution of foreign investment to economic growth and development in the countries of the area, under appropriate conditions, is widely acknowledged. That acknowledgment led most countries to undertake policy reforms specifically aimed at creating a favourable environment for investment. Most countries also engage in promotional activities designed to attract foreign investment. This section examines some of the possible obstacles to trade and investment in the ACS area.
The ACS includes countries at various stages of development with differing technological capabilities and resource endowments, as well as other national attributes which are significant in the determination of the countries' exports. Those of the countries with similar production structures and which produce similar goods for export will tend not to have a great deal of trade among themselves except when intra industry trade is generated; while those with production structures which are dissimilar and which produce different goods for export, will tend to have more trade.

The influence of the production structures, combined with the implementation of the inward looking trade policies of the past, have not been generally conducive to the development of trade among ACS member countries. Policies have tended to restrict market opportunities for exports in the area and created an anti-export bias, thus discouraging the production and development of non-traditional exports. This has, in turn, increased their dependence on the import of intermediate, capital and consumer goods from the industrial countries. Apart from the production of primary commodities, which were essentially exported to the industrial countries, the general orientation of trade and industrial policies had encouraged the development of products essentially geared towards local markets. In turn, this biased physical infrastructure towards serving the domestic market instead of encouraging the production and sale of exports.

Tariffs and non-tariff barriers of differing magnitudes usually designed to protect special domestic industries, still exist in the ACS area. These barriers exist at the national level as well as within those integration arrangements whose objectives were the establishment of a free trade area or a common market. Tariffs and non-tariff barriers can distort trade and the allocation of resources, while at the same time limiting a country's ability to respond to the rapidly changing conditions of the world trading environment. They also tend to impede the development of trade in the wider ACS area. In addition, the recession of the 1980s, which hit most of the countries, and the slowed growth of income in some of the ACS member countries in the 1990s have not encouraged the growth of trade in the area.

The ACS area contains a number of preferential trading arrangements, one objective of which was the liberalization of trade among the members of the arrangements. However, policies were also traditionally biased towards the protection of locally produced goods at the national and subregional levels and may have impeded free trade in the integration arrangements and encouraged trade diversion in these arrangements. In addition, the economies of scale often did not materialize because of the smallness of markets, while the lack of competition has been largely responsible for the absence of efficiency improvements in the economies.

The rules of origin, which establish the conditions under which a product is eligible for preferential access to the markets of the trading arrangement, may constitute another obstacle to trade with non-member countries and may lead to unnecessary problems amongst the members of the group themselves when disputes with respect to the rules of origin are raised. In general, preferences offered
in the integration arrangements may have negatively influenced the pattern and level of trade between
the members of the newly established grouping.

Shipping and air services, which are essential for trade, have only developed among those
member countries where traditional trading links exist. Outside of these countries, transportation
links in the ACS tend to be rather limited. The lack of transport links between some of the countries,
as well as the inadequacies of the ports and airports in some of the countries, tend to add to the costs
and prices of the commodities produced and impedes the development of trade among the countries.

The development of trade requires the support of well functioning payments and credit
arrangements systems. The provision of pre and post shipment financing and the availability of credit
insurance are essential for the production of export goods and their sale in foreign markets. These
trade financing schemes have been particularly useful in the expansion of trade in manufactures.
However, they are usually underdeveloped or even non existent in several member countries and it
seems to have been particularly difficult for small and medium sized firms to access these schemes
where they existed. Also, there seems to have been insufficient focus on the development of
exportable supply and too much emphasis on marketing⁶.

Since the ACS is of a very recent origin, there does not seem to be enough information
available for businessmen of the respective countries to engage in meaningful trade relationships.
Contacts in the form of trade missions between some of the member countries are limited. At the level
of the entry of goods into the customs territories of various countries, customs procedures tend to
be difficult, cumbersome and inefficient resulting in delays in the clearance of goods at ports and
airports and increasing the cost of trade. In some countries, standards, technical regulations and
sanitary and phytosanitary regulations are not always widely known and sometimes stipulate
requirements and specifications which other countries find difficult to adhere to. These regulations
may act as barriers to trade among the countries of the newly established grouping.

Another element of policy which is receiving increasing attention both in the hemisphere and
globally, relates to competition policies. There are few competition policies in effect in the member
countries of the ACS and a number of public and private monopolies are still in operation in some of
the countries which tend to make it difficult for both nationals and non nationals to sell their goods
in the markets which they control.

Trade in services is still more restricted than trade in goods. This remains so despite the
ongoing efforts at the multilateral level, at the level of the western hemisphere and at the level of the
integration agreements. Liberalization in this area is still in its early stages in most ACS countries and
this type of trade in the grouping is still highly restricted.

⁶ See ECLAC, Open Regionalism in Latin America and the Caribbean: Economic Integration as a
Contribution to Changing Production Patterns With Social Equity, 1994.
b. **Investment**

The climate for foreign investment varies widely, given the number of countries involved in the ACS and the diversity of their foreign investment policies. Most countries have undertaken policy reforms designed to achieve macroeconomic stability, which is essential for the attraction of foreign investment. Nevertheless, the approach taken to specific foreign investment issues varies from country to country. Economic growth and the consequent increases in income and demand for goods and services has not been uniform in the ACS member countries; growth being slow or negative in some of them and moderate in most of the others. In addition, some of the member countries have small and, in some cases, very small markets which tend not to be attractive to foreign investment. Although market size could in theory have been removed by the integration arrangements, these do not appear to have resulted in the creation of wider markets since free trade within the grouping often remains constrained.

The infrastructure necessary for the efficient production of goods displays serious weaknesses in some of the countries. These weaknesses include unreliable electricity supply, unreliable or costly transportation systems, inefficient ports and airports. These factors all influence the cost of production and could render products uncompetitive in international markets. The rigidity of labour markets and the relatively low labour productivity in some of the countries reduces the attractiveness of such countries for foreign investment. The financial infrastructure, including banking and other financial institutions often tends to be insufficiently supportive of the needs of the production and export sector.

In addition, there are a number of restrictions which apply to foreign investment which may be hampering the inflows of investment. One of these restrictions concerns the acquisition of land for business purposes and is particularly prevalent in the smaller countries, where land is scarce. Often special permission is required for the transfer of real estate to a foreigner, while a lengthy procedure for the approval of the transfer is necessary in addition to the imposition of high transfer fees. Taxes on land are sometimes higher than those paid by nationals.

Other restrictions include the limitation or prohibition of foreign investors from participating in selected sectors, often deemed to be strategic. Some ACS countries possess regulations governing the sectorial allocation of foreign investment while others reserve certain sectors to the State or to national investors. Transportation, communications, finance, some natural resources were some of the sectors most frequently protected from foreign investors. The countries applying restrictions on foreign ownership usually encouraged joint ventures, stipulating that local firms or nationals hold at least 50 per cent of the equity of the proposed investment.

The repatriation of capital, dividends and profits is sometimes also subject to restriction. In some countries, legislation requires that profits and capital cannot be repatriated except after a specified number of years, while in others, repatriation of capital and profit is restricted to a specified percentage. For example, in Costa Rica the repatriation of profits is not allowed before the completion of two years of the operation of the investment. In Nicaragua, the repatriation of capital
is not allowed before the completion of three years of operation of the foreign investment\(^7\). Also, countries tend to be more restrictive when it comes to outflows of capital when they are encountering balance of payments problems. The taxation regimes which apply to foreign corporations are sometimes different from those which apply to local companies. Corporation tax and withholding tax are, in some cases, higher than those charged to local firms.

The employment of non nationals by foreign companies is also a contentious issue. Although it is allowed in many cases, work permits for such employees are subject to lengthy approval procedures where rules and regulations are sometimes applied arbitrarily. Also, once the permit is issued, it is reviewed annually and a fee is charged, with the amount sometimes depending on the nationality of the employee concerned. Nationals of countries with which the concerned country has an agreement of some type are charged less than those whose countries have no agreement with the country in question. For example in Grenada, CARICOM nationals are charged US$185 for a work permit, nationals of European Union and Commonwealth countries are charged US$556, and nationals of other countries are charged US$741.

Most ACS countries do not have legislation relating to the protection of intellectual property rights and where it exists it is new and encountering enforcement problems. Intellectual property rights legislation is important for foreign investment, especially in the technology intensive sectors. The lack of such legislation or weaknesses in its enforcement may constitute an impediment to foreign investment.

Investment might also be impeded by the approval process for foreign investment. Foreign investors are required to meet criteria which are specified in the investment codes of the receiving countries but which are not always transparent. In addition, the process is sometimes lengthy, involving several government agencies, which are sometimes not clear themselves about the process. Stock exchanges exist only in some of the ACS countries. Usually they are small with few listed companies and have not been able to attract foreign portfolio investment. In some cases, foreign portfolio investment is restricted.

Regional integration arrangements tend to contain provisions designed to promote intra-integration investment when implementation may discriminate against investors from outside the arrangements. This discrimination may also be acting as a barrier to the free flow of investment between the ACS countries members of the arrangements and those which are not members.

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\(^7\) See ECLAC, Foreign Investment in Latin America and the Caribbean, 1995 Report.
III. SOME SUGGESTIONS FOR THE LIBERALIZATION OF TRADE AND INVESTMENT IN THE ACS AREA

Freer global trade, which requires multilateral liberalization on a most favoured nation basis is generally regarded as the first best policy for the achievement of global welfare. It would, therefore, be preferable for the ACS countries to approach their trade and investment liberalization programme in a manner which is most likely to contribute to the achievement of the ultimate goal of multilateral liberalization and freer global trade. This approach does not preclude the determination of transition periods to phase in the liberalization process.

Trade and investment liberalization in the ACS is more likely to contribute to the overall goal of freer trade if the liberalization process involves as many sectors as possible for both goods and services as well as investment. The liberalization activities should involve as many member countries as possible and consider the possibilities of lowering barriers to trade and investment to non member countries with a view to liberalizing trade and investment with those countries at a later stage. In addition, it would be better if the path which would eventually lead to liberalized trade and investment in the ACS was clearly identified and agreed to by all the member countries and if the time-frame for such liberalization did not exceed five years. This timing would be appropriate in that it would help to prepare members for the several proposals and ongoing processes to integrate markets globally.

Investment liberalization within the grouping should include provision for the protection of investment, the extension of national treatment to investors from other member countries, as well as most favoured nation treatment. It would also seek the phasing out of the usual impediments to investment such as export performance, local content and foreign exchange requirements. There should also be as few restrictions as possible on the sectors in which investment is allowed by companies and nationals of other member countries. It would also be desirable not to raise the barriers to investment faced by firms or nationals of non member countries and to consider the possibilities of further liberalizing investment with non member countries at a later stage. The conclusion of double taxation treaties among member countries can also encourage firms from member countries to invest in other member countries.

The following approach is put forward to take the initial steps towards the process of liberalizing trade and investment in the ACS area. These suggestions are not mutually exclusive and could be pursued simultaneously. The ACS Secretariat, in collaboration with the secretariats of the integration arrangements which exist in the area, may wish to start this process by seeking to liberalize trade and investment between the various groupings members of the ACS. This exercise should involve CARICOM, the OECS, CACM and the Group of Three.

1. The Secretariat could examine the provisions of the three agreements on trade, investment and other related issues with a view to making suggestions or providing guidelines which could assist in the process of liberalizing trade and investment among the member countries of these groupings. The private sector organizations operating in the targeted groupings should be fully involved. The ongoing activities involving attempts to establish a free trade area between CARICOM
and CACM should also be taken into consideration. The agreements which already exist between CARICOM and Venezuela and CARICOM and Colombia as well the free trade agreement between Mexico and Costa Rica and the ongoing negotiations between Mexico and the other Central American countries should be taken into account together with members of these groupings' agreements with non member countries of the ACS, i.e., Mexico's membership of NAFTA, Colombia and Venezuela's membership of the Andean Pact, Mexico, Colombia and Venezuela's bilateral agreements with Chile.

2. The ACS Secretariat, in collaboration with the relevant public and private sector institutions of the individual member countries, which do not belong to any grouping, could examine the possibilities of liberalizing trade and investment between them and one of the existing groupings. The direction of the trade of these countries in the area as well as their individual ongoing initiatives to link up with other members of the ACS might provide pointers on the approach to be selected.

3. The Secretariat may also consider the examination of the various bilateral and mini-multilateral agreements existing in the area with a view to choosing one as the basis for trade and investment liberalization among all ACS members and, at a later stage, with other interested countries. The Secretariat should select their model agreement based on the one with the widest ACS membership, that which covers most trade in goods and services and that which contains the most liberal investment rules.

CONCLUSION

Most ACS member countries have implemented substantial trade and investment reforms which have resulted in generally more liberalized trading regimes and a more welcoming environment for foreign investment.

The similarities in production structures of some of the countries, the existence of tariffs and non tariff barriers to trade, the recession of the 1980s and the slow growth of income in the 1990s, deficiencies in basic infrastructure and transportation links and weaknesses in the payments and credit arrangements are some of the factors impeding the development of trade and investment in the ACS. Other factors which tend not to be conducive to the growth of trade and investment include small markets of some of the countries and several cumbersome administrative and regulatory procedures imposed on foreign investors.

In addition, the newly established organization contains a number of integration arrangements and its members are party to numerous bilateral and mini-multilateral agreements which inherently discriminate against trade and investment with non members.

It would be desirable for the ACS to approach its trade and investment liberalization programmes in a manner which will be supportive of multilateral trade and investment liberalization.
This would entail the inclusion in the proposed liberalization programme of as many countries as possible and as many goods and services as possible. The investment liberalization should include as few restrictions as possible. However, the process of liberalization must take into account the existing integration arrangements as well as the bilateral and mini-multilateral agreements already in existence. It is suggested that the ACS Secretariat examine the possibilities of trade and investment liberalization among CACM, CARICOM and the GROUP OF THREE and among individual countries not belonging to any of the groupings and one of the groupings. The Secretariat could also examine the possibilities of liberalizing trade and investment among its member countries using one of the bilateral or mini-multilateral agreements in effect in the ACS region as the basic block on which to build.