



Government
of Guyana



UNITED NATIONS

ECLAC

LIMITED
LC/CAR/L.109
7 February 2007
ORIGINAL: ENGLISH

SPECIAL AND DIFFERENTIAL TREATMENT IN CARICOM

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Executive summary

The conclusions of the 5th Brainstorming Session on the Treatment of Small Economies in International Trade Negotiations (Association of Caribbean States, Port-of-Spain, 28 November 2005) recommended that a meeting should be held with the participation of representatives of subregional integration organizations to examine the provisions for Special and Differential Treatment included in the different integration schemes.

To this end, the Association of Caribbean States (ACS) decided to undertake, with the joint collaboration of the Economic Commission for Latin America and the Caribbean (ECLAC) and the Sistema Económico Latinoamericano y del Caribe (SELA), studies on the incorporation of special and differential treatment in regional integration agreements, and in particular in CARICOM, Central America and the Andean Community.

This document provides an analysis and assessment of Special and Differential Treatment in CARICOM. Its objectives are to: (i) describe and analyze the provisions for Special and Differential treatment in CARICOM; (ii) establish their purpose and examine how these have been rendered operational in practice; (iii) establish the effects and implications on sectors, firms, products receiving special and differential Treatment; (iv) provide policy recommendations regarding Special and Differential Treatment.

Special and differential treatment provisions were designed in principle to facilitate the accession and participation of the Less Developed Economies and in particular of the Organisation of the Eastern Caribbean States (OECS) in the CARICOM trade and integration regime.

Eventually these measures could contribute to narrow the divide between the Less and the More Developed Countries (LDCs and MDCs), respectively. The former group, which was granted a special status within CARICOM, that of being ‘disadvantaged’ includes the Member States of the Organisation of Eastern Caribbean States (OECS) and Belize. The latter group comprises Barbados, Guyana, Jamaica, and Trinidad and Tobago.

The CARICOM Treaty (1973) special and differential treatment provisions included import restrictions but also the imposition of capital controls and monitoring of capital flows. In practice special and differential treatment provisions were limited to quantitative restrictions. The main objective was to protect the LDCs and in particular the OECS intraregional trade share.

Special and differential treatment provisions allowed the establishment of some of the major firms and industries within the OECS. The empirical evidence also shows that in its initial stages the implementation of special and differential treatment provisions coincided with a relative improvement in the GDP per capita of LDCs relative to that of the MDCs. However, this tendency reverted and this coincides with a loss in intra-OECS market share. This grouping exhibited a similar performance within CARICOM and also at the extraregional level. In addition, the OECS member States became exporters, rather than recipients of net of resource flows.

The successor to the CARICOM Treaty, the Revised Treaty of Chaguaramas (2001) addresses special and differential treatment in Chapter VII. It is divided into two sections. The first provides a regime for disadvantaged countries, regions and sectors. The second provides a special regime for less developed countries. Chapter VII contemplates the imposition of import restrictions. Most important, the first regime includes the establishment of a Regional Development Fund whose purpose is the provision of financial or technical assistance to disadvantaged countries, regions, and sectors. The incorporation of a Development Fund underscores the recognition that special and differential treatment provisions should not be limited only to trade provisions but must also incorporate financial provisions.

The way in which these provisions are still under discussion and the specifics of their implementation are still to be determined. The regional development fund was established in January 2006. The OECS have also proposed the tariffication of quantitative restrictions to allow for the protection and expansion of their domestic manufacturing sector.

The case of CARICOM highlights three important lessons regarding special and differential treatment. First, the temporary protection of domestic industry, especially of the major sectors, can yield positive benefits. Most countries, if not all, have always protected their sectoral 'crown jewels.' Second, protection by itself may not be welfare-enhancing or promote diversification unless accompanied by targeted measures of public policy. In this sense policy makers should explore the feasibility of complementing special and differential treatment provisions with those pertaining to a managed trade strategy. Finally, regional integration agreements must incorporate the financial dimension in the special and differential treatment provisions. Constrained access to finance and the existence of thin capital markets remain major obstacles to structural change and sustained long-term economic growth in the OECS and in general in CARICOM.

I. Introduction

The concept of special and differential treatment responds to an empirical fact. Regional inequalities and disparities are inescapable facts of any economic integration scheme. Disparities exist in terms of size, economic structure, performance and development. Regional integration agreements have dealt with these in two ways.

The first is to let market forces work their way through free trade and movement of capital and narrow the disparities. Within such a setting, countries would specialize in the products for which they have comparative advantage. Also capital flows would occur to the country which is relatively undercapitalized and which are also in general the less developed regions, responding to the expectation of higher returns. Greater levels of investment would translate into higher levels of productivity, income and development. This would eventually lead to a process of income and growth convergence.

The second approach recognizes that a regional agreement guided by unfettered market forces among unequal members may aggravate, rather than narrow, existing disparities. As a result regional agreements must incorporate mechanisms, provisions and more precisely a regional policy to level the playing field among different member countries or regions.

Some regional trading arrangements, such as for example CARICOM, grants special status and preferences to some of its signatory member States.¹ These are not necessarily compatible with the General Agreement on Tariffs and Trade (GATT) Article I, Most Favored Nation (MFN) Clause which bars discrimination from trade, or the World Trade Organization (WTO) understanding of Special and Differential Treatment.

In the WTO texts (1994) the concept of special and differential treatment is embodied solely in a set of provisions allowing developing countries greater flexibility in terms of obligations and time frames to overcome these so called 'adjustment costs.' These provisions are grouped under four headings: (i) those recognizing the interests of the least developed and developing countries; (ii) the measures that reduce or ease the rules and obligations that developing economies have to meet; (iii) the provisions providing for longer time frames for the implementation of obligations; and (iv) the provisions for technical assistance (WTO, 1999c, p.225).²

¹ The treaty establishing CARICOM (1973) provided for the creation of two distinct entities: the Caribbean Community and the Common Market. The Caribbean Community (CARICOM) has 15 member states (Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago). The Bahamas is not a member state of the Common Market. CARICOM has five associate members (Anguilla, Bermuda, British Virgin Islands, Cayman Islands, and Turks and Caicos Islands). Aruba, Mexico, Venezuela, Colombia, the Netherlands Antilles, the Dominican Republic, and Puerto Rico are observers. Six member states are considered more developed countries (MDCs) (Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago) and eight countries are considered less developed countries (LDCs) (Antigua and Barbuda, Belize, Dominica, Grenada, Haiti, Saint Lucia, St. Kitts and Nevis, and St. Vincent and the Grenadines). This study deals basically with the CARICOM members excluding Haiti.

² See, WTO. Special and Differential Treatment. Synopsis of WTO Agreements and Related Topics. MM/LIB/SYN4. 23 October 2000 for a detailed list of the provisions of the WTO Agreements on Special and Differential Treatment.

However, the WTO recognizes two exceptions to the MFN clause. ‘Countries that form a customs union or a free trade area can ‘share preferred arrangements. As well developed countries can provide assistance through non-discriminatory preferences.’

In the CARICOM Treaty, the existence of disparities among its member States was recognized early on by the established divide between the More Developed and Less Developed Territories in the Supplemental Agreement (1968) of the Agreement for the Establishment of the Caribbean Free Trade Association signed in 1965. It was established in a more define format (More and Less Developed Countries, MDCs and LDCs, respectively) in the Chaguaramas Treaty (1973).

The treaty included several provisions granting asymmetric treatment to the LDCs as these countries were considered ‘disadvantaged’ in relation to the MDCs. These were contained in the Special Regime for Less Developed Countries (Chapter VII, arts. 51 to 62) and in several other provisions in the Treaty. These provisions included the suspension of common market origin treatment and the regulation of finance and capital flows for the development of the LDCs

In the Revised Treaty of Chaguaramas (2001) which is the basic legal text for the establishment of the CARICOM Single Market and Economy (CSME) the asymmetry issues are explicitly addressed in two sections of Chapter VII. The first establishes a regime for disadvantaged countries, regions and sectors. The second provides a special regime for less developed countries.

As in its predecessor text, the Revised Treaty of Chaguaramas includes the suspension of common market origin (Art.164). In addition, and most important it establishes a development fund (Art. 158) whose purpose is the provision of financial or technical assistance to disadvantaged countries, regions, and sectors.

The CSME was formally launched in 2006 with six initial member States (Barbados, Belize, Guyana, Jamaica, Suriname and Trinidad and Tobago). The Organisation of Eastern Caribbean States (OECS) member States joined in the middle of the year following the establishment of the Regional Development Fund. The precise measures for its implementation are currently being discussed and finalised by CARICOM member States.

This document provides an analysis and assessment of special and differential treatment in CARICOM. Its objectives are to: (i) describe and analyze the provisions for Special and Differential treatment in CARICOM; (ii) establish their purpose and examine how these have been rendered operational in practice; (iii) establish the effects and implications on sectors, firms, products receiving special and differential treatment; (iv) provide policy recommendations regarding special and differential treatment. The document is structured accordingly.

II. Special and differential treatment in the CARICOM Treaty

A. The provisions for special and differential treatment

Provisions for special and differential treatment were included for the first time in the Supplemental Agreement (1968) of the Agreement for the Establishment of the Caribbean Free Trade Association signed in 1965. The Supplemental Agreement was meant “to facilitate the accession of the OECS to the trade regime” established by CARIFTA.

The provisions for special and differential treatment were included in article 39 which contemplated the suspension of ‘area tariff treatment’ by a country mainly to promote industrial development. These provisions were included in one form or another in subsequent CARICOM agreements.

The agreement on the Harmonization of Fiscal Incentives to Industry (June, 1973), signed one month before the Treaty Establishing the Caribbean Community and Common Market (July 1973)³ made the distinction between LDCs and MDCs.

More specifically, the agreement on the Harmonization of Fiscal Incentives to Industry sought to promote investment from domestic and foreign sources; reduce competition among members by placing a ceiling on benefits; target incentives at enterprises with high value added; and seek regional convergence by giving greater fiscal incentives to the LDCs.⁴

The Chaguaramas Treaty (1973) contained as well several provisions providing asymmetric treatment to the LDCs. These were contained in the Special Regime for LDCs (Chapter VII, arts. 51 to 62) and in several other provisions in the Treaty.

The Chaguaramas Treaty marks a change in the conceptualization of special and differential provisions as these addressed both the ‘real’ and ‘financial’ dimensions of trade and development. Indeed, in the Chaguaramas Treaty finance plays an essential part in the granting of asymmetric treatment. More to the point, it can be said that trade and finance were conceived as two intrinsically interrelated aspects of special and differential treatment, something which has never entered the realm of multilateral negotiations.

The rationale for the granting of special and differential treatment included, *inter alia*, to: (i) provide an increased flow of resources to the LDCs; (ii) reduce the cost and adverse repercussions of participating in regional policy instruments; (iii) to recognize the differences in initial conditions; (iv) minimize polarization among member States.⁵

Chapter VII of the Chaguaramas Treaty includes clauses of good endeavor which refer to the inclusion of the ‘the special needs of the less developed countries.’ It also maintains that

³ See Agreement on the Harmonization of Fiscal Incentives to Industry in The CARICOM System (2003), p.172.

⁴ In this sense the Agreement on Harmonization recognized the Principle of Special and Differential Treatment as being applicable within the Caribbean Common Market. The instruments included, as with the preceding domestic legislation, profit tax holidays, tariff exemptions, export allowances for extraregional exports following the expiration of the tax holidays, dividend payments, loss-carry forward, and depreciation allowances.

⁵ Lestrade (1984).

government in the less developed economies can intervene via quantitative or qualitative restrictions to protect their production and/or via subsidies to stimulate exports.

The Treaty's most important articles are 56 and 59. The former allows the LDCs to suspend common market origin treatment restrictions on grounds of production in the LDCs. It also permits the LDCs to impose quantitative restrictions on competing products. It should be understood that article 56 referred mainly to quantitative restrictions.⁶

These trade provisions were complemented by those of article 59 which addressed the financial needs of the LDCs. Article 59 explicitly stated that the MDCs agree to cooperate in: (i) facilitating joint ventures; (ii) negotiating double taxation agreements in respect of the income from investments in the LDCs by residents of other member States; and (iii) facilitating the flow of loan capital to the LDCs. These financial provisions were complemented by article 37 which sought to regulate the flows of capital 'giving attention to the particular needs of the LDCs'.

In a nutshell, as initially conceived, special and differential treatment was a three-legged strategy which included, the regulation of trade (commodity and service flows), the regulation of capital movements and the facilitation of flows of loan capital to the LDCs.

In practice however, the special and differential provisions were partially applied and were limited to those included under article 56. That is, the focus of asymmetrical treatment was placed on the introduction of restrictions on the entry of MDC (and extra regional) products into the OECS. In other words, the objective of special and differential treatment was mainly oriented to the preservation of the OECS market share within the OECS.

CARICOM countries formed the regional CARICOM Investment Corporation (CIC) which was meant to be a vehicle to transfer resources from the MDCs to the LDCs (see Box 1 below).⁷ The CIC was created to provide resources to the OECS at concessional rates since firms and enterprises of the OECS member States are credit rationed, not being able to comply with commercial bank requirements for granting a loan. The cost of debt was considered to be too high. Note that this is still presently the case. In a recent survey of 90 small and medium sized firms, half of those interviewed indicated that their main constraint on diversification, growth and development was the lack of access to finance.

Unfortunately the CIC never fulfilled its task. As put by Lestrade (1984, p.270): "Less than ten years after its establishment the CIC was wound up and had become rather ineffectual five years earlier...The CIC should have been the major manifestation of the LDC thrust that

⁶ It should be pointed out however that Dominica and St. Kitts and Nevis have actually switch from quantitative restrictions to the application of tariffs (tariffication).

⁷ The Governments of the Commonwealth Caribbean Countries through their heads of delegations to the eighth conference of Heads of Government of Commonwealth Caribbean Countries assembled in Georgetown, Guyana, from 9 to 12 April, 1973. Point three (3) of the agreement defined the role of the Caribbean Investment Corporation. The Corporation was used for the promotion and establishment of industries (table 1) in Less Developed Countries. The enterprises from Less Developed Countries were supposed to particularly benefit from the establishment of the Caribbean Investment Corporation (CIC), where recognizing the urgent need for a more balanced approach to the distribution of benefits accruing from the Caribbean Free Trade Area, direct financing would be provided to the private sector, public sector, national and regional finance intermediaries.

was built into the CARICOM arrangements. Its struggles over the years and its acknowledged failure constitute a lesson in the limited possibility of organizing a transfer of financial resources to the LDCs.”

Box 1 Agreement establishing the Caribbean Investment Corporation (Excerpts)
<p>The Caribbean Investment Corporation was established for the promotion of the industrial development including the development of agro-based industries and of integrated agricultural and industrial complexes of the Less Developed Countries. To this end the Corporation was empowered to: (i) make equity investments in industrial enterprises in the Less Developed Countries; (ii) dispose of its equity investments within the Region in order to replenish its financial resources; (iii) guarantee suppliers' credits; (iv) administer, manage and account for its financial resources; (v) provide the technical assistance where necessary for the preparation and analysis of projects to be financed, and do all such other acts that may be necessary or incidental to the achievement of its purposes and the exercise of its functions.</p> <p>The Corporation was to invest in projects which are financially viable, due regard being paid to two other important criteria: (i) the ability of the projects in which it invests to promote further industrial and economic development in the economy of the Less Developed Country concerned; and (ii) the creation of employment opportunities in the Less Developed Country concerned.</p> <p>The Caribbean Investment Corporation had the authority to borrow money, grants loans, and invest the resources that were not needed for its operations.</p>
<p>Source: CARICOM Secretariat (2006)</p>

The financial dimension of special and differential treatment was not incorporated into the implementation of the provisions for special and differential treatment. Special and differential treatment became mainly a vehicle for protection of existing industries and firms and the establishment of new firms under the auspices of subsidies and incentives, much in the spirit of the 1965 Supplemental Agreement to Caribbean Free Trade Association (CARIFTA).

The understanding of special and differential treatment in the CARICOM Treaty, as reflected in specific provisions particularly in articles 56 and 59, marked a definite step forward, as it integrated the real and financial aspects of trade and economic relationships. Its limited application to the real sphere was in fact a set back.

B. The firms and products benefiting from article 56

Article 56 which was in force until December 2005 is considered to have facilitated the establishment of selected firms and associated products such as aerated beverages, footwear, soaps, candles, furniture, margarine, plastic bags, paints and varnishes, and corrugated galvanized sheets.⁸

This is attested by the responses to a survey administered in the form of a short questionnaire to 63 companies which were identified as companies eligible for the receipt of benefits of Article 56 (see table 1 below).⁹ The questions included, among others, the type of

⁸ See, Lestrade (1984) and OECS (2006).

⁹ The survey was administered by telephone, fax and electronic mail. Respondents were contacted through each of these means where possible (i.e. where any of the methods of contact were available such as telephone number, fax

manufactured products; number of employees; the type of special and differential benefits received and its impact, as well as the time frame during which the benefits were received.

Sixty-two firms in the OECS benefited from special and differential treatment. This is shown in Table 2 below, which provides a list of the products by country and respective number of firms.

Figures 1 and 2 below show the country share of article 56 firms and the product share. Saint Lucia followed by Grenada and Antigua and Barbuda have the highest share of article 56 firms (25 per cent, 17 per cent and 17 per cent, respectively). At the product level, furniture, followed by food products and aerated beverages are the products that benefited the most from article 56 (37 per cent, 24 per cent and 18 per cent of the total). At the other end of the spectrum, arts and craft is the product that benefits the least from article 56 provisions.

number or e-mail address.) There were 12 responses to the questionnaire; a 19% response rate. The most popular channel of response was fax through which six (6) responses were received, next was telephone interview through which five (5) responses were received and 1 response was sent via electronic mail. The countries with the largest number of respondents was Saint Lucia with four (4) respondents next was Antigua and Barbuda and St. Vincent and the Grenadines with three (3) respondents each; Dominica and Grenada had one (1) respondent each.

Table 1
Tabulated responses to a questionnaire on the provisions of benefits of Special and Differential Treatment to the LDCs

Company	Sector/ Product(s)	No. of Persons Employed	Benefits Received	Years Receiving Benefits	Will CSME affect benefits?	Further Comments
Antigua Brewery	Aerated Beverages (Soft Drinks)	54	None	N/A	CSME will have a negative effect on the smaller economies of the region	The application of equal rules among unequal partners is unreasonable; SDT must be applied to LDCs to keep them afloat.
Renford Furnishings	Furniture	5	None	N/A	Not really since currently Products are entering the countries from both inside and outside of the region	None
Khouly Detergent Factory	Liquid Detergents. Cleaning Products	Sometime 2, 4 or 6 on a temporary basis.	Import Restrictions	Six months in 1995 or 1996	N/A	Benefits aren't being received although authorities claim that the industry is receiving protection
Simeon's Furniture	Furniture	---	Import Restrictions	Protection ended approx one year ago.	---	No Protection currently being received. There have been no updates on the status of the switch from Article 56 to 164.
L&M Investments Ltd.	Industrial Gases	10	No Answer given but it was indicated that benefits were received	Approx 10 years	Yes, Negatively, especially in countries where local manufacturers cannot supply the entire market since imported goods will be allowed local goods may no longer be bought.	SDT has allowed the company to grow and it has increased the efficiency of healthcare and assisted with the introduction of new products.

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Tabulated responses to a questionnaire on the provisions of benefits of Special and Differential Treatment to the LDCs

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Solar Dynamics	Solar Water Heaters	24	No Specific Answer given except protection from competition of MDCs	1993-present	Yes, negatively it will expose us to more competition from MDCs who can produce at a much cheaper rate.	SDTs has made us more competitive; we have been able to improve efficiency and reduce costs.
Carib Pasta	Pasta Products	38	Import Restrictions; however this does not seem to be in force presently.	12 years	Yes, it will affect the industry negatively.	SDT helped to establish business locally and venture into other OECS countries but the rules are not currently being enforced.
Ghera Ltd	Pasta	8	None	Never	No Answer	The company hopes for some relief
Windward and Leeward Brewery Limited	Aerated Beverages (Beer)	106 Directly >250 Indirectly	1. Concessions on full Government Tax 2. Concessions on import duties on all raw materials; packaging materials 3. Concessions on import duties of building materials for extension of the factory.	1. Always 2. Always 3. One Year	Not enough Information to comment.	There is still the need for protection from large breweries from outside of the region which even with freight costs sometimes turn out to be cheaper than the local breweries
Vingren Gas Co,	Industrial Gases	2 or sometimes 3	None	N/A	Staffing concerns will be affected.	None

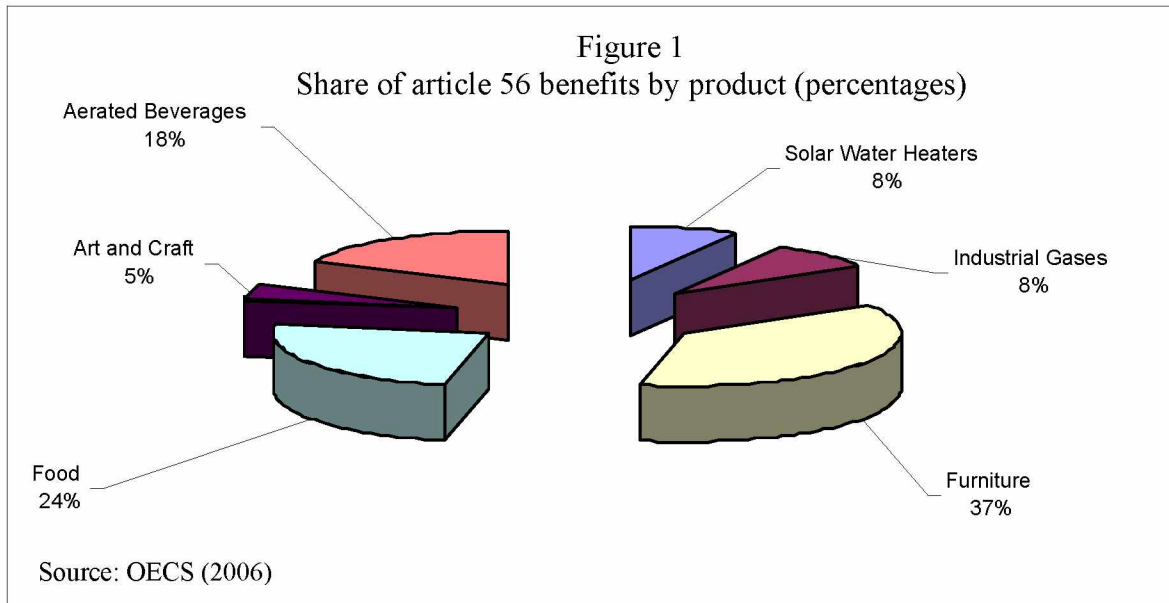
Table 1
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Davy Agro	Pasta Manufacturers	16	Some Import Restrictions though It does not always seem to work.	No answer	No answer	Not enough information is given out about the program; word of mouth among businessmen is how one finds out. Implementation of this article is a problem; there seems to be a struggle with the customs dept.
Bottlers St Vincent Limited,	Aerated Beverages. (Soft Drinks, Water)	No Answer	Don't Know	N/A	N/A	Knows Nothing of either Article 56 or 164.

Source: Questionnaire elaborated and administered by ECLAC on the benefits of Special and Differential Treatment.

Table 2		
Article 51 products by producing countries and number of firms		
	Producing countries	Number of firms
Curry powder	Saint Lucia	1
Pasta products	Grenada, St. Kitts, Saint Lucia, St. Vincent and the Grenadines	11
Industrial Gases	Dominica, Grenada, Saint Lucia, St. Vincent and the Grenadines	5
Wheat flour	Grenada, St. Kitts, St. Vincent and the Grenadines	3
Aerated beverages and beer	Antigua, Dominica, Grenada, St. Kitts, Saint Lucia, St. Vincent and the Grenadines	11
Solar water heaters	Antigua, Dominica, Saint Lucia	5
Chairs and furniture	Antigua, Dominica, Grenada, St. Kitts, Saint Lucia, St. Vincent	23
Art and crafts	Grenada, Saint Lucia	3
Total		62

Source: OECS (2006)



The firms and respective products that benefited from article 56 are important to the OECS economies in terms of their contribution to consumption expenditures, capital investment, exports, the generation of government revenue, employment and output.

Tables 3 and 6 below, show the composition of intra-OECS exports at the bilateral and aggregate level. As the data presented in the tables indicate, the export products from the milling industry and beverages are the most important products traded within the OECS representing 33 per cent of the total. All article 56 products account for more than half of intra-OECS trade.

In addition, available data indicates that the employment provided by these firms exceed 7,000 workers and that their combined capital investment represent more than 5 per cent of the combined GDP of the OECS. Moreover in some cases, 56 article firms contribute to generate more than 7 per cent of tax revenues.

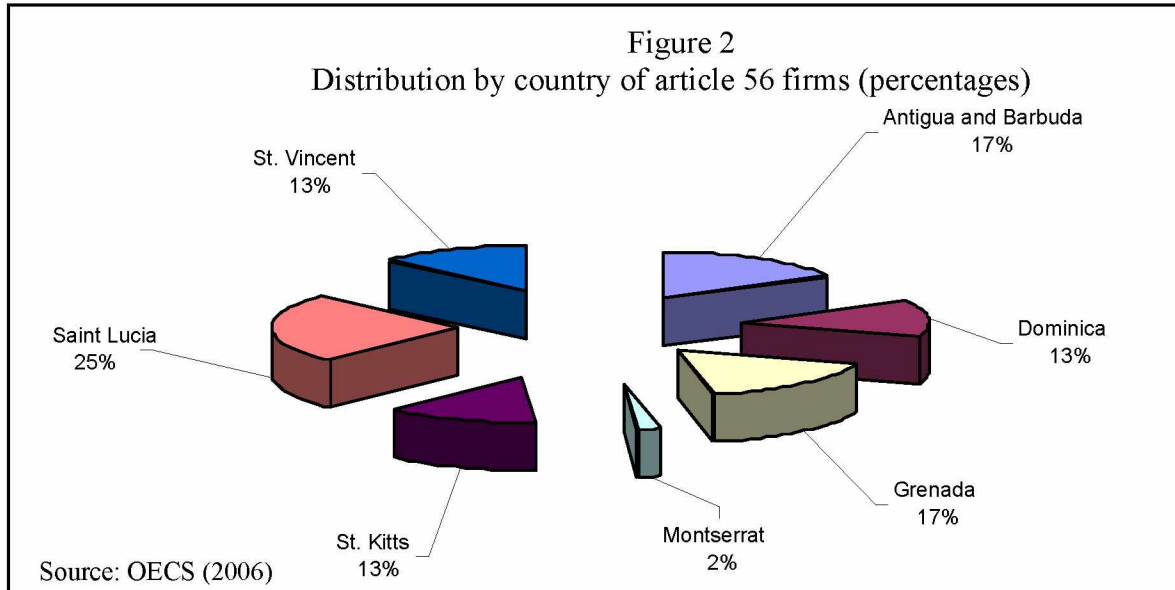


Table 3
Exports of the OECS to OECS
2002

Product	Product Name	No. of Total Lines	Imports Value	Percentage share	Accumulated share
11	Prod.mill.indust; malt; starches; inulin; wheat g	36	6997.167	19.336427	19.336427
22	Beverages, spirits and vinegar.	338	5240.531	14.482025	33.818452
48	Paper & paperboard; art of paper pulp, paper/pape	125	2992.246	8.2689676	42.08742
32	Tanning/dyeing extract; tannins & derivs; pigm et	271	2374.752	6.5625445	48.649964
23	Residues & waste from the food indust; prepr ani	80	2006.615	5.5452107	54.195175
10	Cereals	53	1889.455	5.2214431	59.416618
72	Iron and steel.	116	1808.641	4.9981164	64.414735
08	Edible fruit and nuts; peel of citrus fruit or me	162	1566.563	4.3291423	68.743877
34	Soap, organic surface-active agents, washing prep	132	1364.938	3.7719586	72.515835
85	Electrical mchy equip parts thereof; sound record	185	995.44	2.7508638	75.266699
84	Nuclear reactors, boilers, mchy & mech appliance;	281	940.413	2.5987986	77.865498
25	Salt; sulphur; earth & ston; plastering mat; lime	35	861.238	2.3800012	80.245499
39	Plastics and articles thereof.	366	523.575	1.4468813	81.69238
87	Vehicles o/t railw/tramw roll-stock, pts & access	181	475.704	1.3145914	83.006972
33	Essential oils & resinoids; perf, cosmetic/toilet	109	446.017	1.2325524	84.239524
62	Art of apparel & clothing access, not knitted/cro	245	431.779	1.1932062	85.43273
19	Prep.of cereal, flour, starch/milk; pastrycooks'	50	420.787	1.1628302	86.595561
07	Edible vegetables and certain roots and tubers.	144	372.718	1.0299932	87.625554
94	Furniture; bedding, mattress, matt support, cushi	135	368.469	1.0182513	88.643805
04	Dairy prod; birds' eggs; natural honey; edible pr	11	328.865	0.908807	89.552612
61	Art of apparel & clothing access, knitted or croc	123	293.009	0.8097202	90.362332
15	Animal/veg fats & oils & their cleavage products;	31	264.25	0.7302457	91.092578
38	Miscellaneous chemical products.	58	235.699	0.651346	91.743924
76	Aluminium and articles thereof.	46	223.758	0.6183474	92.362271
73	Articles of iron or steel.	180	204.367	0.5647611	92.927032

Source: WITS (2006)

Table 4
Exports of the OECS to MDCs
2002

Product	Product Name	No. of Total Lines	Imports Value	Percentage share	Accumulated share
34	Soap, organic surface-active agents, washing prep	76	10666.09	23.98	23.98
22	Beverages, spirits and vinegar.	135	6805.85	15.30	39.29
33	Essential oils & resinoids; perf, cosmetic/toilet	47	4719.95	10.61	49.90
48	Paper & paperboard; art of paper pulp, paper/pape	68	3848.09	8.65	58.55
03	Fish & crustacean, mollusc & other aquatic invert	78	3111.32	7.00	65.55
08	Edible fruit and nuts; peel of citrus fruit or me	119	2556.31	5.75	71.30
10	Cereals	42	2467.10	5.55	76.85
25	Salt; sulphur; earth & ston; plastering mat; lime	9	1789.45	4.02	80.87
38	Miscellaneous chemical products.	26	1318.55	2.96	83.84
07	Edible vegetables and certain roots and tubers.	69	1226.37	2.76	86.59
27	Mineral fuels, oils & product of their distillati	112	669.85	1.51	88.10
61	Art of apparel & clothing access, knitted or croc	40	589.19	1.32	89.42
84	Nuclear reactors, boilers, mchy & mech appliance;	102	557.84	1.25	90.68
32	Tanning/dyeing extract; tannins & derivs; pigm et	36	554.50	1.25	91.93
09	Coffee, tea, matn and spices.	33	317.60	0.71	92.64
39	Plastics and articles thereof.	93	281.13	0.63	93.27
11	Prod.mill.indust; malt; starches; inulin; wheat g	14	277.77	0.62	93.90
44	Wood and articles of wood; wood charcoal.	35	272.23	0.61	94.51
23	Residues & waste from the food indust; prepr ani	22	209.69	0.47	94.98
73	Articles of iron or steel.	55	184.61	0.42	95.39

Source: WITS (2006)

Table 5
Exports of the OECS to MDCs (6 digit level)
2002

Product	Product Name	No. of Total Lines	Imports Value	Percentage share	Accumulated share
340111	For toilet use (including medicated products)	15	5426.1	12.201	12.201
220300	Beer made from malt.	47	5138.5	11.555	23.756
330610	Dentifrices	12	4687.9	10.541	34.297
340119	Other	8	3367	7.5711	41.869
080300	Bananas, including plantains, fresh or dried.	13	2236.8	5.0298	46.898
481910	Cartons, boxes and cases, of corrugated paper or p	10	2072.3	4.6597	51.558
100630	Semimilled or wholly milled rice, whether or not p	24	1964.7	4.418	55.976
252321	White cement, whether or not artificially coloured	1	1585.3	3.5647	59.541
340220	Preparations put up for retail sale	31	1511.6	3.399	62.94
481810	Toilet paper	8	1442.9	3.2445	66.184
380840	Disinfectants	8	1301.8	2.9273	69.112
030379	Other	18	1240.9	2.7904	71.902
030231	Albacore or longfinned tunas (Thunnus alalunga)	2	1088.2	2.447	74.349
220290	Other	15	1061.7	2.3873	76.736
071490	Other	42	987.06	2.2195	78.956
271000	(-2001) Petroleum oils and oils obtained from bitu	111	657.54	1.4786	80.434
321000	Other paints and varnishes (including enamels, lac	28	552.38	1.2421	81.676
610910	Of cotton	10	510.53	1.148	82.824
100620	Husked (brown) rice	12	448.15	1.0077	83.832
340520	Polishes, creams and similar preparations for the	3	290.09	0.6523	84.484
110100	Wheat or meslin flour.	4	266.19	0.5986	85.083
071420	Sweet potatoes	3	231.29	0.5201	85.603
030621	Rock lobster and other sea crawfish (Palinurus spp	1	222.56	0.5005	86.104

Source: WITS (2006)

Table 6
Exports of the OECS to OECSs (6 digit level)
2002

Product	Product Name	No. of Total Lines	Imports Value	Percentage share	Accumulated share
110100	Wheat or meslin flour.	22	6739.827	18.62527	18.62527
220300	Beer made from malt.	41	2777.074	7.674346	26.29962
481910	Cartons, boxes and cases, of corrugated paper or p	11	2339.258	6.464457	32.76408
230990	Other	69	1949.803	5.388212	38.15229
220210	Waters, including mineral waters and aerated water	53	1653.538	4.569494	42.72178
321000	Other paints and varnishes (including enamels, lac	70	1600.094	4.421803	47.14358
100630	Semimilled or wholly milled rice, whether or not p	25	1314.345	3.632146	50.77573
721041	Corrugated	22	1216.421	3.361536	54.13727
080300	Bananas, including plantains, fresh or dried.	18	914.097	2.526075	56.66334
852520	Transmission apparatus incorporating reception app	4	693.834	1.917386	58.58073
340111	For toilet use (including medicated products)	29	580.467	1.6041	60.18483
100620	Husked (brown) rice	23	574.534	1.587704	61.77253
252329	Other	9	531.892	1.469865	63.2424
320810	Based on polyesters	42	515.504	1.424577	64.66697
481810	Toilet paper	10	504.713	1.394756	66.06173
340119	Other	11	494.647	1.366939	67.42867
330610	Dentifrices	14	338.565	0.935612	68.36428
842959	Other	3	315.745	0.87255	69.23683
040229	Other	1	289.11	0.798945	70.03578
190219	Other	12	286.489	0.791702	70.82748
071490	Other	30	233.44	0.645103	71.47258
721240	Painted, varnished or coated with plastics	6	228.755	0.632156	72.10474
220290	Other	57	228.713	0.63204	72.73678
610910	Of cotton	34	217.196	0.600213	73.33699
761010	Doors, windows and their frames and thresholds for	6	216.202	0.597467	73.93446

Source: WITS (2006)

C. Special and differential treatment in the CARICOM Treaty: An assessment

Special and differential treatment permitted the establishment of some of the major manufacturing firms in the LDCs, such as breweries and milling companies. It has also allowed for firms in the LDCs to remain operational and in some cases to expand and grow over time.

Notwithstanding these positive aspects, some the most important goals for which special and differential treatment was established, namely to protect intra-LDC market shares and encourage capital flows to the LDCs, were only partially or temporarily fulfilled.

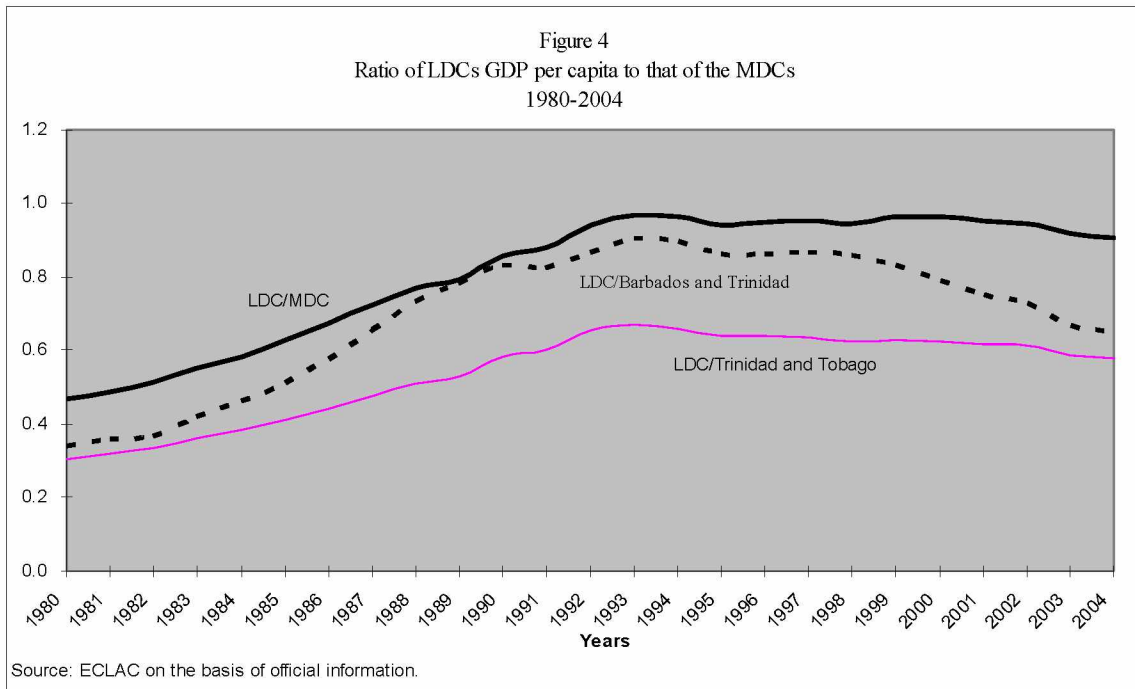
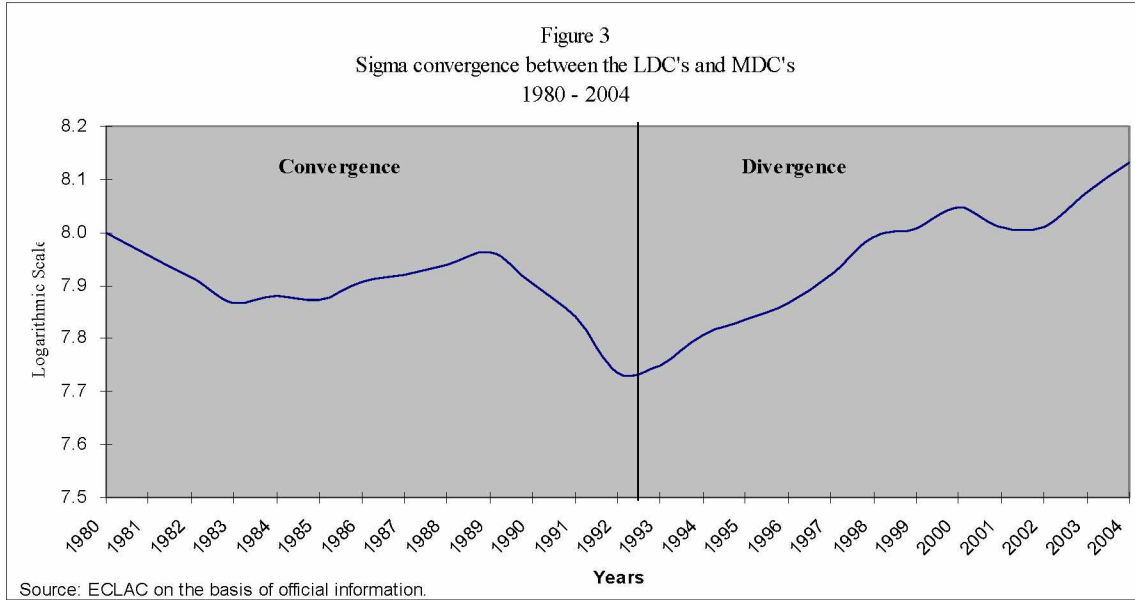
The adoption and implementation of special and differential treatment provisions must be understood and assessed within the specific context in which they were applied. The adoption and implementation of special and differential treatment provisions coincided with a period of narrowing disparities in terms of GDP per capita between LDCs and MDCs until the early part of the 1990s.¹⁰ This is shown in figures 3 and 4.

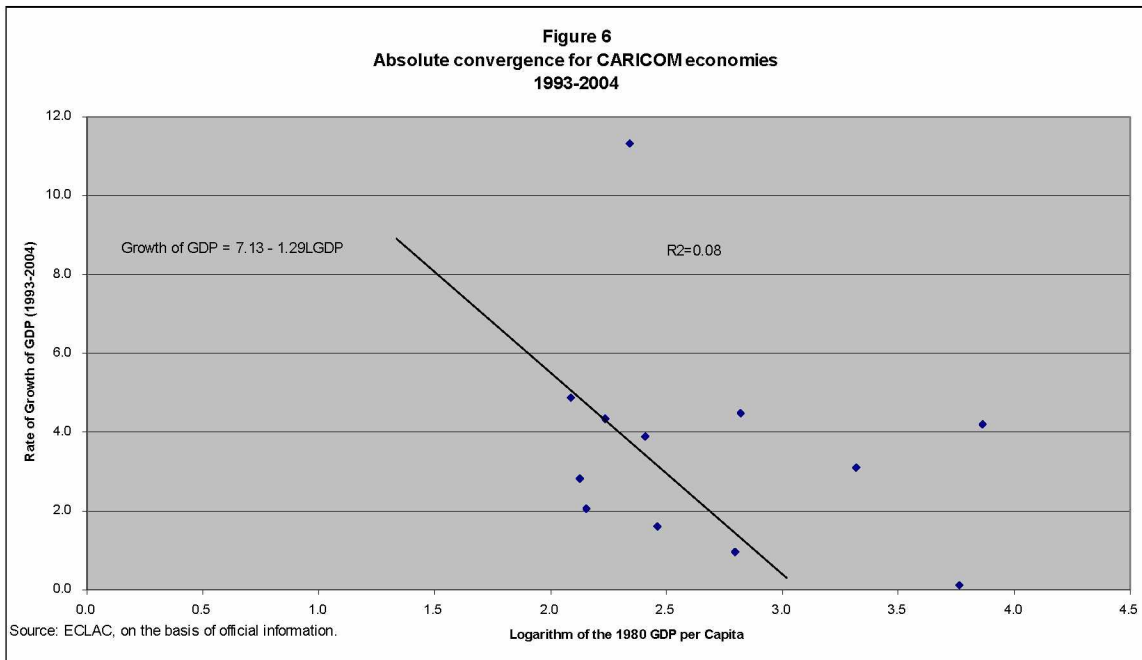
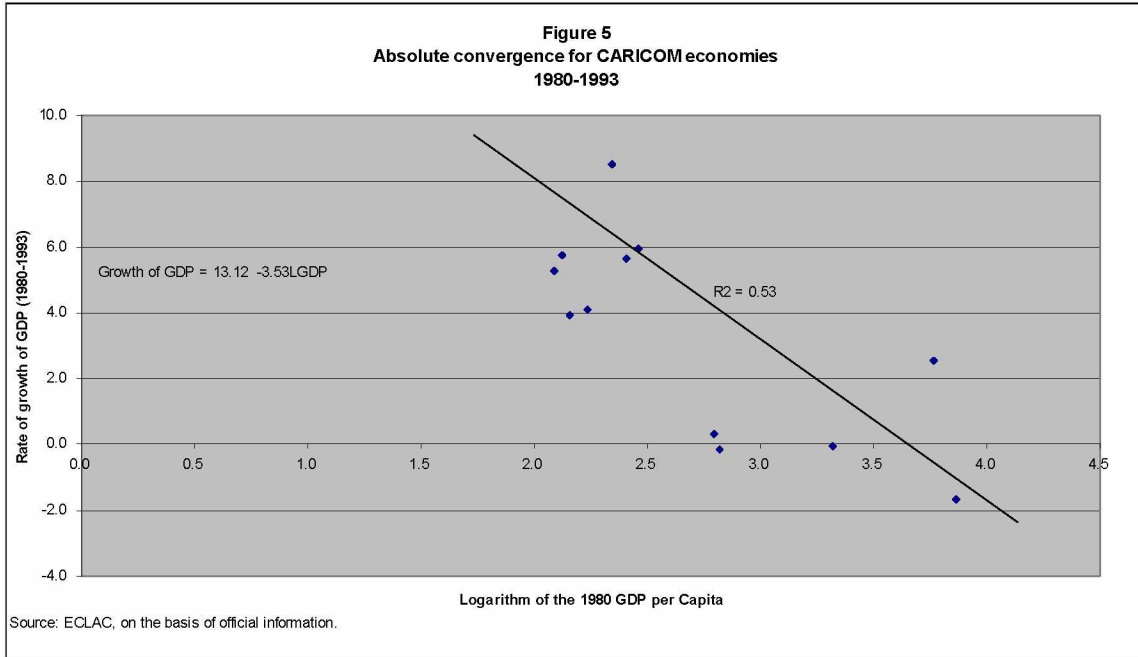
The former plots the dispersion of the LDCs relative to the MDCs (i.e., sigma convergence) for the period 1980-2004. The dispersion between both groups of countries declines from 1980 to 1993. Thereafter it trends upwards. The existence of sigma convergence for that time period implies a process of catch-up between the LDCs (lower income level group) relative to the MDCs (higher income level group).

These findings are confirmed by figure 4 which plots for the same time domain the ratio of the GDP per capita of the LDCs relative to that of the MDCs relative to Barbados and Trinidad and Tobago, and relative to Trinidad and Tobago, respectively. In all cases, the ratio is less than one throughout the entire sample period. This indicates that the GDP per capita of the LDCs is on average below that of the MDCs, that of Barbados and Trinidad and Tobago, and that of Trinidad and Tobago.

Also, the said ratios tend to increase in all cases from 1980 to 1993. This means that the GDP per capita of LDCs increased at a faster rate than that of the MDCs. The LDCs show the fastest rate of increase relative to the MDCs and to Barbados and Trinidad and Tobago. That is, there is a process of catching-up.

¹⁰ The literature distinguishes two concepts of convergence. These are termed sigma and beta convergence. Sigma convergence refers to a decline in the dispersion across a group of countries or regions over time. Sigma convergence can be measured by the standard deviation say of GDP per capita or by a coefficient of variation (defined as the ratio of the standard deviation over the mean). Beta convergence refers to the relationship between the rate of growth of a variable over time (say GDP) and the level of that variable for a given year. The existence of sigma convergence between a lower and higher level income countries implies that there is a process of catching-up between the former and the latter. That is, the lower income level countries grow at a faster rate than the higher level income ones. Sigma convergence is compatible with absolute convergence (See, Barro and Sala-i-Martin, 1995, pp.26-28 and 383-386). More recently some authors have explored the possibility of simultaneous convergence and divergence. See, Elmslie and Milberg (1996) and Carter (2004).





Contrarily, from 1993 onwards the opposite phenomenon occurs. The MDCs which have the relatively higher income level grew at a faster rate in per capita terms than the LDCs. During this period there is an absence of sigma convergence and thus a catch-up process among both country groupings.

The econometric analysis (for Beta convergence) summarized in figures 5 and 6 for CARICOM also yields the same results. For the period 1980 to 1992 the rate of growth of GDP

is negatively related to a given reference level (1980 in the analysis here presented). The relationship is statistically significant. The coefficient of goodness of fit (R2) is equal to 0.53. For the period 1993-2004 there is no such statistically significant relationship.

The time period characterized by the absence of convergence and catch-up is also the time period during which the LDCs trade market share declined at both the intraregional and extraregional level. Thus the intraregional trade performance of LDCs may have been hampered in part by the greater degree of disparity between LDCs and MDCs.

Available data for the OECS shows that the market share of the OECS has declined in relation to CARICOM and the rest of the world from 0.79 per cent to 0.45 per cent in the case of the former and from 3.4 per cent to 1.9 per cent in the case of the latter between 1990 and 2004. This represents a loss of roughly 50 per cent of the OECS' intra-OECS market share. This is shown in figure 7 below. This performance of the OECS in other markets follows a similar pattern. As an example, in the CARICOM market as well, the OECS lost a significant slice of its market share (see section D below).

The behavior of the aggregate measure of market share is representative of that of some of the main products that benefit from article 56. As shown in table 7 below, most of these products lost market share.

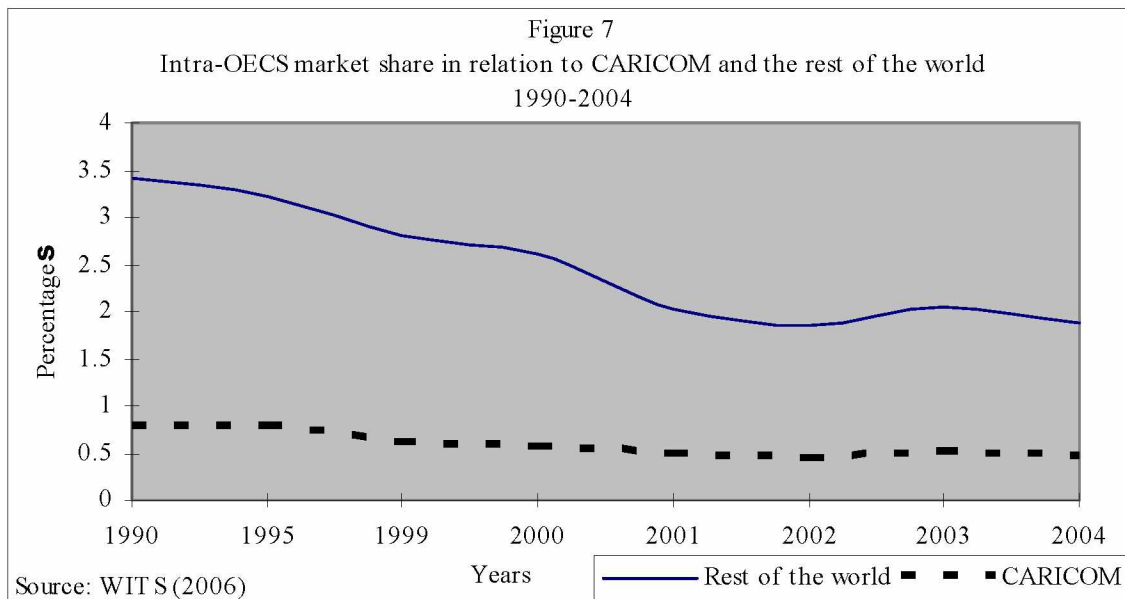
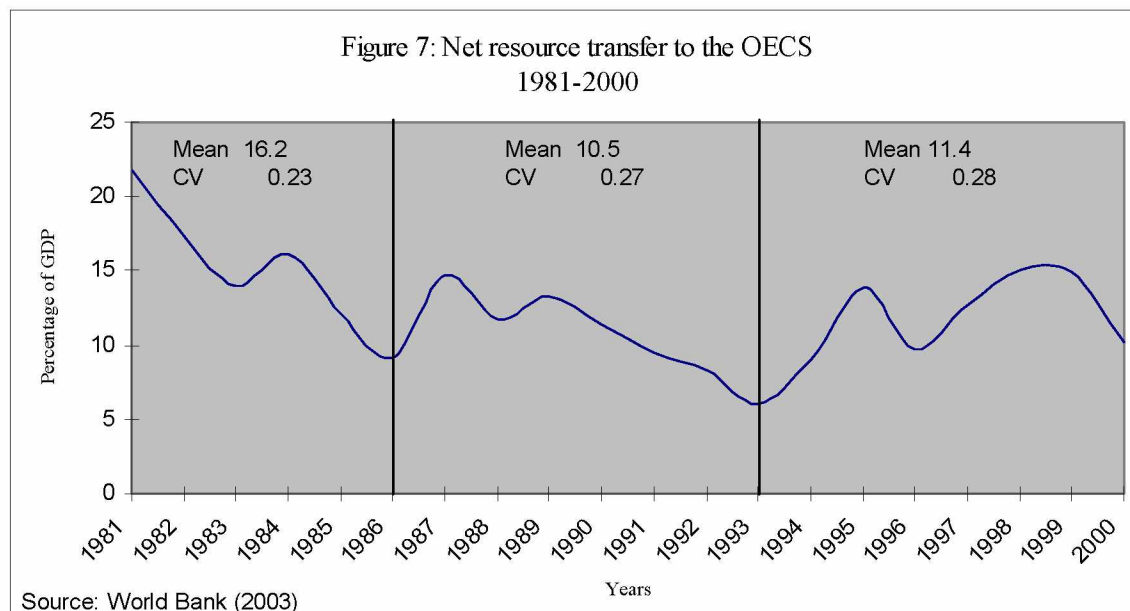


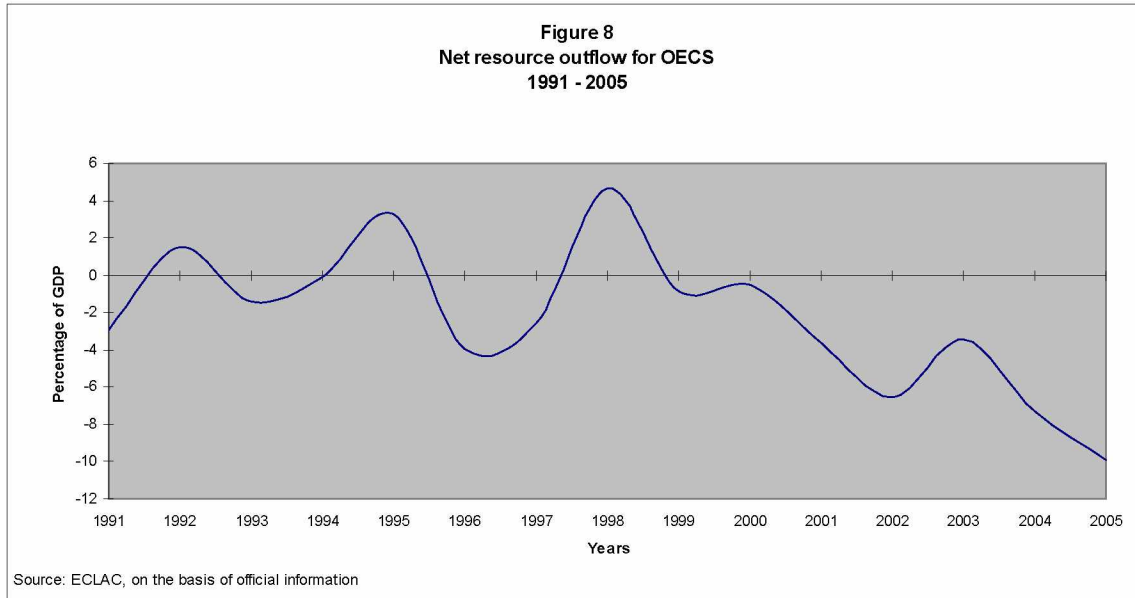
Table 7 Intra-OECS market share of article 56 products (Percentage averages)								
1990-2004								
	1990	1995	1999	2000	2001	2002	2003	2004
Food products	0.2	0.5	0.3	0.3	0.2	0.2	0.2	0.8
Lemonada	3.8	2.8	2.6	2.6	1.5	2.0	2.4	2.7
Paints	10.4	9.9	9.7	9.7	8.3	8.8	9.0	8.5
Water	17.3	3.3	2.0	2.2	2.2	1.2	1.5	2.9
Candles	32.4	59.3	23.0	19.7	34.0	11.7	9.2	3.5
Flour	48.5	44.3	36.5	40.0	39.0	31.4	32.2	28.4
Spirits	1.0	1.1	1.2	0.8	1.4	1.3	1.2	2.3
Lard and margerine	16.1	12.4	3.8	3.4	3.4	3.9	3.2	3.2

Source: On the basis of WITS (2006)

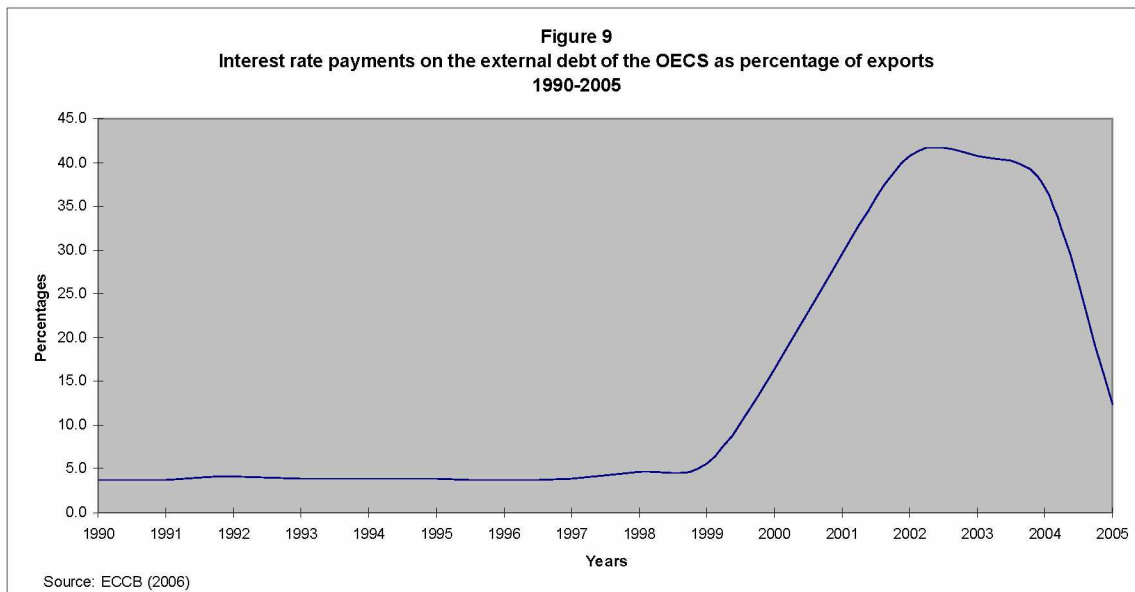
The analysis of capital flows shows that the OECS witnessed a decline of net capital inflows since the beginning of the 1980s. That is the OECS were not recipient of resources that could have contributed to their overall development. As shown in figure 7 below, the average level of the net transfer of resources declined from 16 per cent to 10 per cent of the OECS combined GDP between 1981-1986 and 1986-1993, and stayed around that level thereafter.

Moreover the volatility has increased over time. On average the coefficient of variation rose from 0.23 for the period 1981-1986 to 0.28 for the period 1993-2000.





More importantly the net resource inflow has not been commensurate with the net resource outflow, thus generating a financing gap that is the ‘Achilles heel’ of the OECS economies. Figure 8 above shows the net resource outflow for OECS economies not taking into account debt flows. Expressed as a percentage of GDP it has increased, in absolute terms from 3 per cent to 12 per cent in the space of roughly a decade (1991-2005).



As a general principle, the financing gap is positively related with a given or ‘target’ domestic income growth level and negatively related to the growth in external demand, debt service obligations and profit repatriation flows. The greater the domestic growth rate, the greater the import level and hence the greater the level of capital flows to finance that level of imports. The larger the debt service payments, the greater the foreign exchange requirements. In

a similar way the larger the proportion of capital flow repatriation, the greater will be the foreign exchange requirements to achieve a given ‘target’ growth rate.

As a result, if debt service obligations and repatriation flows are considered exogenous variables, countries such as the OECS that face a financing gap must confront the choice of promoting the attraction of capital flows or of revising downwards the target output growth. For the most part OECS economies opted, for obvious reasons, for the first alternative. This alternative also included the contracting of external debt. This ultimately increased the resource outflow.

In fact the period during which the net resource outflow is the greatest coincides with the period of debt accumulation in the OECS (86 per cent and 106 per cent of GDP in 1999 and 2005) and the increase in interest rate payments. These shot up from less than 5 per cent to 42 per cent of exports between 1999 and 2004 (see figure 9 above) .

D. A competitive analysis of OECS exports to CARICOM

The export composition of the OECS to CARICOM has not changed substantially over time. Table 8 below shows that taking 1985 as a reference year, the majority of products exported in 1985 (85 per cent of the total) are also those that were exported in 2000 (79 per cent of the total).

Product	1985	1990	1995	2000
054 Vegetables, fresh, chilled, frozen or simply preserved;	27.09	2.32	nre	3.14
554 Soap, cleansing and polishing preparations;	9.54	17.10	18.05	14.02
057 Fruit and nuts (not oil nuts) fresh or dried;	8.83	3.03	3.50	4.23
642 Paper and paperboard, cut to size or shape, articles of;	7.48	10.93	11.49	6.79
674 Universals, plates and sheets, of iron or steel;	6.23	3.79	2.37	3.37
046 Meal and flour of wheat and flour of meslin;	5.87	8.41	11.96	11.71
424 Other fixed vegetable oils, fluid or solid, crude, etc.;	4.53	7.03	2.33	nre
081 Feeding stuff for animals (excl. unmilled cereals);	2.93	2.68	2.95	2.75
846 Under garments, knitted or crocheted;	2.42	1.71	1.30	1.38
821 Furniture and parts thereof;	2.34	2.87	nre	nre
091 Margarine and shortening;	1.98	1.80	1.27	nre
112 Alcoholic beverages;	1.98	4.27	5.49	10.60
775 Other household type, electrical and non-elec. eqpt.;	1.19	2.13	1.15	nre
697 Household equipment of base metal, n.e.s.;	1.00	1.08	0.77	nre
533 Pigments, paints, varnishes and related materials;	0.94	2.29	3.26	3.63
111 Non-alcoholic beverages n.e.s.;	0.80	2.19	2.68	4.56
423 Fixed vegetable oils, soft, crude, refined or purified;	0.18	1.72	nre	nre
058 Fruit, preserved and fruit preparations;	0.08	2.02	nre	nre
553 Perfumery, cosmetic and toilet preparations;	0.07	1.12	nre	6.32
042 Rice;	0.00	3.48	8.52	6.79
Total	85.48	81.96	77.07	79.28

Source: TradeCAN (2002)

In order to gauge the competitiveness of OECS exports to CARICOM a competitiveness matrix was constructed (see table 9 below). The computations were carried out using the ECLAC Competitive Analysis of Nations (CAN) software programme.

The analysis combines the increase or decrease of a country's market share in a given product in a given import market with the increase or decrease in the share of a product in a given market. When a country's market share in a product increases (decreases) the country is a winner or efficient (inefficient or loser) in the export of that product. When the import market share of a commodity increases (decreases) the demand for the product in the said market is dynamic (stagnant).

Competitiveness movements refer to the change over time of a product in a market with respect to the market share for that product and the share of the product in that market. An increasing country share (say, Saint Lucia) in a product whose relative importance in the imports of the reference country or trade partner (say Barbados) is growing is referred to as a Rising Star. An increasing (declining) country share (say Saint Lucia) in a product whose relative importance in the imports of the reference country or trade partner (say Barbados) is growing (shrinking) is referred to as a Rising Star (Retreat). A declining country share (say Belize) in a dynamic (stagnant) product (a product that is increasing (decreasing) its importance in the imports of Barbados) is referred to as a Missed Opportunity (Declining Star).

Table 9					
OECS exports to CARICOM					
Market share competitive matrix, 1985-1990, 1990-1995 and 1995-2000					
at the three digit level and expressed as a percentage of the final year exports					
<u>Stagnant commodities</u>			<u>Dynamic commodities</u>		
		First period	59.8	First period	36.6
		Second period	37.1	Second period	62.8
		Third period	62.2	Third period	37.7
<u>Market share gains</u>		<u>Declining stars</u>		<u>Rising stars</u>	
First period	73.4	First period	41.1	First period	32.3
Second period	43.6	Second period	29.1	Second period	14.4
Third period	44.0	Third period	19.7	Third period	24.4
<u>Market share losses</u>		<u>Retreats</u>		<u>Missed opportunities</u>	
First period	23.0	First period	18.7	First period	4.3
Second period	56.3	Second period	8.0	Second period	48.3
Third period	55.9	Third period	42.6	Third period	13.4
Source: CAN (2002)					

The matrix orders commodities following two criteria: their dynamism/stagnation and market share gains and losses for three time-periods spanning 1985-1990; 1990-1995 and 1995-2000 (see table 29 above).

In the first period (1985-1990), the OECS benefited from favorable demand conditions mainly in stagnant markets. The OECS registered market share gains for most exports (73 per cent of the total). The majority of the market share gains (60 per cent) occurred in stagnant markets and 37 per cent of the total occurred in dynamic markets.

In the second period (1990-1995), the OECS reversed their market share gains and witnessed market share losses in the case of more than 50 per cent of their intraregional exports. Also the market share losses occurred mostly in dynamic commodities (63 per cent of the total).

In the third period (1995-2000), the OECS member States maintained their market share standing from the previous period (that is, the percentage of market losses remained roughly constant). However, contrarily to the second period the majority of market share losses occurred in stagnant commodities.

Detailed empirical evidence at the product level (presented in tables 30 and 31 below) reveals that on average the OECS intraregional market share for its major commodities steadily declined between 1985 and 2000 (7.6 per cent, 7.6 per cent, 5.98 per cent, 5.75 per cent for 1985, 1990, 1995 and 2000, respectively). At the same time, the average import share of the commodities exported by the OECS to CARICOM decreased from 0.40 to 0.33 between 1985 and 1990 and then increased to 0.41 in 1995 and remained at that level in 2000.

The same evidence also shows that in 1985, the OECS held a market share greater than 25% in five products and a market share greater than 10 per cent in nine of the products exported intra-regionally. In 2000, the OECS had an intraregional export market share greater than 25 per cent in only one commodity (meal and flour of wheat and flour of meslin) and a market share greater than 10 per cent in only five products (soap, fruit and nuts, meal and flour of meal, alcoholic beverages and rice).

Furthermore the results presented indicate that only five products witnessed an increase in intraregional market share between 1985 and 2000. This list comprises meal and flour of wheat (25 per cent and 44 per cent in 1985 and 2000, respectively), alcoholic beverages (5 per cent and 12 per cent in 1985 and 2000), non-alcoholic beverages (6 per cent and 9 per cent in 1985 and 2000), travel goods (1 per cent and 2 per cent in 1985 and 2000), perfumery and cosmetics (0.2 per cent and 7 per cent in 1985 and 2000), stone, sand and gravel (0.2 per cent and 6 per cent in 1985 and 2000) and rice (0 per cent and 11 per cent in 1985 and 2000).

III. Special and differential treatment in the Revised Treaty of Chaguaramas

A. The provisions for special and differential treatment in the Revised Treaty

The Revised Treaty of Chaguaramas (2001) sought to deepen the regional integration process by establishing the CSME.¹¹

The CSME was born from the desire “to advance beyond the Common Market towards more comprehensive integration, recognizing that while it had achieved significant liberalization of the market for goods, the further development of the regional economy was constrained by restrictive Treaty provisions limiting the free movement of services and capital and skilled labour” (CARICOM, 2000).

Its explicit objectives include the free movement of goods, services, capital and persons; more intensive coordination of macroeconomic policies and economic relations; and the harmonization of laws governing trade and other economic activities within the common market area. It also provided for full application of the Common External Tariff (CET). This entailed simplifying the CET structure and reducing its level, with a view to diminishing its protectionist content.

Implementation of the CSME called for the creation of new institutions to manage the deepening of the integration process. The original treaty was amended by nine protocols affecting the structure of the organization, the movement of capital and labour, and policies regarding trade, agriculture and transport in the region.

The new integration framework contained in the Revised Treaty of Chaguaramas (2001) maintains the recognition of differences in size and development contained in the treaty establishing CARICOM (Treaty of Chaguaramas, 1973). The treaty’s Common Market Annex differentiates between LDCs and the MDCs.

The asymmetry issues are mainly addressed in Chapter VII of the revised Treaty. There are also good endeavour clauses (i.e., parties in the negotiation should take into account the special needs of the LDCs) throughout the treaty.

Following preliminary considerations Chapter VII is divided into two sections. The first provides a regime for disadvantaged countries, regions and sectors. The second provides a special regime for less developed countries.

Even though the scope of special and differential treatment in the Revised Treaty is broad, the discussion has centered on two aspects, article 164 and the Establishment and Functioning of the Regional Development Fund (article 158). Article 158 belongs to the first regime and article 164 to the second regime of Chapter VII.

It is important to note that, as in the case of the CARICOM Treaty, special and differential treatment comprises an aspect dealing with flows of goods (a real sector aspect) and

¹¹ This is stated in the first preambular paragraphs of the Revised Treaty.

another one dealing with flows of money (a monetary and financial aspect). In this sense, the Revised Treaty recognizes that trade and finance are two complementary aspects. Nonetheless, there are no provisions for the regulation of capital or financial flows. Instead the focus is on the removal of restrictions to the movement of capital among CSME signatory economies (p.e., Art. 40).

B. The Regional Development Fund

Central to the first regime contemplated in the Revised Treaty of Chaguaramas for disadvantaged countries, sectors, and firms is the establishment of a development fund (Art. 158) whose purpose is the provision of financial or technical assistance to disadvantaged countries, regions, and sectors. Disadvantaged countries, regions and sectors are defined in article 1 of the Revised Treaty.¹²

The term ‘disadvantaged’ should be understood as the inability to fully participate in the CARICOM integration agreement. From the point of view of this study, ‘disadvantage’ results mainly from size, policy implementation, external shocks and temporary development conditions (see table 10 below).

The less developed countries are, at least for the OECS, considered disadvantaged mainly because of the limitations imposed on their development by their small size.

Policy implementation refers to the negative impact or consequences of the operation of the CSME. In the case of disadvantaged countries the Revised Treaty (Art. 1) makes reference to “the adverse impact of the operation of the CARICOM Single Market and Economy.” In the case of both disadvantaged regions and sectors the Treaty makes explicit reference to economic dislocation. At the sectoral level disadvantaged sectors refer to a sector, in which ‘economic enterprises experience dislocation from the operation of the CSME.’ (Art. 1.)

Table 10	
The Regional development Fund	
	Disadvantaged

¹² The concept of a development fund is not new. The concept was put forward at the Twenty First Meeting of CARICOM Ministers Responsible for Foreign Affairs. The objective was to guarantee the effective participation of the smaller less developed economies by facilitating their international trade competitiveness within the context of the Free Trade Area of the Americas Agreement. In 1998, the Government of Guyana under President Cheddi Jagan submitted a proposal for the establishment of a Regional Development Fund to the XXI Latin American Council Meeting of the Latin American Economic System. The Regional development Fund was renamed as the Regional Integration Fund. The objectives of the Regional Integration Fund were fourfold:

- (i) strengthen and diversify the productive base of the smaller economies of the Western Hemisphere through the promotion and facilitation of enterprise development and private sector participation;
- (ii) foster infrastructural development, including telecommunications infrastructure, in these economies;
- (iii) encourage human resource and technological development in the smaller economies, and
- (iv) facilitate the competitiveness of the goods and services produces by the smaller economies.

See, The Regional Integration Fund. Assisting the Smaller Economies Towards the Free Trade Area of the Americas. Second Summit of the Americas. Santiago, Chile, April 18-19, 1998. Compiled by the Ministry of Foreign Affairs, Guyana. See also, Address by His Excellency Dr. Cheddi Jagan, to the Hemispheric Summit Conference on Sustainable Development. Santa Cruz, Bolivia, 7-8 December 1996.

	Country	Region	Sector
Size	Less Developed Countries		
Policy implementation	Adverse impact of the operation of the CSME	Economic dislocation from the operation of the CSME	Economic Dislocation from the operation of the CSME
External factors	Natural disasters	Natural disasters	Natural disasters
Development condition	Temporary low levels of development HIPC Status	Temporary low levels of development	

External shocks refer to natural disasters, which cause impairment of resources at the country level and region level, and economic disorder at the sectoral level. Note that the level of exposure to natural disasters is one of the main explanatory variables of vulnerability.¹³

¹³ According to the standard definition vulnerability is “associated with exposure to external economic factors. It is the consequence of two sets of factors: (1) the incidence and intensity of risk and threat; and (2) the ability to withstand risks and threats and to ‘bounce back’ from their consequences.” In turn the threats have their origin in the particular characteristics of some of the smaller economies, remoteness insularity, and economic exposure. This general definition of vulnerability has paved the way for arguing that the vulnerability of the smaller economies is structural rather than conjectural. That is, it does not depend or is not a consequence of policy decisions. It is independent of political or economic choice. Vulnerability proponents have clearly emphasized that this concept is not related to measures of economic performance such as GDP per capita. A country can have an internationally relatively high GDP but be still vulnerable (i.e., The Bahamas).

The vulnerability index for any country is defined as the predicted value of its output volatility. The predicted value of output volatility is obtained by regressing the actual value of output volatility on variables for economic exposure remoteness and insularity and susceptibility to environmental events and hazards (Atkins, Mazzi, and Easter, 2001). According to the results the preferred estimated equation was:

$$\text{Outvol}_i = \alpha_0 + \alpha_1 \text{Vuln}_i + \alpha_2 D_i + \alpha_3 \text{Exdep}_i + \alpha_4 \text{Div}_i$$

Where, Outvol_i = actual output volatility

Vuln_i = susceptibility to natural disasters

Exdep_i = export dependence

Div_i = export diversification index

D = dummy variable

i = 1, ..., N and N is the number of selected countries.

Figure 10

Schema of Chapter VII of the Revised Treaty of Chaguaramas

<p align="center"><u>Special regime for less developed countries</u></p> <p align="center">Part II</p>	<p>Good intention provisions</p>	<p>Rules of origin (Art. 161)</p> <p>Incentives program (Art. 162)</p> <p>Implementation of the common external tariff (Art. 163)</p>
	<p>Conditional provisions</p>	<p>Imposition of import duties (Art. 160)</p> <p>Suspension of community origin on grounds of production in one or more less developed countries (Art.164)</p>
<p>Special regimes</p>	<p>Measures to counteract the negative effects of the operation of the CSME (Arts.142 & 143)</p>	<p>Technical and financial assistance to address economic dislocation (Art. 143)</p> <p>Arrangements to ameliorate or arrest adverse economic and social impact.</p> <p>Grant of incentives (Art. 146)</p> <p>Non-application of national (Art.148) treatment for selected services</p> <p>Non-application of national treatment to persons exercising the right of establishment in selected activities (Art. 149)</p> <p>Limitations on imports (Art.150)</p> <p>Suspension of community treatment to products of other Member States (Art.151)</p> <p>Support domestic production in respect of public undertakings through duties and quantitative restrictions (Art.152)</p>
<p><u>Regime for disadvantaged countries, regions and sectors</u></p> <p align="center">Part I</p>	<p>Measures to strengthen the productive base and infrastructural development (Art.143)</p>	<p>Temporary derogations from obligations of the Treaty (Art. 146)</p> <p>Measures to attract investment and industries (Arts.143 & 147)</p> <p>Measures to assist industries to become efficient and competitive (Art. 143)</p> <p>Assistance for structural diversification and infrastructural development (Art. 143)</p> <p>Establishment of joint ventures (Art. 147)</p> <p>Capital flows from other members (Art. 147)</p> <p>Investment for economic diversification (Art. 147)</p> <p>Research, development and the transfer of technology (Art. 147)</p> <p>Promote the establishment of infrastructure (Art. 154)</p>

Finally temporary development conditions include ‘temporary low levels of economic development’ and Highly Indebted Poor Country (HIPC) status.

In the first regime, the provision of technical and financial assistance through the development fund is complemented by other measures and arrangements. These include, at the general level, temporary derogations from the obligations of the Treaty, measures to attract investment and industries among others (see figure 10 above for synthetic schema of the major provisions of the regimes included in Chapter VII).

The debate and analysis of the regional fund has centered to a great extent on its size and financing mechanisms. These aspects are certainly important. There are, however, fundamental issues that must be clarified and addressed if the development fund is to be used for the countries, regions and sectors it seeks to benefit.

First, Chapter VII should provide a clearer and accurate definition of the role of the development fund. As matters stand, due to the broad definition of ‘disadvantaged,’ the development fund has a dual role. It acts as a development fund per-se (long-run) and at the same time as a compensatory fund (short-run). These are two separate and distinct concepts requiring perhaps different actions and funding mechanisms as well.

Second, Chapter VII states that the measures for disadvantaged countries, regions and sectors for both regimes are of a transitory or temporary nature (Art.143.1). It is understandable that measures of a transitory or temporary nature be undertaken to deal with short-run factors such as ‘temporary low levels of development’ or negative impact arising out of the operation of the CSME or ‘external shocks.’ It is harder to understand how measures of a transitory or temporary nature can deal effectively with the economic limitations imposed by small size. These are not of a temporary nature.

Third, Chapter VII should define dislocation and the economic boundary between dislocation and non-dislocation in a precise manner. In addition it should specify, at least in terms of broad principles, the reasoning, mechanisms and institutions through which it can be determined that a given dislocation is indeed caused by the operations of the CSME and not by any other factor or phenomenon.

Fourth, Chapter VII should define the relationships and interdependence between sector, region and country, for this affects the type of measure that should be implemented when one of these geographical entities is affected by the operations of the CSME. A negative impact on a sector may spill over to the regional and, eventually, to the country level. Chapter VII should explain, at least at the general level, how the measures contained therein are to deal with geographical externalities.

Fifth, as currently defined, the development fund can lead to a free-rider problem and moral hazard issues. Some firms including those belonging to the most important economic sectors (cement, brewery, paint, metal, food and beverage, paper and paperboard, and distiller industries) have undertaken plans to restructure. Restructuring is a strategy to achieve a higher level of competitiveness in the face of greater competition brought in part by the operation for

the CSME and thus a strategy to avoid the negative impact of the CSME. Firms that restructure, unlike firms that do not restructure, have less likelihood of being negatively affected by the operation of the CSME. Thus the firms that do not restructure are likely to benefit from the development fund whereas firms that are restructuring may not benefit from the fund's financial and technical assistance since they may simply not be considered 'disadvantaged.'

Finally, the development fund should address the basic development problems of the Caribbean in a regional and concerted strategy. The development fund should specifically give priority to the factors that have been found to be the drivers of economic growth. These include the development of human capital, investment in research and development and the reform and design of an infrastructure facilitating competitiveness. In this sense, the development fund should follow the broad guidelines and objectives of the Integration Regional Fund (see footnote 11 above).

C. Regional development funds: The European Experience

CARICOM is not the only regional integration agreement contemplating the establishment of a development fund. This has also been one of the main objectives of the most perfected regional integration agreement, that of the European Union. The European Union's experience, while different than that of the Caribbean, can provide valuable lessons.

Europe's regional policy is one of economic and social cohesion. It is a question of social articulation rather than one focused on economic growth. The policy of social articulation is carried out through structural actions. These comprise structural and cohesion funds (see table 11 below). The former and latter represent 90 per cent and 10 per cent of the total funds allocated to structural actions. The largest programme is the European Regional Development Fund (ERDF), which absorbs 58 per cent of structural funds.¹⁴ Structural actions represent one third of the European Union budget and for 2000-2006 are estimated at 3 per cent of the European Union's GDP for 1999.

The disparities in regional agreements, such as for example the European Union, are measured by the respective GDPs per-capita relative to the mean. The countries that are below the mean are termed 'disadvantaged.' Those exhibiting a GDP per capita above the mean are the 'advantaged' regions. The advantaged/disadvantaged threshold has changed over time. In the case of the European Union the threshold was set at 90 per cent in 1991 and then at 75 per cent in 1999 of the average GNP and GDP for Europe

¹⁴ The others include the European Social Fund, the European Agricultural Guidance and Guarantee Fund and the Financial Instrument for Fisheries Guidance.

Table 11		
Structural actions in Europe		
Objectives and funds		
Objectives		
Structural funds	Cohesion funds	
<p><u>Objective 1:</u></p> <p>Development and structural adjustment of the poorest regions of Europe. The poorest regions are those whose GDP per capita is below 75% of the European average expressed in purchasing power</p> <p><u>Objective 2:</u></p> <p>Economic and social restructuring of regions with regional deficiencies.</p> <p><u>Objective 3:</u></p> <p>Adaptation and modernization of education systems, training and employment.</p>	<p><u>Objective:</u></p> <p>Supports transportation and infrastructure projects.</p> <p>Cohesion funds are allocated to the states with a per capita national product below 90% of the European Average measured in purchasing power. These states are: Greece, Portugal, and Spain.</p>	
Structural actions by beneficiary countries as a percentage of the total and of their respective GDPs		
Countries	Percent of the total	Percent of GDP
Spain	26.4	1.4
Germany	14.0	0.2
Italy	13.9	0.4
Greece	11.7	3.0
Portugal	10.7	3.1
Source: On the basis of World Bank. European Integration, Regional Policy, and Growth. Washington D.C.: The World Bank (2003).		

The impact of structural funds in the European Union can be divided into a demand and supply side effects. The former refers to the effect of increasing expenditure on aggregate demand. The latter refers to the effect on the productive potential of an economy. The demand effect is generally visible in higher expenditure levels and short-term reduction regional income disparities. Nonetheless, it is insufficient to justify the use of structural funds because it is tantamount to equating structural funds with income transfer mechanisms. However, supply-side effects are harder to identify.

It is generally accepted that structural funds have had a positive impact on the development of Europe and the convergence of its member countries as attested by the Spanish and Irish experiences. Besides demand and supply effects, some authors have also identified the positive effects of regional aid on the improvement in the 'quality of expenditures and institutions.'¹⁵

However, the usefulness of structural funds and regional aid in Europe has not gone unchallenged. Bodrin and Canova (2003, p.89) view structural funds as pure transfer

¹⁵ Funck et Al. Overview in European Integration, Regional Policy and Growth. Eds. Bernard Funck and Lodovico Pizzati (2003). The World Bank: Washington D.C.

mechanisms with few positive long-term effects. In addition, both authors claim that these generate rent-seeking behavior and they lead to “inefficient allocation of resources within regions that are the main beneficiaries of such transfers”. In their own words structural funds lead to: “...suboptimal allocation of regional labour, capital and entrepreneurship and to a self-perpetuating system of expectations in which below- average income levels are almost ‘sought’ by the regional administrations as a conduit for additional funding.”¹⁶

The European experience, although obviously different than that of the Caribbean, should alert policy makers in the Caribbean that structural funds should not be seen as a panacea for growth and convergence. Structural funds are a means to attain those goals. Fundamental to this endeavor is the precise specification of the mechanisms that should be used for their attainment, and the precise identification and demarcation criterion for their use and beneficiaries. Structural fund provisions, if they are to be useful, must move beyond the realm of the general principles.

D. The Special Regime for Less Developed Countries

The second regime of Chapter VII, targeted to LDCs, comprises eight articles (Articles 160 to 167). Excluding article 164 which will be dealt with in the next section, these can, in turn, be divided into three groups. The first group (comprising articles 165 and 167) provides provisions in favor of the LDCs and Belize. The article referring to the LDCs refers to public undertakings.

The second group can be termed ‘the good endeavour clauses’. These are four (articles 161, 162, 163 and 166), that is half of the total. They are articles in which the special needs of the less developed countries are taken into account. The special needs are taken into account in the application of the common external tariff, rules of origin and the implementation of incentives. However, throughout these articles there is no commitment or guarantee that this will be the case.

The third group comprises article 166 which makes reference to the imposition of import duties and most important article 164 which replaces, at the end of December 2005, article 56 of the CARICOM Treaty. The application of both is subject to the authorization of COTED and in the second case the decision of the Council for Trade and Economic Development (COTED), requires “the affirmative votes of all the less developed countries and at least two of the more developed countries.”

From the point of view of this study, the recognition that the Less Developed Economies of CARICOM are considered disadvantaged, in the sense of not being able to fully participate in an integration agreement, is equivalent to recognizing that these countries are not competing or negotiating on the same footing as larger and/or more developed economies.

As a result, a regime addressing the needs of the less developed economies of CARICOM should include more than ‘good endeavour’ or ‘conditional clauses or provisions.’ In fact it should include a set of provisions providing for asymmetric treatment to level the playing field.

¹⁶ Boldrin, M. and Canova, F. (2003) Regional Policies and EU Enlargement in Funck et Al. Op.cit.

The formulation of special and differential treatment provisions within CARICOM could well start by following those put forward in the WTO texts (1994). In the WTO, the concept of special and differential treatment is embodied in a set of provisions allowing developing countries greater flexibility in terms of obligations and time frames. These provisions are grouped under four headings: (i) those recognizing the interests of the least developed and developing countries; (ii) the measures that reduce or ease the rules and obligations that developing economies have to meet; (iii) the provisions providing for longer time-frames for the implementation of obligations; and (iv) the provisions for technical assistance (WTO, 1999c, p.225).¹⁷ These measures could provide a blueprint for the type of asymmetric treatment needed by disadvantaged countries to be able to fully participate in the CSME.

E. Article 164 of the Revised Treaty of Chaguaramas

In the Revised Treaty, article 164 replaces article 56 of the CARICOM treaty whose provisions expired in December 2005. The focus of article 164 is the suspension of community origin treatment to any imports on grounds of production in the LDCs.

Article 164 is not granted on an automatic basis but must rather be negotiated. It is granted on the basis of economic reasons and for a limited period. The firm or industry requesting the benefits of article 164 must specify how it plans to use the period requested.

The process involves: (i) requesting the benefits of article 164; (ii) the support of two MDCs to use article 164 as a temporary measure; (iii) the ratification of the request by COTED and by the Community Council; and (iv) the ratification by the Conference of Heads of Government.

COTED decided at its 19th meeting, and at the request of OECS member States, to undertake consultations with CARICOM member States with the aim of developing proposals on measures to promote the industrial development of the LDCs in accordance with the provisions of article 164. The consultations aim to preserve and extend the concessions of article 56 and are centered on the original list of article 56 products.

One of the key arguments put forward for preserving the concessions granted by article 56 is the disparity of costs among member States of CARICOM. As a general rule, firms or countries that have lower costs have a greater potential to improve their competitiveness. More

¹⁷ See, WTO. Special and Differential Treatment. Synopsis of WTO Agreements and Related Topics. MM/LIB/SYN4. 23 October 2000 for a detailed list of the provisions of the WTO Agreements on Special and Differential Treatment. Caribbean economies have built on the WTO provisions to propose additional provisions specific to smaller economies meant to allow the progressive integration of smaller economies in the current multilateral trading regime. These can be grouped under seven headings. (Bernal, 2001): (i) a lower level of obligations; (ii) asymmetrically phased implementation timetables; (iii) best endeavor commitments; (iv) exemptions from commitments in certain areas; (v) flexibility in application and adherence of disciplines under prescribed circumstances; (vi) enabling access to mediation; (vii) technical assistance and training.

specifically differences in cost structure are seen as leading to a cumulative process of asymmetries such as that described by Verdoorn's Law.¹⁸

In the particular case of CARICOM, bigger economies have for the most part lower costs due the comparative large scale of production, access to lower cost materials due plainly to natural resource endowments (comparative advantage). Table 12 below shows the structure of costs including energy, communications, transport and labor for CARICOM economies. It is readily seen that some of the bigger economies have greater cost advantage in energy, communications and labor.

On the basis of the said consultations, the recommended strategy by the OECS for the application of article 164 is the substitution of quantitative restrictions by price measures (tariffs).¹⁹ The tariff measures would be applied on a temporary basis. The time frame for their application would be guided by financial and economic considerations. The introduction of tariffs seeks to protect and expand the OECS domestic market share.

As a result the OECS firms and industries would replace existing quantitative restrictions by tariffs which would be levied at higher than existing rates. This implies the suspension of the CET rates. Also the OECS member States have requested that the MDCs suspend CET treatment with respect to third countries as well in respect of beer, malt and flour.

¹⁸ In a nutshell Verdoorn's Law establishes a relation between growth of output and productivity growth. It states that greater output leads to greater productivity. In the particular case referred to above lower costs lead to greater output which in turn induces a faster rate of growth of productivity. See, McCombie J., Pugno, M. and Soro B. (2002) Productivity growth and economic performance (Macmillan: New York).

¹⁹ In other words tariffs would be applied on regional and non-regional products.

Table 12
Comparative costs for Caribbean economies

	Cement price buildup			Port Costs			Electricity Costs	Transportation costs	Wages	Telecommunications
	Landed cost	Average trading cost	Freight prices	Berth Occupancy	Mooring charges	Harbour dues	Kwh	(Ocean freight rates)		
Barbados				1025.60			0.11	1235	1.00	0.65
Jamaica						504.14	0.11	1519	0.80	0.25
Guyana			12.00				0.18	1135		0.57
Surinam			13.50				...	1165		
Trinidad and Tobago				325.53	159.00	724.55	0.03	....	1.27	0.72
Antigua and Barbuda	...	...	...	298.20	55.50	438.42	0.17		3.28	
Dominica	23.81	3.53	12.00	222.00	61.05	221.40	0.26	1790	1.81	0.61
Grenada	8.23	5.51	10.00	179.20	111.00	296.00	0.16	1780	2.12	0.61
St. Kitts and Nevis	38.02	3.69	13.00				0.16		2.87	0.61
Saint Lucia	12.37	6.73	10.00	88.80	29.60		0.17	1385	...	
St. Vincent and the Grenadines	8.23	5.51	10.00	148.00	64.80	188.19	0.36	1635	1.32	1.20

Note: The cement price buildup consists of three components, landed costs, average trading costs, and freight prices. Landed cost includes port/cargo and tonnage dues, landing charges, transport dock charges and stevedoring. Average cost comprises transport, average handling and burst of bags costs. Vessel port costs include terminal user and mooring charges, and terminal charges. The data was provided by PLIPDECO. The data is made comparable by using a sample vessel, the Tropic Carib. Specs. The vessel has the following specifications NRT = 3,601; GRT = 10,851 and LOA = 159.9).Electricity costs are defined in terms of US cents per kilowatt hour. Transportations costs refer to ocean freight rates of shipping one 20 or 40 foot container from a Caribbean country to Jamaica. Telecommunication cost is the international daytime rate per minute from the country of origin to the United States. Fuel cost is the price of gasoline (unleaded) and diesel per litre. Factory rental is the cost per year per sq. foot. Data on wages is expressed on an hourly basis and is shown for the minimum wage, and skilled and unskilled workers when available. In the case of the minimum wage, data for Saint Lucia refers to the manufacturing and tourism sectors. For Jamaica and Trinidad and Tobago the minimum wage is the national minimum wage. In the case of St. Kitts and Nevis, the minimum wage is that paid in the manufacturing sector (in the Hotel and Casino sector the minimum wage is 1.41 US).

Source: Author's own computation on the basis of official and country data.

Table 13
Proposal for the extension of benefits to the OECS under article 164

Product	Tariff rates (in percentages)				Time frame	Rationale Tariff changes	Rationale for time frame proposed
	CET	Effective	Proposed in relation to MDCs	Proposed in relation to third countries			
Aerated beverages	30		80	100	10	ERP	One of the most sensitive products to be affected by liberalization. High cost production.
Aerated waters	25 and 30		80	100	10	ERP	One of the most sensitive products to be affected by liberalization. High cost production.
Beer	11.00/lg		80	100	10	ERP	Time frame of investment required to expand capacity.
Malt	25		80	100	10	ERP	Time frame of investment required to expand capacity.
Coconut water	0		0	0	0	ERP	...
Candles	30		40	50	7	ERP	...
Wheat or meslin flour	5 and 25		80	100	10	ERP	Time frame of required to pay off investments and buffer stock against excess supply.
Curry powder	40		30	40	5	ERP	Production mainly for the domestic market. Require support to expand.
Pasta	20, 25 and 30		50	100	5	ERP	Production mainly for the domestic market. Require support to expand.
Animal feed	5, 25 and 30		50	100	10	ERP	Time frame of required to pay off investments and buffer stock against excess supply.
Wooden furniture	10		40	50	10	ERP	Time frame of required for expansion and modernization.
Solar water heaters	30		40	50	10	ERP	Time frame of required for expansion and modernization.
Industrial gases	5, 20 and 25		40	50	10	ERP	...

Note: ERP = effective rate of protection.

Source: OECS (2006)

That is, the level of tariff protection afforded to OECS firms and industries with respect to third countries should be applied and instituted throughout CARICOM. Moreover the OECS is seeking to encourage joint collaboration with the MDCs to develop a programme of effective and operational assistance to promote the industrial development in the OECS. Finally, the products benefiting from the provisions of article 164 should ‘receive the designation’ of sensitive products, and as a result should be subject to the slowest pace of liberalization, and excluded from any tariff concession granted by the MDCs on a bilateral or multilateral basis.

Table 13 above shows the current and proposed tariff rates by product benefiting from article 56. The table also indicates the accompanying time frame for the granting of benefits under article 164 and the rationale for the time frame. In certain cases the time frame coincides with the period of maturity of an investment. In other cases, the time frame is requested on grounds of high costs, excess supply and vulnerability to external conditions

F. Special and differential treatment and the rules of origin

Special and differential treatment, as contemplated by article 56 in the CARICOM Treaty or article 164 in the Revised Treaty of Chaguaramas, centers around the “suspension of Community origin treatment to any description of imports eligible on grounds of production in one or more developed countries.” It refers to the imposition of restrictions on imports.

However, the Treaty and Revised Treaty also contemplate the reverse side of the coin. That is, these texts contemplate, under special circumstances, the granting of community origin to an extraregional product. That is, it grants special and differential treatment and therefore discriminates in favour of selected extraregional products. While this measure is available to all CARICOM members, the larger countries, by the structure of the economy, are prone to use it on a more regular basis.

Contrary to a protectionist measures which keep products outside a given sphere, and are therefore a static measure, the granting of rules of origin is dynamic. Its application can in fact lead to the importation of inputs with lower cost and higher quality and technological content. This, in turn, can set up a scenario for dynamic learning economies of scale.

The implementation of the CET requires the specification of rules of origin. These are found in articles 31 and 32 in the CARICOM Treaty and articles 83 and 84 in the Revised Treaty of Chaguaramas.

According to Article 84 of the revised Treaty of Chaguaramas, a commodity is treated as being of Community Origin if it has been ‘wholly produced within the Community or if it has been produced within the Community wholly or partly from materials imported from outside the Community or from materials of undetermined origin by a process which effects a substantial transformation.’ The transformation is characterized by the difference in the Harmonized Code Tariff Heading of the material input and the final product.

Article 83 allows the producer to obtain inputs from extraregional sources when ‘unable by reason of circumstance beyond his control to obtain supplies of the regional materials.’ This

clause is part of the suspension facility of the Treaty which states that tariffs may be suspended or altered when a product is not produced by the community, when the quantity of the product being produced in CARICOM does not satisfy the regional demand or when the quality of the product is below that of the regional standard.

As a result, extraregional inputs can be granted CARICOM common market origin allowing foreign producers to gain preferential access to the regional market while at the same time permitting access to lower cost inputs from outside the region, if necessary.

Inputs for the development of economic sectors and industrial production can be granted duty-free treatment when belonging to the list of conditions for duty exemptions. These are end-user defined. CARICOM members can decide, at their own discretion, which list of activities to include in the list of exemptions.²⁰

At the same time, the CET Schedule also includes a list of commodities which are non-eligible for duty exemptions.²¹ This list comprises some of the most important commodities traded within CARICOM (cement, paints, waters, flour, among others). This list protects not only some of the most important commodities, but also the firm structure, which is highly concentrated, corresponding to each of these commodities. Article 83 of the rules of origin can be used to obtain tariff exemptions on the list of ineligibles for duty exemptions.

In general the suspension mechanism provided by article 83 has been used by the bigger economies of the Caribbean. The larger economies are more diversified than the smaller ones. The greater the degree of diversification of an economy, the greater is the likelihood that it will require inputs or intermediate goods that can only be supplied by extraregional suppliers.

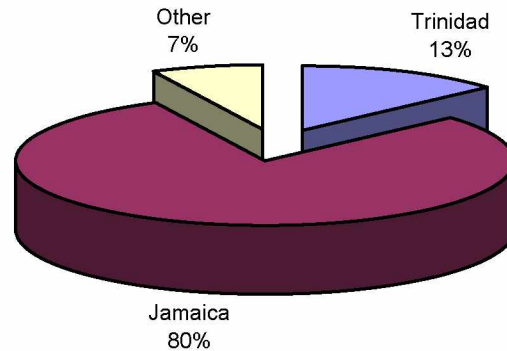
Recent available data shows that the CARICOM Secretariat received for the period May to December 2004, 409 requests for the suspension of the CET under paragraph 3 of article 83 of the Revised Treaty. Own estimations reveal that this represents 3 per cent of CARICOM total imports, but 24 per cent of intraregional traded products. A close inspection of the data also shows that 93 per cent of the requests were made by the bigger economies (80 per cent for Jamaica and 13 per cent for Trinidad and Tobago) (see figure 11 below). The number of OECS requests for the application of the suspension mechanism was minimal.²²

²⁰ See, Gonzales, *op.cit.*; World Bank (1990) *op.cit.* and the Common External Tariff of the Caribbean Common Market. Second Edition (1996). Volume 3. Revised Draft Incorporating the Decisions of the 17th Special Meeting of the Common Market Council, 9-10 June. Caribbean Community Secretariat. Pp.774-781.

²¹ See, The Common External Tariff of the Caribbean Common Market. Second Edition (1996). Vol. 3. pp.782-812.

²² The computations here presented should be understood as an illustration of the fact that bigger economies are for the most part the beneficiaries of the suspension facility of article 83. Other estimations show that Trinidad and Tobago is the country that makes the most use of this facility. See Hamilton and Associates (2002).

Figure 11
Share of requests for the application of the suspension of the CET
May-December 2004



Source: On the basis of information provided by CARICOM Secretariat

An analysis at the product level shows that a significant part of these can be classified as products with a high technological content. In turn, products with a high technological content constitute a vehicle that allows the generation of processes of learning-by-doing. This by itself can be a means for structural change and growth and thus for diversifying the manufacturing sector. This process can be further enhanced by unrestricted access to certain categories of skilled labour as currently contemplated in the CSME provisions.

Greater diversification and the use of the CET suspension mechanism are correlated. However, it has not been determined whether diversification leads to the greater use of the suspension mechanism or vice versa.²³ There is also the possibility that diversification and the suspension facility of the CET have a bi-directional relationship and feed back on each other.²⁴

The rules of origin jointly with the list of conditional duty exemptions and ineligibles for duty exemptions protect the development of economic sectors, the main traded commodities within CARICOM and the non-competitive conditions for the supply and production of goods. In this sense the trading regime is not conducive to the generation of efficiency or optimality conditions or for the existing production structures in the way these concepts are understood by the mainstream economic literature.

To the extent that the bigger economies make greater use, mainly due to their size and thus level of diversification, of the suspension mechanism these can enhance their levels of

²³ That is correlation does not imply causation. The causality issue remains an area for further research.

²⁴ In their review of trade policy instruments and administrative practices governing the operation of the CARICOM CET and rules of origin, Hamilton and Associates write (2002, p.17): "The use of the CET suspension mechanism stimulates competitiveness in intra-regional trade". Countries or exporters, which secure most of the suspension of the CET/derogation from the Rules of Origin, are the most competitive exporters to CARICOM. See, Hamilton, T. and Associates (2002). Final Report to Review of trade policy instruments and administrative practices governing the operation of the CARICOM CET and rules of origin. CARICOM-Secretariat.

competitiveness. To the extent that the suspension mechanism can become a vehicle for the creation of dynamic processes, it can further enhance the existing levels of diversification and efficiency of these economies. This, in turn, can widen rather than narrow the existing disparities and inequality of initial conditions between the LDCs and MDCs and thus offset, to some extent, the intended objectives of special and differential treatment provisions, which seek to level the playing field between LDCs and MDCs.

IV. Special and differential treatment in CARICOM: lessons learned

As originally conceived in the CARICOM Treaty, special and differential treatment was a three-legged strategy comprising, protection from external competition, access to finance and the regulation of capital flows. In practice the application of special and differential treatment was limited to the application of quantitative restrictions.

The provisions for special and differential treatment allowed the establishment of some of the major firms in the LDCs as reflected in their export potential, output, contribution to government revenue and employment. Moreover the LDCs exhibit a traditional export structure demonstrated to be resilient in the face of adversity. The array of intraregional export products that represented more than 80 per cent of the total in 1985 still accounted for roughly 80 per cent of the total in 2000.

However, the provisions for special and differential treatment have fulfilled only part of the objective for which they were introduced in the CARICOM legal texts. Indeed, the empirical evidence shows that the OECS has lost market share at the intra-OECS level and at the aggregate level. Article 56 products have shown a similar behavior.

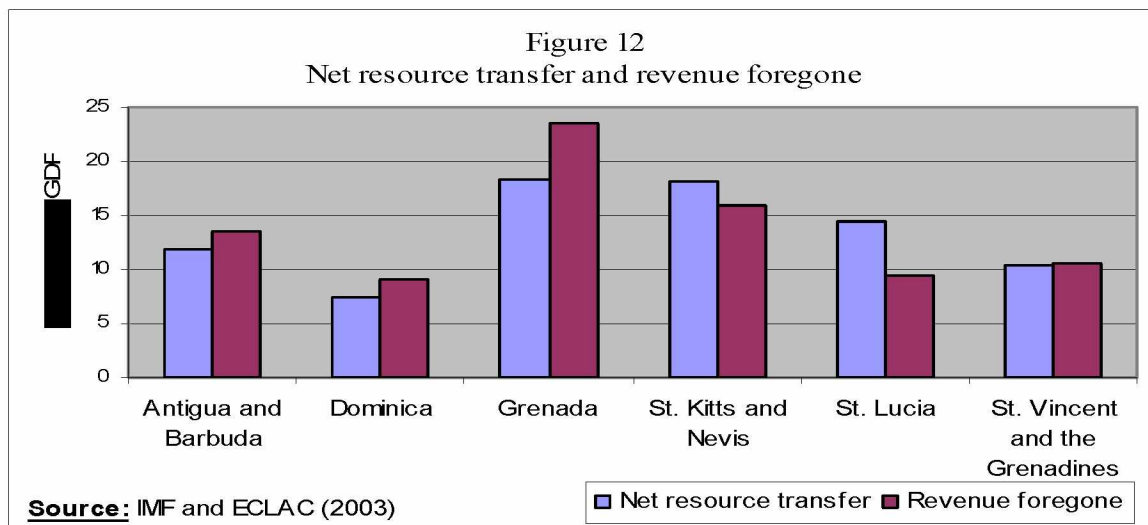
It has been argued that special and differential treatment has negative or insignificant effects. However, special and differential treatment provisions can have positive effects as shown by the available empirical evidence (see table 14 in the Annex).

The loss in market share occurred in fact during a period of widening divergence over time between LDCs and MDCs. At a broader level the OECS situation reflects the general macroeconomic performance of the OECS which has been characterized especially in the 1990s by low growth and impending macroeconomic disequilibria. The deterioration in export performance is reflected in CARICOM's loss of its market share of goods and services in its major extraregional markets overtime.

Indeed, even services which are the linchpin of growth for the OECS have not been immune from this trend. The growth of the services sector has stagnated and the growth of export services has declined over time. In addition, services have been produced inefficiently, as the resource foregone in order to attract capital flows directly to the services sector has exceeded for most OECS economies the net capital resource inflow (see figure 12 below).

More importantly what has happened during the 1990s is that the OECS has not been recipient to foreign capital flows rather, the smaller economies of CARICOM have actually

transferred resources to the rest of the world. This ‘perverse phenomenon’ is in fact the key to the understanding of the OECS performance during the 1990s.



In the Revised Treaty of Chaguaramas special and differential treatment provisions are included mainly in Chapter VII. Chapter VII comprises two regimes. The first deals with disadvantaged sectors, regions and sectors. The second regime deals with the LDCs of CARICOM.

As explained in the corresponding section of this document, the first regime should give a more precise definition of the terms guiding its principles, provisions and recommended actions.

The regional fund, a center piece of Chapter VII, as it addresses finance, deals with two separate issues, those of compensatory and structural actions. These must be distinguished for they may require different criteria for implementation and funding. The former amounts to an income transfer mechanism (short-run) whereas the latter is meant to establish, at least partly, the foundations for sustainable growth and development (long-run).

In addition, the fund is prone to free-rider and moral hazard issues that must be addressed.

Finally the fund should tackle some of the fundamental constraints on the development of the smaller economies of CARICOM and be guided according to the general guidelines conceived in the Caribbean Proposal for the Regional Integration Fund for the Free Trade Areas of Americas (FTAA).

The study of economic history shows that protectionism can have a beneficial impact on growth when accompanied by other types of measures. That is, protection by itself does not guarantee continuity in time nor diversification or growth. The evidence of pre-World War I Europe is a case in point.

The consensus conclusion of the empirical evidence of the pre- WWI European case is succinctly stated by Bairoch (1993): “it remains generally true that in all countries (except Italy) the introduction of protectionist measures resulted in a distinct acceleration in economic growth during the first ten years following a change of policy and that this took place regardless of when the measures were introduced.”²⁵ As well, more recently, Ha-Joon Chang (2002) makes the case that the developed countries used during their period of industrialization “interventionist industrial, trade and technology policies to promote infant industries during their catch-up period.”

In a globalized and liberalized world, interventionist policies can focus on delineating and implementing export promotion policies. Export promotion policies are virtually non-existent in most CARICOM countries. Although there are export promotion institutions that provide assistance to firms, the linkages and follow-up processes are very weak. Fundamental to the success of an export promotion policy is the creation of an export culture of which export training courses and programmes are an essential component. Export success is not the product of *laissez-faire*, but the result of a concerted public policy effort. As well, initiatives should be conceived to improve the productivity of imports.

The implementation of Chapter VII is very important for the success of the CSME. The CSME is a dynamic, continuous and sequential process. Its success requires that policy makers understand that dynamic processes unfold in historical time. And historical time is irreversible.

As a result, the definitions and concepts, goals and expectations of the CSME must be attuned to its impending reality. The objectives of the CSME must conform to the economic reality which it seeks to change and transform. This is a key reason for the necessity to incorporate special and differential treatment in a manner that promotes growth, productivity and employment, where trade and finance provisions are part of an integration text.

²⁵ See also, O’Rourke (2000) and Clemens and Williamson (2002).

ANNEX

Table 14		
Summary of findings of recent studies on special and differential treatment		
Purpose	Findings	Conclusions
<ul style="list-style-type: none"> • Clark (1997). A Diffusion Model of the Process of Implementing the Caribbean Basin Economic Recovery Act. 		
<p>- This study analyzes the share of preferential exports, in total exports over time, for CBERA beneficiaries, in order to seek estimates of the adoption rates and upper limit on participation under the tariff preference scheme.</p>	<p>- 13 of 21 countries examined showed varying degrees of success in utilizing provisions of the CBERA.</p>	<p>- Adopting a tariff preference scheme allows beneficiaries to increase their share of preferential exports in total exports over time.</p>
<p>- It also seeks to identify factors responsible for inter-country differences in the rates and levels of CBERA participation.</p>	<p>- Trade orientation of a beneficiary prior to implementation of the CBERA is important in determining CBERA participation.</p>	<p>- Logistic function of beneficiaries as a group remains a cause for concern as the estimated ceiling share (15 per cent) is close to ceiling attained in 1989 (13.6 per cent).</p>
	<p>- Trade orientation is important in determining CBERA adoption rates and ceiling participation values.</p>	<p>- New CBERA provisions, due to go into effect in 1992, extend product coverage to include those areas previously excluded from CBERA eligibility.</p>
	<p>- Ratios of agricultural exports, agricultural imports, and manufactured imports relative to GNP are positively correlated with CBERA participation measures.</p>	
	<p>- There is a lack of association between manufactured exports relative to GNP and CBERA participation as many manufactured products consistent with the comparative advantage of beneficiaries are not eligible for duty free treatment and also because most manufactured products are already eligible for duty-free GSP status.</p>	
	<p>Inadequate infrastructure and limited labor supply in some beneficiary countries are a major barrier to expanding the manufacturing sector.</p>	

Purpose	Findings	Conclusions
<p style="text-align: center;">• Loper, Abbott and Foster (2003). Preferential Trade of Agricultural Commodities in the Caribbean Basin</p>		
<p>- This paper examines the performance of agricultural exports under the Caribbean Basin Economic Recovery Act (CBERA) as well as the trade component of the CBI and the GSP programs from beneficiary countries to the US.</p>	<p>- The first group of non-preferenced goods (bananas, coffee and cocoa) have experienced low prices and low export earnings due to worldwide imbalances between supply and demand.</p> <p>- The second group covered under CBERA and GSP, in relation to the former - meat and sugar, meat exports to the US from CBI countries dropped considerably from 1993-2002. In relation to sugar, exports from CBI countries to the US were negatively affected due to the Uruguay Round. Changes in US domestic farm policies and NAFTA allowed CBI countries to lose market share due to diminished quotas.</p> <p>- Third group, all other groups under CBERA/GSP, is divided into demand driven, successful and crowded-out goods. This group also experienced preference erosion but differs in the way the erosion occurred. Exports for demand-driven goods were affected by demand and supply fluctuations in the US. Goods which were successful were likely to have found a niche in the US market, while other goods have been crowded out because exports from CBI countries may not have been as competitive as goods from other sources.</p> <p>- Competition from other sources and not a decline in US import demand led to the observed trends in CBI exports to the US.</p>	<p>- CBERA and GSP have become a larger component of total agricultural exports, increasing from 38.3 per cent in 1989 to 54 per cent in 2002.</p> <p>- By disaggregating the trade data it was found that preferential trade programs have been continuously successful and have expanded at faster than 10% per year from 1989 to 2002 in six goods: live tree slips or cuttings, dasheens, fresh or dried pineapples, cantaloupes, frozen orange juice, and ethyl alcohol.</p> <p>- Exports for politically sensitive goods such as meat and sugar fell as trade barriers limited CBI access to US markets.</p> <p>- Through the Armington model, it was possible to examine the effect of preference erosion effects versus import demand, export supply and structural change effects on market share changes. It was found that preference erosion contributed in small measure to falling market shares and that large variation in market shares through time can be attributed to relative import price changes.</p>
<p>- Three groups of export products are examined in order to analyze export trends. <i>First group</i> includes non-preferenced goods not covered under CBERA or GSP. <i>Second group</i> includes goods covered under CBERA and GSP where imports are affected by quantitative restrictions such as tariff rate quotas (TRQ) and the <i>third group</i> includes other goods benefiting from CBERA and GSP programs.</p>	<p>- The paper hypothesizes that goods that have been successfully exported may be differentiated and goods with declining exports may be homogeneous and have been crowded-out. It assumes that differentiated goods will have a small elasticity of substitution (using the Armington model)²⁶.</p>	<p>- The Armington model used in this analysis was not good at predicting structural change observed in the trade data which could have been useful for some goods that have been successful under CBERA and GSP programs.</p>
		<p>- Preference erosion as calculated by model predictions from tariff changes accounted for a fraction of observed market adjustments.</p>

²⁶ The Armington model recognizes that goods may be differentiated, that is, source providers from different countries that export the same good may be imperfect substitutes. It uses a two-stage utility maximization process. The first stage determines the total demand for a good, while the second stage specifies a constant elasticity of substitution demand function.

Purpose	Findings	Conclusion
<ul style="list-style-type: none"> • Nilsson, Lars. (2002) Trading relations: Is the roadmap from Lomé to Cotonou correct? <i>(full text article not sourced)</i> 		
<p>- This paper makes a comparative analysis of the effects of the EU's Lomé Convention and GSP on exports of developing countries using a gravity type model.</p>	<p>- Results of the paper indicate positive and statistically significant export effects of both the Lomé Convention and the GSP.</p>	<p>- Export effects are greater for the Lomé Convention for the study period from 1973-1992.</p>
<p>- It illustrates EU country distribution of the export effects and shows that Belgium and the Netherlands are the EU countries that have increased their exports the most from the developing countries under both the Lomé Convention and the GSP schemes.</p>		
<ul style="list-style-type: none"> • Topp, Vernon. (2003). Are trade preferences helpful in advancing economic development? 		
<p>This article examines whether trade preferences serve as an effective tool for development assistance to poor countries. It asks the question of whether other measures could be more efficient and effective. The analysis is elaborated by examining the implications of trade preferences for the subgroup of LDCs. Findings are based on UNCTAD's 1999 data concerning the use of preferences by countries under the major GSP schemes.</p>	<p>- In considering the question of whether major schemes offer preferences to LDCs for the types of goods they export, it was found that major schemes do not offer preferences to LDCs for the types of goods they export. It was found that for the EU, most of the imports from LDCs are covered by preferences, Japan's covers 41 per cent of dutiable imports from LDCs, while low coverage from Canada and the US is provided to LDCs.</p>	<p>- Trade preferences do not encourage high-cost producers who depend on them to be innovative or competitive. - Trade preferences are inconsistent with the goal of trade liberalization. - Major industrialized countries have used trade preferences to extend protectionist policies to selected developing countries.</p>
	<p>- The article also considered whether LDCs make full use of the preferences on offer. In this regard, it was found that LDCs use most of the preferences on offer for their exports only to some countries and not to the EU, where potential coverage for preferences is greatest.</p>	<p>- There are serious underlying flaws and limitations in existing preferential schemes which should be addressed collectively by industrialized countries before granting further preferences.</p>
	<p>- It was also found that preferences were not a very important factor in overall exports from LDCs since they covered only 18 per cent of total LDC exports to the major developed preference providers (excluding US petroleum imports).</p>	<p>- Industrialized countries should focus on providing developing countries (LDCs) with assistance to improve efficiency and competitiveness of their economies. - Poor countries need to improve their capacity to produce high-quality, cost competitive goods.</p>
<ul style="list-style-type: none"> • Stoeckel, Andrew and Brent Borrell. (2001). Preferential Trade and Developing Countries: Bad Aid, Bad Trade. 		
<p>This study aims to analyze and explain why preferential trade is not a possible route to development for developing countries and is damaging to world trade.</p>		
	<p>In making the case that preferences are harmful to developing countries, this study finds that they serve to insulate producers from competitive pressures and weaken disciplines to control costs. This has a negative effect, as insulated producers adopt new cost reducing technologies at a slower rate than producers who are fully exposed to global competition.</p>	<p>- Preferences do not work. They impose costs on non-preference receiving countries who become non-competitive in the export market in which the preference is granted, their sales drop, they therefore export and import less which is costly to world trade.</p>

<ul style="list-style-type: none"> Stoeckel, Andrew and Brent Borrell. (2001). Preferential Trade and Developing Countries: Bad Aid, Bad Trade. 		
This study aims to analyze and explain why preferential trade is not a possible route to development for developing countries and is damaging to world trade.		
Purpose	Findings	Conclusion
	- The argument is illustrated through various case studies. Mauritius receives subsidies through preferential access to the European Union for its sugar produce, yet the sugar industry in Mauritius is struggling. The country has also retained tiny mills, less than the size of efficient mills operated by competitive exporters, making them uncompetitive.	- For recipient countries, preferences have a negative effect as they encourage rent-seeking behavior, create vested interests that block reform, hinder competition policy and distract policy attention from development.
	- The case of Mauritius illustrates that preferences have insulated the sugar industry from competitive developments within its economy and the world sugar market.	- Preferences weaken the central principle of non-discrimination of the WTO.
	- A case study of Cuba further reveals that subsequent to the collapse of the Soviet Union and the loss of preferential market access, Cuba's sugar industry has become internationally uncompetitive. This illustrates that preferences can make a country vulnerable to their removal and do not offer stability to the country.	- The article concludes with the view that developing countries would be better served if preferences were discarded and an open trading system based on non-discrimination and untied aid delivered directly to countries that need it.
	- As it refers to the Philippines, preferential access to the US market was established in 1898. However, this was lost in the 1980s resulting in the stagnation of the Philippine industry to the extent that the industry has decreased exports by 80 per cent and now imports sugar to meet domestic needs.	- Both developed and developing countries gain from non-discriminatory trade liberalization through increased competition, efficient use of resources, innovation, best practice and increased growth.
		- The study concludes that non-discriminatory trade liberalization by developed countries and unilateral liberalization of their own economies would be more in the interests of developing countries than preferential arrangements.