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S E R I E S

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## Regional integration in the Caribbean

The role of trade agreements and  
structural transformation

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UNITED NATIONS

ECLAC

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## Abstract

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Despite having relatively open economies and a dedicated strategic focus on export expansion, Caribbean economies still account for a small proportion of global trade (goods and services). Indeed, the continued failure of the institutional machinery of the Caribbean and the mechanics of the Single Market to deliver the competitiveness, productivity, trade and welfare gains upon which it was premised, has limited the region in its development efforts. This, not surprisingly, has increasingly brought the relevance and validity of the current regional integration initiative into question. In addition, the subregion's bilateral Free Trade Agreements (FTAs) have not yielded the intended broad-based expansion in exports, with utilization rates among many CARICOM countries being relatively small.

The CARIFORUM-EU Economic Partnership Agreement, which came into force at the end of 2008, sought to address the absence of trade-led growth within the subregion by leveraging development support and market access towards deepening subregional integration as well as enhancing supply side capacity, competitiveness in CARIFORUM. However, the agreement has not yet succeeded in improving intra-regional trade or subregional integration. More specifically, empirical analyses have unmasked a clear disparity between the competitiveness of the Dominican Republic and other Caribbean commodity exports in the EU market. Hence it may be necessary for the subregion to examine alternative platforms for delivering convergence.

It would appear that domestic production systems within the subregion have not been transformed to optimize resource allocation and facilitate exploitation of strategic extra-regional niche markets, where preferential access is on offer. What is equally crucial is that the subregion generally has relatively low trade complementarity with the EU and North America, its major export markets. This notwithstanding, the Caribbean has relatively higher and increasing complementarity with the Central American Integration System (SICA) and Asia, suggesting that these economies may be the subregion's natural trading partners.

This paper therefore posits that the subregion adopt a new dais of regional integration, which favours deeper trade and economic integration with countries which are the region's natural trading partners. This would, however, necessitate greater intervention by regional governments and the private sector in the production of regional public goods that are crucial for structural transformation towards the sustainable development of the subregion. Under such conditions, the nexus of Regional Trade Agreements (RTAs), FTAs and regional integration frameworks advanced here can be expected to be net trade creating, efficiency enhancing and welfare gains optimizing.



## I. The Caribbean brand of neo-regionalism

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The changing dynamics within the Commonwealth Caribbean's major export markets during the 1980's — the most significant of which were the transitioning of the European Community (9) to the European Union (25)<sup>1</sup>— and movement towards the creation of the North American Free Trade Area (NAFTA), in no small way would have also influenced the decision<sup>2</sup> of regional governments to establish the CARICOM Single Market and the Economy (CSME).

This second wave of regionalism however, was very much an integral part of a much broader policy shift towards market liberalization and export promotion initiated during the late 1980's and early 1990's. In contrast to the first, this Caribbean variant of South-South regional integration was viewed as a development tool in itself, based on the belief that fostering increased competitiveness and integration into the global economy was the most effective way to increase economic welfare of individual Members of the Community.

Two decades on, the CSME has emerged as the signature mechanism of the Caribbean brand of regionalism and seeks to create the requisite facilitatory environment for competitive production, economic development and investment. This open regionalism is a pragmatic means of facilitating the deeper integration of Caribbean countries, while individual economies seek to navigate their insertion into the wider multilateral trading system. For the Community, the regionalism-driven CSME provides a framework for strengthening integration and cooperation amongst CARICOM economies, and a platform from which individual Member States can integrate into the global economy.

Through its Single Market, CARICOM has conceived an internal space within which goods, skills, capital and commercial enterprises can move in a relatively unrestricted manner. As a consequence of the advanced nature of the regional integration process, the Caribbean Community milieu essentially provides an extension of the domestic markets of individual Member States; effectively offering an internal market of 19 million people. Guided by recognition that the regional

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<sup>1</sup> The accession of Great Britain to the Union and its attendant implications for the non-reciprocal preferences granted to its former colonies in the Caribbean.

<sup>2</sup> Meeting of the Heads of Government of CARICOM, Grand Anse, Grenada (1989).



market itself is relatively small and the region's commerce is dominated by extra-regional sources and markets, a nexus of bilateral free trade agreements<sup>3</sup> and preferential arrangements<sup>4</sup> proffer a second tier of integration. Consequently, a significant proportion of the Region's exports are accorded duty-free access into the markets of our major trading partners, as well as strategic Western Hemispheric countries.

Hence, from a policy perspective, the crafters of the CSME undoubtedly deemed expanding production and trade as a necessary ingredient for broad-based income growth, employment generation, welfare convergence and poverty alleviation. However, while barriers to trade between Member States have been gradually dismantled, in a practical sense the appetite among individual islands of the Community to institute the requisite legislative change for full implementation has seemingly diminished, and progress towards the establishment of the single economy has effectively stalled.<sup>5</sup> In addition, the consolidation and strengthening of sub-regional integration among Eastern Caribbean States through the establishment of the OECS Economic Union has added a new dimension to the Caribbean regional integration process.

Also germane in this regard is the fact that despite having relatively open economies and a dedicated strategic focus on export expansion, CARICOM economies still account for a small proportion of global trade (goods and services).<sup>6</sup> In addition, bilateral FTAs have not yielded the intended broad-based expansion in exports, with utilization rates among many CARICOM countries being relatively small.

More importantly, Caribbean economies have not established themselves as competitive suppliers of a wide range of goods and services, and have consistently been out-paced by many other hemispheric partners in respect of productivity, competitiveness and innovation. Indeed, the continued failure of the institutional machinery of the Caribbean Community and the mechanics of the Single Market to deliver the competitiveness, productivity, trade and welfare gains upon which it was premised, has limited the region in its development efforts. This, not surprisingly, has increasingly brought the relevance and validity of the current regional integration initiative into question.

What is becoming increasingly clear is that this development problematique, cannot be solved merely focussing on the full implementation of Single Market and the negotiation of additional market access. There must by necessity be a rethinking and a re-engineering, of the basis of integration in order for greater welfare gains to accrue to the region. The region's low utilization of its bilateral FTAs suggests that trade agreements while being necessary, are not necessarily sufficient for increasing exports, particularly if adequate attention is not paid to addressing structural rigidities, transforming production systems, enhancing trade-related economic infrastructure; and instituting the appropriate trade policies for fostering the private sector development, innovation and investment necessary for increasing production, productivity and competitiveness.

This would require a fundamental shift from integration efforts seemingly dominated by considerations of geographical proximity, culture, small-size, shared experiences and destiny as small states, language and colonial heritage, to a dais of regionalism which is predicated upon broader comparative advantage-based production and trade integration and development cooperation. The focus of this neo-regionalism should be the wider Caribbean and Central America in the first instance, and then Latin American other advanced developing economies and major global players, subsequently. The remainder of this paper will seek to succinctly explore theoretical underpinnings and practical issues which support this notion.

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<sup>3</sup> With the European Union, Venezuela, the Dominican Republic, Colombia, Cuba and Costa Rica.

<sup>4</sup> With the USA - CBI, CBTPA, CEBERA and Canada – CARIBCAN.

<sup>5</sup> A key feature of the Caribbean Community construct which should not go unmentioned is the recognition of the inherent development asymmetry of its Members, is the designation the OECS countries and Belize as Less Developed Countries (LDCs) of the Community and Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago as More Developed Countries. The Revised Treaty of Chaguaramas establishing the CSME this distinction and articulate mechanisms and concession to accommodate same.

<sup>6</sup> Trinidad and Tobago accounts for merely 0.12% of global aggregate exports.

## II. Overview of the performance of the regional integration initiative

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Caribbean economies have demonstrated a distinct propensity towards market-based integration demonstrated by Caribbean economies. Hence, an assessment of trade performance represents the most appropriate departure point for eliciting new ideas for recasting the regional integration process to make it more amendable to delivering economic convergence.

### A. Macro-economic performance

With regard to its economic performance, the Community experienced a relatively low average growth rate of 2.4 per cent<sup>7</sup> over the period 2000-2012. The subregion's GDP expanded by 1.1 per cent in 2013 and its economic growth in 2014 is expected to be in the region of 2 per cent. In addition, most CARICOM Member States have registered current account deficits of varying degrees over the same period,<sup>8</sup> with the regional average in 2013 standing at 16.2 per cent of GDP and the Eastern Caribbean States averaging 16.8 per cent. Several CARICOM Member States also continue to grapple with high levels of indebtedness. In 2012,<sup>9</sup> three CARICOM countries registered public debt-to-GDP ratios in excess of 100 per cent - Barbados (107.5 per cent), Jamaica (137.0 per cent) and St. Kitts and Nevis (103.1 per cent).

The process of adjustment during the post crisis period has been largely dominated by programmes of fiscal consolidation and debt reduction, particularly among the more highly indebted economies. Further, the decline in regional and extra-regional demand for major goods and services exports of many Caribbean economies has further tightened the fiscal grip. Collectively, these factors

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<sup>7</sup> United Nations Conference on Trade and Development (UNCTAD) statistical database.

<sup>8</sup> Economic Commission for Latin America and the Caribbean (ECLAC) on the basis of official figures.

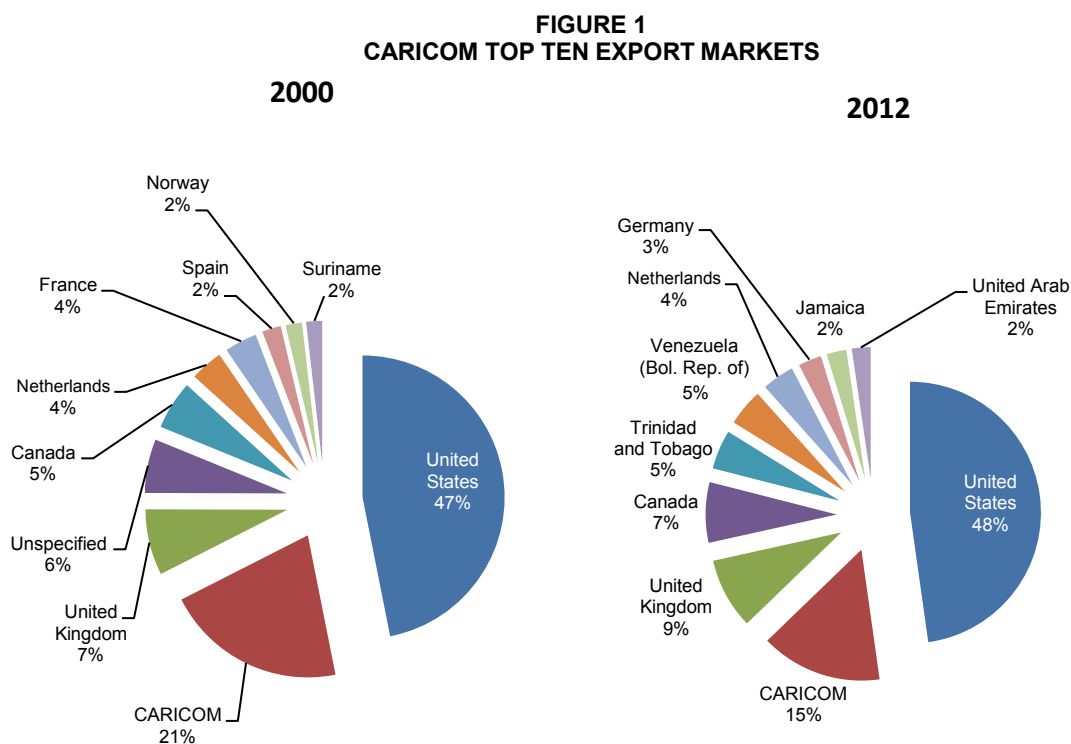
<sup>9</sup> Economic Commission for Latin America and the Caribbean (ECLAC) on the basis of official figures.

have served to dampen the urge for integration. In addition, the failure of the Member States to approach the international donor community as a group, on the heels of the global crisis, was a lost opportunity for building solidarity and leveraging external support on concessional terms. These factors have collectively constrained the resources that most Member States, and by extension the Region, have at their disposal to invest in building institutional capacity to implement the commitments enshrined in FTAs and the CSME, as well as finance export development.

This notwithstanding, the Eastern Caribbean Economic Union (ECCU) is currently emerging from two consecutive years of positive, albeit marginal, growth in 2012 (0.2 per cent) and 2013 (0.7 per cent); and all subregional economies are projected to expand in 2014. Whether this positive economic outrun is sufficient to provide some measure of renewed impetus to the regional integration movement is left to be seen.

## B. Trade performance

CARICOM economies are relatively open, with many Member States having trade openness indices<sup>10</sup> in excess of 100 per cent.<sup>11</sup> In addition, the pattern and structure of CARICOM's trade in goods has remained somewhat unchanged, with trade being dominated by extra-regional traditional partners such as the US, Canada, the UK and the rest of the EU (27), and intra-regional trade restricted to a relatively small share. Even more worrisome is the fact that the subregion's exports have become increasingly concentrated within the North American and European markets, while the relative share of intra-regional commerce has declined. (See figure I). Interestingly though, MERCOSUR presently accounts for 4 per cent of the region's trade.



Source: COMTRADE via WITS database.

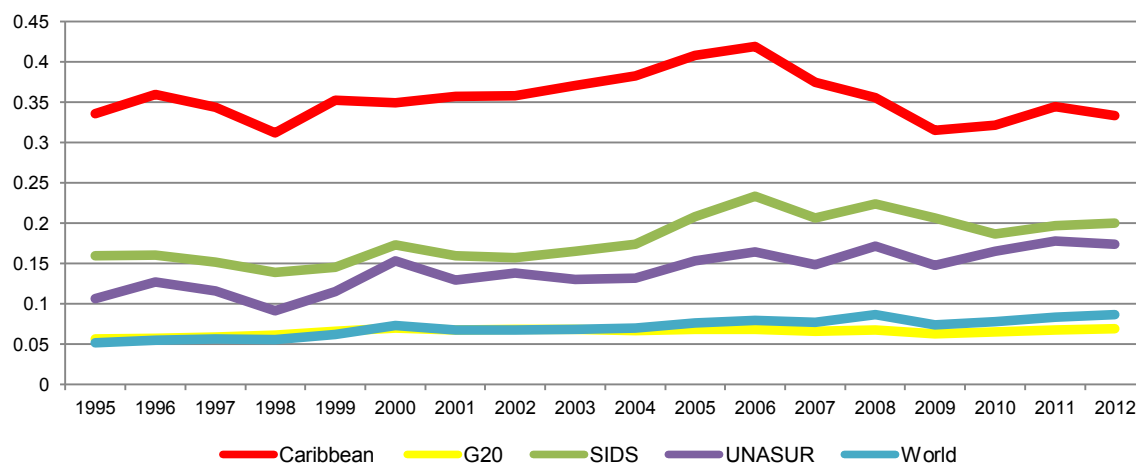
<sup>10</sup> Ratio of exports and imports to GDP.

<sup>11</sup> This, coupled with the undiversified export base and markets of Member States, makes the Region vulnerable to external shocks, particularly commodity prices and demand for major exports.

Even worse, over time the Region's goods exports have become increasingly concentrated in a narrow range of products, with the top ten products presently accounting for over 75 per cent of the Region's total exports. Both intra and extra-regional trade is dominated by CARICOM MDCs with Trinidad and Tobago being the leading exporter and Jamaica the leading importer.<sup>12</sup> In addition extra-regional markets account for 90 per cent of CARICOM's exports. Hence, diversification of both exports and markets represents another major structural challenge for the Caribbean.

A perusal of the trade concentration index shows that Caribbean countries are far more specialized in fewer products compared to the world average or even to that of the Small Islands Developing States (SIDS).<sup>13</sup> As a matter of fact, many Caribbean countries depend on the export of a few agricultural products or mineral resources for foreign exchange earnings.<sup>14</sup> (See Figure 2 below).

**FIGURE 2**  
**TRADE CONCENTRATION INDEX**



Source: United Nations Conference on Trade and Development statistical database (UNCTADStat).

Consistent with the imperatives of globalization,<sup>15</sup> the Caribbean has increasingly sought to negotiate bilateral trade agreements within the western hemisphere and more recently with traditional trading partners.<sup>16</sup> These trading arrangements are seen as a means of improving the quality and predictability of access to key export markets while strengthening the subregion's wider integration into the global economy. It was generally felt that the increased commerce generated through these trading arrangements would deliver economies of scale, productivity and efficiency gains and optimal resource use. The extent to which these objectives were achieved will be examined more closely hereunder.

Despite these considerable regional efforts to deepen market integration through the CARICOM Single Market and strengthen trade relations with existing and non-traditional partners, the subregion's competitiveness and export performance remains continues to be constrained by the existence of several structural gaps. These gaps are most acute in the areas of trade-related infrastructure, connectivity, trade-

<sup>12</sup> Trinidad and Tobago accounts for 80 per cent for total regional exports and Jamaica 28 per cent of imports.

<sup>13</sup> This index is also known as Herfindahl-Hirschmann index which can measure the degree of given market's concentration – in this case, export. The index obtains values from 0 to 1. The value of the index decreases when the number of products increases and share of each product falls. Contrary, the value approaches to 1 when export structure is specialized in a fewer products.

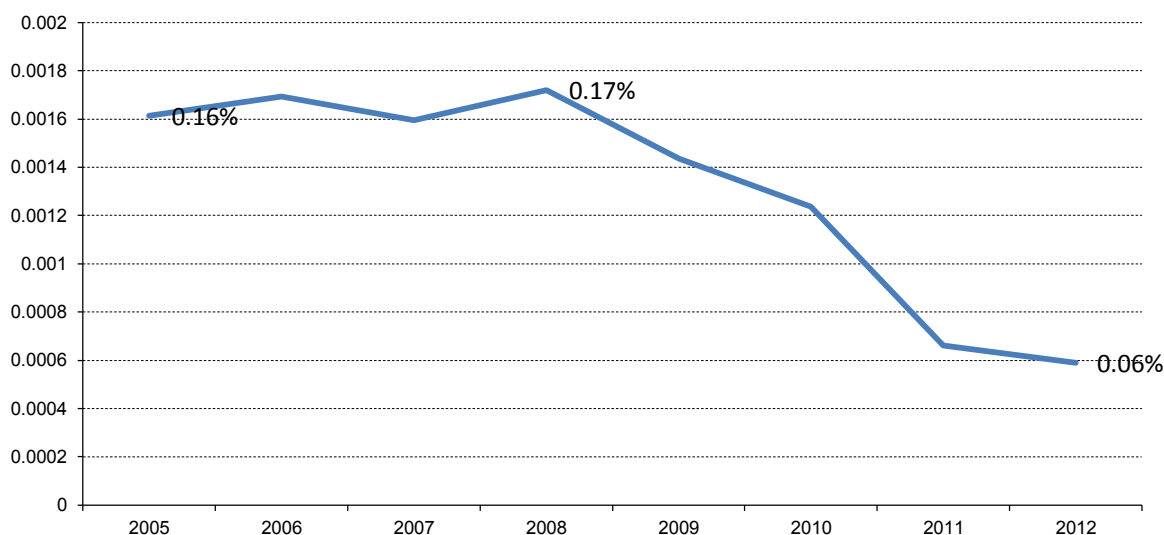
<sup>14</sup> Given the instability global commodity prices, Caribbean economies need to diversify their export structure in order to mitigate the possible trade shocks.

<sup>15</sup> There was also the not unrelated issue of the threat posed by both the expiration of long-standing non-reciprocal preferential arrangements; and acceleration of the erosion of preferential margins in markets of the North (i.e. the EU, and North America).

<sup>16</sup> Implementation of the CARIFORUM-EU Economic Partnership Agreement commenced in 2009 and CARICOM is currently negotiating a Trade and Development Agreement with Canada.

related institutions, production systems as well as and private sector innovation.<sup>17</sup> Not surprisingly, the subregion commands a marginal share of global trade (0.06 per cent), which has declined steadily since 2008 (0.17 per cent). (Figure 3 refers). It has also been estimated that the subregion is operating at 46 per cent below its true trade potential.<sup>18</sup>

**FIGURE 3**  
**CARIBBEAN TRADE**  
(Percent of total world trade)



Source: COMTRADE via WITS database.

Moreover, although the maximization of intra-regional trade is one of the main objectives of the integration process, it continues to be less than many other regional groupings, including the Association of Southeast Asian Nations (ASEAN), the Central American Common Market (CACM), Union of South American Nations (UNASUR) and the European Union (EU). This has primarily been due to low regional trade complementarity and competitiveness, which are key issues which will be explored further, later in this paper.

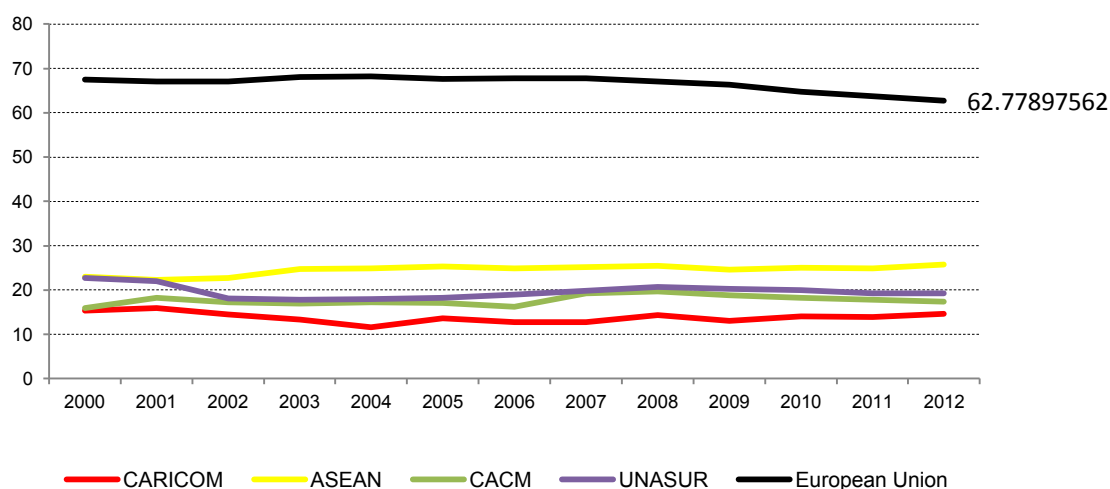
Further, within the Caribbean subregion intra-regional trade accounts for merely 11.5 per cent (2013) of total trade, which rises to just under 27 per cent if Latin America is included.<sup>19</sup> This further underscores the emerging importance of trade with Latin American, which accounts for 5.9 per cent of the Caribbean exports (2013) as well as heavy dependence on preferential market access to markets of the United States, European Union and Canada (See Figure 4 below).

<sup>17</sup> Mc Lean, Sheldon, An Initial Examination of Requests by Sint Maarten, Curacao, French Guiana, Guadeloupe and Martinique for Associate Membership in the Caribbean Community: A Trade and Development Perspective, prepared for consideration by the Technical Working Group on Associate Membership, CARICOM Secretariat, June 2012.

<sup>18</sup> Mc lean, Sheldon et. al, February 2013, Caribbean Regional Aid for Trade Strategy, Caribbean Community Secretariat and the Inter-American Development Bank.

<sup>19</sup> COMTRADE via WITS database

**FIGURE 4**  
**INTRA-REGIONAL EXPORT**  
*(Per cent of total export)*



Source: COMTRADE via WITS database.

Furthermore, of the six<sup>20</sup> countries with which the Region has formal trading arrangements in place, CARICOM generated trade surpluses with only two (2) in 2012 - Cuba and Canada.<sup>21</sup> The Caribbean has also consistently registered trade deficits with Brazil, India and China. Moreover, it has been demonstrated that the subregion's extra-regional trade agreements with Costa Rica, Colombia and the Dominican Republic do not impact significantly on exports of CARICOM countries.<sup>22</sup>

It is also noteworthy that, with the exception of the European Union and Venezuela in 2011 and 2012, the utilization rates<sup>23</sup> of all of the subregion's existing bilateral Free Trade Agreements, have contracted over the period 2007-2012. The development support and improved market access provided under the CARIFORUM-EU Economic Partnership Agreement and the PetroCaribe initiative with Venezuela may have provided impetus for increased exports to these countries under the respective Agreements. (See table 1).

Given the longstanding trading relationship that the Caribbean has had with Europe and the resurgence in importance of the European market within recent time, the following subsection seeks to examine the regime currently governing the subregion's bilateral trade the EU-27.

<sup>20</sup> Costa Rica, Colombia, Cuba, the Dominican Republic and the European Union

<sup>21</sup> In contrast, in 2010 the Caribbean community generated positive trade balances with Cuba, Costa Rica, the Dominican Republic and Canada.

<sup>22</sup> Hosein, Khadan and Mc Lean et. al, Preliminary Study on the Status of Implementation of the EU-CARIFORUM Economic Partnership Agreement, United Nations ECLAC, January 2014.

<sup>23</sup> Exports to a country with which a Party has a FTA as a percentage of its total exports. It provides a rough measure of the extent to which a trade agreement has led to an increase in export share or relative importance of a specific export market.

**TABLE 1**  
**TRENDS IN UTILIZATION RATES OF BILATERAL TRADE AGREEMENTS**  
(2007-2012)

Country	2007	2008	2009	2010	2011	2012
Colombia	1.94	1.26	1.05	1.92	0.06	0.07
Costa Rica	0.45	0.40	0.53	0.97	0.02	0.01
Cuba	0.12	0.19	0.05	0.17	0.08	0.20
Dominican Republic	2.51	2.40	1.17	0.94	0.36	0.25
European Union	13.60	16.61	16.20	12.40	17.16	22.56
Venezuela (Bolivarian Republic of)	0.11	0.11	0.04	0.52	1.48	4.28

Source: COMTRADE via WITS database.

### III. The CARIFORUM-European Union Economic Partnership Agreement

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The European Union and CARIFORUM countries<sup>24</sup> signed a trade and development centred Economic Partnership Agreement (EPA) in October 2008, which provisionally came into force on 29 December of the same year. The Agreement succeeded in satisfying the requirements of GATT Article XXIV and in bringing the EU's trading relations with CARIFORUM Member States into conformity with the World Trade Organization (WTO) Most Favoured Nation (MFN) principle. In so doing, the EPA effectively ended the decades long regime of unilateral, non-reciprocal, preferential market access granted by the European Union to CARIFORUM countries under successive Lomé (I-IV) and Cotonou Agreements, thereby ushering in a trading regime for both goods and services governed by the principle of reciprocity.

The EPA is a deep and wide-ranging trade and development agreement, which aims to promote trade, investment and development cooperation between CARIFORUM and the EU. The Agreement, *inter alia*, also seeks to promote regional integration and the gradual integration of CARIFORUM States into the global economy, and to enhance supply side capacity, competitiveness and economic growth in CARIFORUM.

However, during its first five years, implementation within CARIFORUM economies has been largely uneven, which has left the impact of the Agreement on CARIFORUM unclear. This notwithstanding, the post-EPA period has been characterized by a decline in some of the region's traditional exports, e.g. rice, bananas and bauxite, to the European Union, and a switch to specialized services including offshore financial services in many CARICOM economies.

In addition, for the majority of Caribbean countries (with the possible exception of possibly Trinidad and Tobago), the Agreement has yet to deliver the broad-based welfare and trade gains expected. It also appears that the EPA has also seemingly generated disparate benefits to CARIFORUM Member States, with the Dominican Republic largely benefiting from increased market access

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<sup>24</sup> The member States of the Caribbean Community (CARICOM) and the Dominican Republic.



opportunities in the EU given its capacity to implement the agreement and its trade preparedness.<sup>25</sup> Empirical analyses<sup>26</sup> have also unmasked a clear disparity between the competitiveness of the Dominican Republic and CARICOM commodity exports in the EU market.

The Dominican Republic's merchandise exports, have generally proved to be relatively more competitive in the EU market under the EPA than their CARICOM counterparts. In the presence of the EPA, the Dominican Republic's comparative advantage and trade complementarity<sup>27</sup> with the EU has improved, while that of CARICOM has remained weak and declining. In fact, the majority of the Dominican Republic exports to the EU can be categorized as rising stars. Most of the OECS's exports to the EU are classified as missed opportunities, suggesting that export shares are falling in commodities where demand in the EU is rising.

Moreover, the Dominican Republic has been shown to outperform the Caribbean economies of Barbados, Dominican Republic, Guyana, St. Kitts and Nevis and Saint Lucia in terms of both the number of commodities that recorded comparative and competitive advantage improvements since the EPA came into force. In fact all the aforementioned Caribbean economies saw a contraction in the number of commodities for which they enjoy a comparative advantage with the EU. Furthermore, using a gravity model, it has been shown that the EPA has not had a significant effect on the Caribbean's exports.<sup>28</sup> This should be a source of concern given that the Agreement is seen by many as a tool for quickening the pace of integration of Caribbean economies into the multilateral trading system.

Deeper empirical analysis has yielded useful insights into the underlying dynamics of Caribbean-EU trade. For example, trade complementarity<sup>29</sup> between the Caribbean and the EU is generally low, suggesting that the EU may not be a natural trading partner of the subregion. In contrast, the Dominican Republic has demonstrable and increasing trade complementarity with most of the EU countries. This pervades the view that the existence of long-standing non-reciprocal preferences rather than trade complementarity and comparative advantage have traditionally influenced the region's exports to Europe. Collectively, results infer that, all things remaining the same, the EPA may not lead to welfare enhancing outcomes for Caribbean economies.<sup>30</sup>

In fact, several studies have conducted experiments to measure the fiscal and welfare impact of the EPA on CARICOM countries.<sup>31</sup> The results from these studies indicate that Caribbean economies are likely to experience significant declines in tariff revenues on existing EU imports and imports from other sources which are diverted towards the EU on account of the EPA. Notably, the members of the ECCU have a higher dependence on tariff revenues than other CARICOM countries (see figure 5).

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<sup>25</sup> Hosein, Khadan and Mc Lean et. al, Preliminary Study on the Status of Implementation of the EU-CARIFORUM Economic Partnership Agreement, United Nations ECLAC, June 2014.

<sup>26</sup> E.g using TradeCAN, Vector Autoregressive, Partial Equilibrium Analysis and Gravity models and computing Revealed Comparative (RCA) Index

<sup>27</sup> Assessed using computations of RCA and TCI indices respectively.

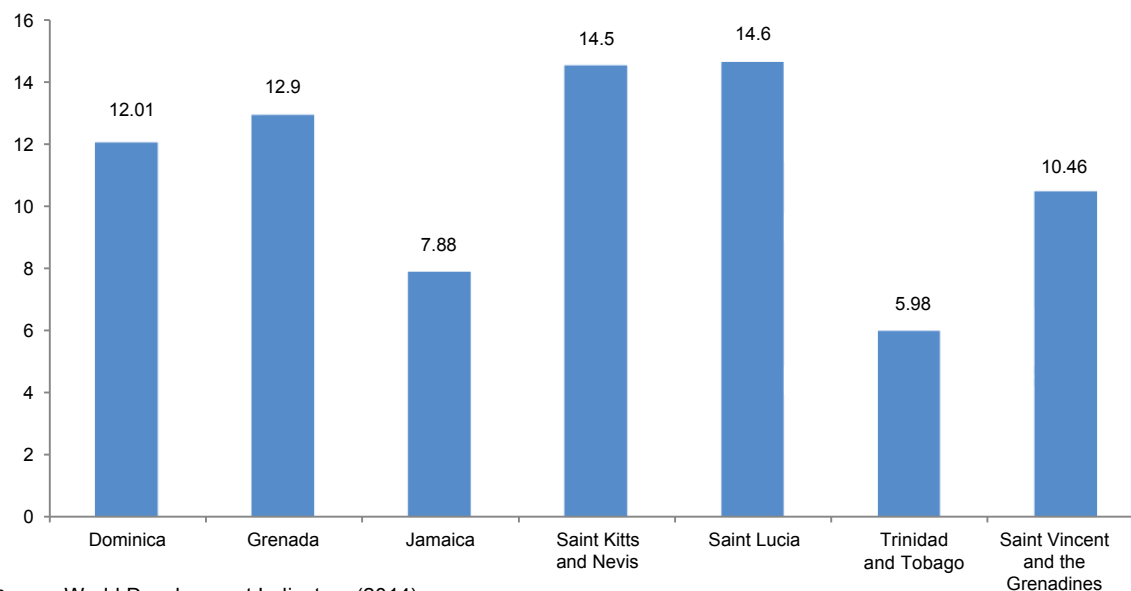
<sup>28</sup> Hosein, Khadan and Mc Lean et. al, Preliminary Study on the Status of Implementation of the EU-CARIFORUM Economic Partnership Agreement, United Nations ECLAC, June 2014.

<sup>29</sup> Trading partners are natural if their trading structure is characterized by complementarity i.e. if one country tends to import what the other partner exports.

<sup>30</sup> Hosein, Khadan and Mc Lean et. al, Preliminary Study on the Status of Implementation of the EU-CARIFORUM Economic Partnership Agreement, United Nations ECLAC, June 2014.

<sup>31</sup> Khadan, Jeetendra and Hosein, Roger (2014): Trade, Economic and Welfare impacts of the CARICOM-Canada Free Trade Agreement. [http://mpr.ub.uni-muenchen.de/54836/1/MPRA\\_paper\\_54836.pdf](http://mpr.ub.uni-muenchen.de/54836/1/MPRA_paper_54836.pdf)

**FIGURE 5**  
**IMPORT DUTIES AS A PERCENTAGE OF TAX REVENUES**  
*(2001-2011)*



Source: World Development Indicators (2014).

These results imply that any decline in import duties can have adverse effects on government revenue and fiscal space. Moreover, the use of domestic fiscal policy (for example increasing taxes) to correct this short-fall can have adverse effects on economic growth especially as many of these economies are already operating in a high debt–low growth environment. The overall change in welfare associated with the EPA is also negative for all CARICOM countries and range from US\$8 million for Dominica to US\$ 387 million for Trinidad and Tobago.<sup>32</sup> These results indicate that trade creation in the area of merchandise trade is generally low which calls for strategic policies to improve export competitiveness and trade complementarity between CARICOM and European Union countries with the framework of the EPA.

In this regard, it is important for the subregional economies to consider utilizing the EPA commitments to leverage a series of economic reforms aimed at increasing and bolstering productive and regulatory capacity. Such policy shifts should by necessity also seek to transform as well as restructure production systems, enhance competitiveness and diversify exports of Caribbean economies into value-added products with a view to tapping into global and regional value chains. Furthermore, many stakeholders have pointed out that the absence of health and safety legislation and regulations has been a major obstacle to Caribbean exports to the European Union. Hence in order for subregional economies to capitalize on market access opportunities (agricultural goods) in Europe under the EPA, many CARIFORUM States therefore require the institution of appropriate SPS regimes that satisfy European Union health and food safety requirements. The quality infrastructure, including laboratory and testing facilities, need to systematically modernized in many Caribbean countries.

This notwithstanding, it must be recalled that the Caribbean possess a distinct comparative advantage in the area of services, and the sector has emerged a major growth pole in many regional economies. Within the framework of the EPA, the European Union has liberalized 94 per cent of sectors listed under GATS (General Agreement on Trade in Services). Accordingly, the Region managed to elicit notable market access gains in the area of Mode 4 (temporary movement of natural persons), Cultural Industries,

<sup>32</sup> Khadan, Jeetendra and Hosein, Roger (2014): Trade, Economic and Welfare impacts of the CARICOM-Canada Free Trade Agreement. [http://mpr.ub.uni-muenchen.de/54836/1/MPRA\\_paper\\_54836.pdf](http://mpr.ub.uni-muenchen.de/54836/1/MPRA_paper_54836.pdf)

professional services, and Contract Service Suppliers. The Protocol on Cultural Cooperation further buttresses CARIFORUM's access to the EU entertainment market by providing for increased collaboration in cultural-related areas and special provisions on audio-visuals and co-production, which facilitate the meeting of cultural content rules in all EU Member States.<sup>33</sup> Thus, the expansion of services exports represents one key avenue where the Region can benefit from the Agreement.

Despite having built-in asymmetry and targeted development support, the EPA has not yet succeeded in improving intra-regional trade or subregional integration. Hence it may be necessary for the subregion to examine alternative platforms for delivering convergence. The broad elements of such a dais will be explored in the following sub-section.

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<sup>33</sup> Mc Lean, Sheldon, *An Initial Overview of The Economic Partnership Agreement Between The CARIFORUM States and The European Community and Its Member States*, CARICOM Secretariat, February 2009.

## IV. Trade, broader regional integration and Caribbean convergence

It is an inescapable truth that the geography of the global economy has undergone considerable reshaping over the last two decades. A major characteristic of this reshaping is the distinct shift in growth centers. Growth in developed countries has virtually come to a halt with projections seeing these markets expanding at an average of 2 per cent from 2011-2020. In contrast, emerging economies, such as Brazil, Russia, India and China are expected to grow at an annual average rate of approximately 7 per cent over the same period.<sup>34</sup> Trade<sup>35</sup> has become the engine of growth for these emerging economies.

### A. The possible role of emerging economies

In fact, (Brazil, Russia, India, China and South Africa) BRICS share in global output has increased from 8 percent in the period 1961-1970 to 20 percent in 2011-2012. On the other hand, the contribution to world output of the seven largest economies in the world (G7) declined from 60 percent of world GDP to 48 percent over the same period (see table 2).

**TABLE 2**  
**CONTRIBUTION OF BRICS AND G7 TO WORLD OUTPUT**

	G7	BRICS
1961-1970	59.63	7.74
1971-1980	63.39	6.87
1981-1990	65.20	6.64
1991-2000	66.07	7.84
2001-2010	58.46	12.16
2011-2012	47.92	20.01

Source: World Development Indicators (2014).

<sup>34</sup> How to Win in Emerging Markets: Lessons for Japan by Shigeki Ichii, Susumu Hattori and David Michael, Harvard Business Review, May 2012.

<sup>35</sup> The production and export of goods and services.

Not only have these emerging economies become competitive exporters, fuelled by increased domestic incomes, but they also represent lucrative and expanding markets. There are several areas in which Caribbean countries can benefit from the rapid growth of BRICS. One critical area is tourism. Outbound expenditure and tourism outflows from BRICS have increased significantly in the last decade. In particular, outbound tourism expenditure from BRICS increased from US\$23million in 1995 to US\$145million in 2011. Outbound travellers also increased significantly over the same period from 34 million to 90 million. It is important to note that the emerging market tourist differ from the traditional tourist in that they travel mainly for shopping, sightseeing and opportunities to gain status/social recognition which are critical elements to consider in wooing the BRICS tourist to the Caribbean (see Tourism Intelligence International 2011).

In terms of exports, many Caribbean countries can benefit from increased exports to the BRICS, especially in natural resources (commodities). Already, the top exports from the subregion to the BRICS are dominated by products such as natural gas, aluminium, methanol, wood etc. These commodities make up 41 percent of Caribbean exports to the world. Apart from these natural resource based products, the subregion has not been able to penetrate the lucrative BRICS market which indicates a lack of export competitiveness, as well as inadequate production diversification, in other sectors. The inclination of Caribbean countries to reinforce a historically determined trade patterns, where they continue to specialize in the export of primary products should be curtailed. This type of trading relationship can stifle the growth of vibrant manufacturing sectors which is critical to promoting growth and creating industrial linkages in the domestic economy (see table 3). Of course, the subregion is now exploring opportunities to diversify its trade to emerging economies.

**TABLE 3**  
**CARICOM TOP EXPORTS TO BRICS**

HS 6 digit	Description	US\$mn	Per cent in total exports to BRICS
271111	Natural gas, liquefied	95.78	25.58
281410	Anhydrous ammonia	68.58	18.32
281820	Aluminium Oxide	55.09	14.71
721399	Bars and rods, hot-rolled	40.21	10.74
720310	Ferrous products	27.44	7.33
290511	Methanol (methyl alcohol)	8.41	2.25
271490	Bitumen and asphalt, natural asphalt	7.22	1.93
720711	Semi-finished products of iron/non	7.34	1.96
440729	Wood sawn/chipped lengthwise, slice	5.29	1.41
310210	Urea, whether/not in aqueous	4.99	1.33
Total (top 10 products)		320.36	85.56

Source: World Integrated Trade Solutions Database (2014).

The BRICS also present a significant resource for investment opportunity for Caribbean countries, as evidenced by their economic activities in the subregion over the past decade, particularly from China.<sup>36</sup> However, commodity prices have begun to cool recently (2013) and are expected to decline further in 2014.

<sup>36</sup> See Jhinkoo, J. 2013. "Highlighting the China-Caribbean relationship." Caribbean Centre for Money and Finance, Newsletter: Volume 6, No. 10 and Hosein, Roger and Jeetendra Khadan. 2012. "The Impact of Emerging Markets (BRICs) on CARICOM", Bank of Valletta Review, 45(Spring): 1-54.

## B. A new framework for Caribbean convergence

For goods based subregional economies, the decline in commodity prices has adversely affected their exports receipts which resulted in an expansion of deficit in goods trade balance (2013). An extreme case is that of Suriname whose current account balance moved from surplus to deficit for the first time since 2006, due to the fall in gold price, and an increase in imports. Commodity exporters in the Caribbean may thus be experiencing the decline in the commodity price super cycle.

‘A Time for Action’, the pivotal 1992 Report of the West Indian Commission,<sup>37</sup> recognized that trade can be an important driver of economic growth, poverty reduction and development; and defined the conditions for trade-led growth. At that time, the Report provided a blue-print for placing the Region on an upward growth trajectory while successfully navigating international and regional imperatives. The recommendations also acknowledged the importance of other issues such as technology, innovation, intellectual property, research and development, building human capital, infrastructure and private sector development in driving growth.

Two decades on, the Eastern Caribbean Currency Union Member Countries remain the most vulnerable of Caribbean Community and consistent with the view of the Commission at that time, deserving of continued ‘special consideration under the integration process.’ Innovation, competitiveness and efforts to improve production remain key drivers of export-led growth; and a comprehensive regional maritime project for the Eastern Caribbean, as recommended by the Commission, persists as a policy priority. Furthermore, in recommending that agriculture, manufacturing and tourism be developed symbiotically, the Commission foreshadowed the strategic importance of clustering. This issue is now increasingly engaging the attention of Caribbean governments and private sector. This suggests the absence of critical elements in the current policy milieu for achieving Caribbean convergence.

As a corollary, there has been considerable discourse as regards what has been described as a new framework for Caribbean convergence, and the need for the Caribbean to follow a policy-path that institutes the necessary and sufficient conditions for generating income converging broad-based export-led economic growth.

Credible regional development policy and strategy-setting of the order of which the region now seeks, however, necessitates a somewhat more focused analysis beyond the mere examination of trends in regional and bilateral commerce. Analysis of the available data reveals that the number of products for which the subregion commands a comparative advantage has decreased across all of its major markets, including all countries or groups of countries with which it has established trade-related arrangements, non-reciprocal or otherwise, over the periods 2003-2007 and 2008-2012. We can therefore concede that the subregion’s competitiveness has declined considerably in all of its major export markets, even in the presence of predictable, preferential market access in many instances (table 4 refers).

It would appear that domestic production systems have not been transformed to optimize resource allocation and facilitate exploitation of strategic extra-regional niche markets, where preferential access is on offer. Intuitively, Caribbean economic integration by its very nature was market driven, patently ignoring the supply-side capacity constraints of its economies, which in turn limited the ability to competitively satisfy import demand in FTA-partner markets. Hence a strategy of resource-production integration may have been more feasible.<sup>38</sup>

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<sup>37</sup> The Heads of Government of the Caribbean Community at their Meeting at Grand Anse, Grenada in 1989 agreed to the establishment of the West Indian Commission which was charged with the responsibility of charting a course for the future of the region.

<sup>38</sup> Farrell (2001).

**TABLE 4**  
**COMPETITIVENESS TRENDS USING REVEALED COMPARATIVE ADVANTAGE (RCA) INDEX**

	Number of commodities with comparative advantage (HS 6 digit level)			
	CARICOM		DOMINICAN REPUBLIC	
	2003-2007	2008-2012	2003-2007	2008-2012
Canada	105	93	37	108
Colombia	31	12	17	64
Costa Rica	18	15	35	94
European Union	142	96	82	172
Mercosur	39	17	6	75
SICA	112	103	81	249
United States of America	244	169	250	411
Venezuela (Bolivarian Republic of)	119	11	57	73

Source: World Integrated Trade Solutions Database (2014).

This in no small way would have contributed to the fact that trade complementarity within the Caribbean has traditionally been, and continues to be low and essentially limited to primary products. The ECCU, however, enjoys greater levels of trade complementarity among its economies than the rest of the Caribbean,<sup>39</sup> suggesting that it has the potential to deliver trade-led growth if the process towards strengthening the economic union is managed properly. What is equally crucial is that subregion generally has relatively low trade complementarity with the EU and North America.

This notwithstanding, the Caribbean<sup>40</sup> has relatively higher and increasing complementarity with the Central American Integration System (SICA)<sup>41</sup> and Asia suggesting that these economies may be the subregion's natural trading partners. Further, the Caribbean Community's complementarity<sup>42</sup> where it exists with Mercosur, Latin America, Africa and Asia is restricted to a limited number of distinct commodities<sup>43</sup> (see figure 5).

<sup>39</sup> UN ECLAC Port of Spain Sub-regional Headquarters for the Caribbean. See also Jeetendra Khadan and Roger Hosein, *The Natural Trading Partner Theory, Trade Complementarity and CARICOM Trade Patterns: 2000-2010*, University of the West Indies, St. Augustine Campus, 2011.

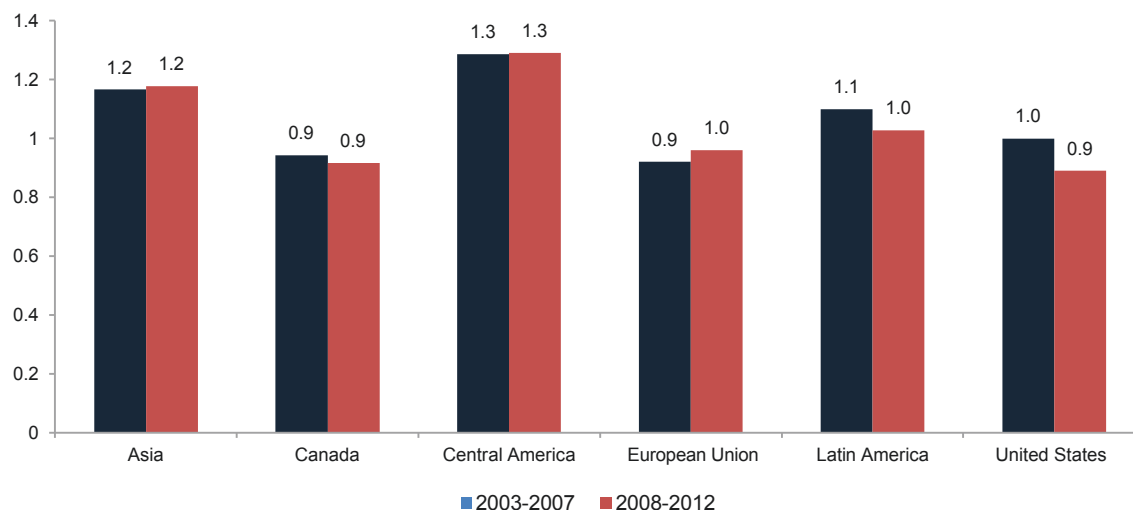
<sup>40</sup> As defined by the United Nations Economic Commission for Latin America and the Caribbean (UNECLAC)

<sup>41</sup> UN ECLAC Port of Spain Sub-regional Headquarters for the Caribbean.

<sup>42</sup> These vary from aluminium ore and concentrates, petroleum products soaps and cleaners, sugar and molasses and honey in Latin America and MERCOSUR; electrical switches, relays and circuits, soaps and cleaners and petroleum products in Central America for example

<sup>43</sup> Jeetendra Khadan and Roger Hosein, *The Natural Trading Partner Theory, Trade Complementarity and CARICOM Trade Patterns: 2000-2010*, University of the West Indies, St. Augustine Campus, 2011.

**FIGURE 6**  
**TRADE COMPLEMENTARITY BETWEEN CARICOM AND SELECTED TRADE BLOCS**



Source: Khadan, Jeetendra & Hosein, Roger, 2013.

### C. Central America

The analysis has shown that Central American and Caribbean economies possess relatively strong and increasing complementary trade structures, and as such are to a large extent natural trading partners. SICA and the Caribbean also have interlocking membership, with Belize belonging to both configurations. Accordingly, establishing formal trade and economic relations with SICA countries should form the basis of the next tier of Caribbean integration. The Trinidad and Tobago – Panama Free Trade Agreement, along with broad parameters for development cooperation, could be explored as the basis for such an initiative.

This integration effort however should be guided by the constraints encountered with the Central American Integration System (SICA) and the challenges faced in its effort to generate discernible trade expansion notwithstanding the market opportunities on offer. With this in mind, deeper economic integration with SICA in no way provides a panacea for the trade and development dilemma faced by the Caribbean. This relationship however can offer possible avenues for productive capacity building, structural transformation-based south-south development cooperation.

### D. Latin America

The Caribbean enjoys modest trade complementarity with MERCOSUR and Chile. In the first instance however, integration efforts should be restricted to exploring avenues for development cooperation, South-South Aid for Trade and public-private sector partnerships. In addition, the Guyana-Belize-Brazil Partial Scope Trade Agreement can form the basis of a Caribbean-wide, asymmetric trade and development cooperation arrangement with Brazil. Such an initiative may allow the region to capitalize on opportunities for development cooperation, south-south Aid for Trade initiatives and capacity building through technology transfer.



The continued declining fiscal performance<sup>44</sup> and high debt servicing costs of many Caribbean economies constrain the subregion's ability to confront head-on the issues of structural rigidities which have limited production diversification and trade competitiveness, which has, and will continue to restrict the trajectory of Caribbean growth. In this regard it is noteworthy that although average public debt declined<sup>45</sup> in 2013, debt servicing remains at levels that could shift resources away from infrastructural and other development projects.

## E. Conclusion

The analysis and discussion undertaken in this subsection point to expanding associate membership in the Community; concluding free and partial scope trade agreements with Central America and/or Central America economies; and establishing development cooperation arrangements with Latin America as necessary antecedents for deepening the Caribbean's regional integration movement.

There must however, also be an accompanying fundamental shift in the philosophical thinking of regional policy makers. Instead of trade policy reform and export growth being perceived as drivers of economic growth in itself, they should be viewed from the broader prism of facilitating production integration and tapping into regional and global value chains. Once this is done, there will be an appreciation of the desirability for trade policy to be shaped by an industrial policy focused on structural transformation to address the Caribbean's overreliance on primary goods and tourism services, and marginal intra-regional trade. These fundamental notions will be further be explored in more detail in the chapter that follows.

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<sup>44</sup> In 2013, 13 countries Caribbean covered by ECLAC, with the exception of St. Kitts and Nevis, registered fiscal deficits. The deficit widened for Antigua and Barbuda, Barbados, Belize, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago in the same year. Moreover, despite instituting fiscal consolidation programmes, particularly in the ECCU, the fiscal deficit for the Caribbean as a whole increased from 3.3% of GDP in 2012 to 4.0% of GDP in 2013. The deficit was higher than that seen in the years just following the global crisis, when it averaged 2.8% between 2010 to 2012.

<sup>45</sup> From 73.2% of GDP in 2012 to 72.4% of GDP in 2013.

## V. Trade, structural transformation and sustainable development

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Caribbean economies have embraced trade liberalization since the 1990s and have pursued market-based integration while at the same time becoming increasingly integrated into the global economy. The economies of the Caribbean Community are therefore relatively open. Beyond the constraints of relatively small populations and geographical dispersion, Caribbean economies also possess major structural gaps that have constrained their growth and development. The resulting fragmented, inefficient production systems and undiversified export base present distinct challenges to trade expansion and regional integration.

This subsection seeks to succinctly highlight the most pertinent of these structural gaps and posits an approach towards bridging these, thereby demonstrating how the region might pursue a path towards structural change for sustainable development.

Using a variety of measures<sup>46</sup> it can be demonstrated that in many instances there is a disparity between the leading exports (goods and services) of Member States and the products for which they possess a relatively higher and increasing competitiveness relative to the world and major trading partners. Moreover, it would also appear that the region's leading trading partners are not our natural trading partners. Trading partners are natural if their trading structure is characterized by complementarity.<sup>47</sup> Using the trade complementarity index,<sup>48</sup> the data have revealed that the region possesses relatively weak trade complementarity (goods) with the United States, European Union and Canada. In contrast Central America, Asia and Latin America are increasingly shown to be the region's natural trading partner.

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<sup>46</sup> The measures used include the Revealed Comparative Advantage index which is a measure of competitiveness. A country has revealed comparative advantage when its share of exports of a good exceeds the equivalent share of exports of the world. It is likely to have extremely high values when countries are very specialized.

<sup>47</sup> That is, if one country tends to import what their prospective partner exports (Schiff (2001)). Trade agreements between natural trading partners are expected to be more welfare enhancing.

<sup>48</sup> An empirical technique that can be used to assess the extent to which the export specialization and the import specialization of trade partners complement each other in relation to world trade. A TCI of 1 is the threshold value for, albeit marginal, complementarity. The higher the index the greater will be the degree of trade complementarity.

It appears that inherent structural gaps, particularly in the areas of productivity, and competitiveness and interconnectivity have limited the ability of Caribbean economies to transform domestic production systems in order to optimize resource allocation and achieve sustainable growth. It has been shown that each subregional economy specializes in periphery products with little opportunity for structural change (Hausmann, and Klinger 2009). Furthermore, services account for in excess of 70 per cent of GDP in many Caribbean economies.<sup>49</sup> However due to lack of diversification, the sector has not been transformed in such a way as to optimize its contribution to regional economic development. Not surprisingly therefore, the Caribbean Community accounts for a mere 0.058 percent of global trade (goods and services).

Improving the region's trade competitiveness and ensuring that trade truly becomes an engine of growth for CARICOM economies, necessitates reducing cross-sectoral gaps within Member States and the structural gap between the Caribbean and developed as well as emerging economies. This, however, would require a fundamental shift to a dais of economic convergence, which embraces the wider Caribbean, Latin American. This approach is predicated on the need to restructure regional production systems, enhance competitiveness and diversify exports into value-added products with a view to tapping into global and regional value-chains. This has become particularly crucial given the declining competitiveness<sup>50</sup> of the regional tourism industry. The region however lacks the technical capacity and financial resources needed to facilitate the necessary structural transformation (see figure 7).

Many Caribbean economies continue to grapple with relatively high indebtedness. Success of any structural transformation endeavour would thus invariably depend on the willingness of the international community and the region's development partners to acknowledge the peculiar circumstances of Caribbean SIDS. They must assist the regional economies in their endeavour to construct the requisite robust trade complementarity structures.

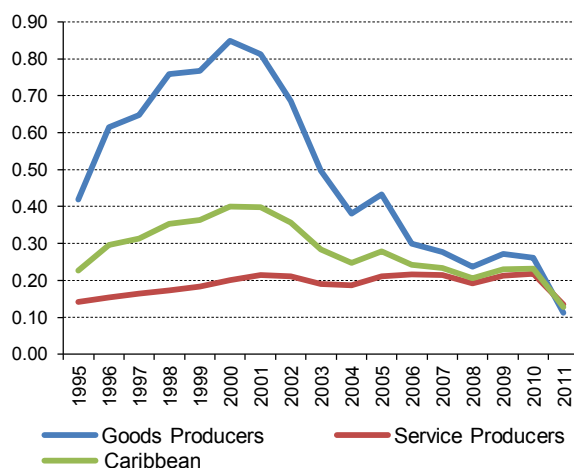
This notwithstanding, the Caribbean is now largely a middle income region. This graduation coupled with an increasing focus of official development assistance on social services and social infrastructure has led to a secular decline in Aid for Trade flows in to the Caribbean since 2008, with inflows standing at US\$ 371 million in 2012. (Figure 8 refers). However, many of the structural impediments to broad-based growth and development of Caribbean go beyond the social sector and individual economies differ in the capacities to address same. These structural gaps should by necessity be factored into a broader set of indicators which would modify consideration of per capita income in determining access to development cooperation resources. Such an approach would also require sensitivity to the existence of considerable heterogeneity between and within low, middle and high-income countries (ECLAC 2012), thus avoiding the adpotion of a one size does not fit all approach.

A central challenge for the region moving forward therefore is addressing the interconnection, labour productivity and technology gaps that have retarded inclusive growth. In this regard, the production of key public goods and investment in innovation should be viewed as crucial levers for delivering the requisite structural transformation necessary for fostering the regionalization of production and upgrading of the product-set. This will go a long way towards ensuring that the Region generates a critical mass of compact clusters of capital and consumer goods as well as high-end services, which in turn facilitate further transformation towards the production of new products (goods and services) with dissimilar technological content (Hausmann and Klinger 2006), that will allow for increased value chain (VC) participation.

<sup>49</sup> E.g. Antigua (90%), Dominica (78.8%), Grenada (78.1%), St. Kitts and Nevis (74%) and St. Vincent (74.4%) in 2012.

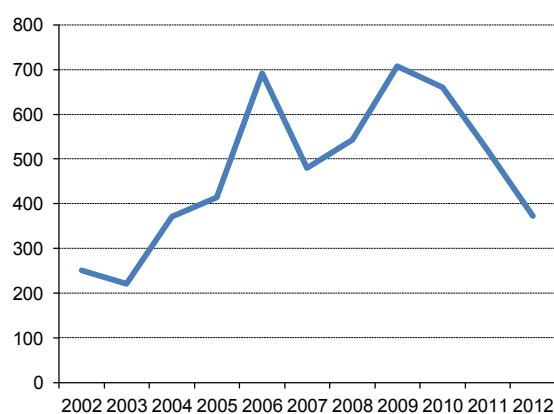
<sup>50</sup> Tourism Competitiveness = Average of (tourism expenditure for country i/world tourism expenditure) / (country i arrivals/world arrivals)

**FIGURE 7**  
**TOURISM COMPETITIVENESS**



Source: United Nations Economic Commission for Latin America and the Caribbean

**FIGURE 8**  
**CARIBBEAN TOTAL BILATERAL AID FOR TRADE**  
(US dollars)



Source: Organization for Economic Co-operation and Development database.

In this respect a principal trade-related development objective of the region should be formulating a new development-paradigm which attracts complementary resources through a mix of aid for trade, south-south development cooperation, development financing, technical assistance and public-private partnerships for improving regional connectivity in the areas of Maritime Transport, ICT and Energy. Paramount in this regard is the establishment of a Pan-Caribbean Maritime Corridor; development of the renewable energy potential of the Region so as to supply to a grid; and creation of a single ICT space within the Caribbean.

Given that logistics costs in the Caribbean are estimated to be twice the world average,<sup>51</sup> the need to address trade facilitation challenges and bottlenecks has become a major area of policy focus for the region. In this regard, harmonizing national customs legislation; establishing a protocol for free circulation of goods in the CARICOM Single Market and Economy (CSME); inter-operability of national single electronic windows (SEWs);<sup>52</sup> and a goods transit system for cargo transported by sea are priority policy priorities for the Caribbean.

The aforementioned public goods stand to have the greatest positive impact on regional competitiveness by lowering input costs and enhancing labour productivity and in so doing would allow for a shift to the production of more sophisticated products and services that have higher unit values (Thaddée et al 2013). This results in a shift of the subregion's goods and services basket from the periphery of the production frontier.<sup>53</sup> This should quicken the pace of structural transformation while also generating economies of scale. In addition, the increased interconnection will undoubtedly reduce productivity gaps between sectors; and allow labour and other resources to move seamlessly from less productive to more productive activities (across sectors and between regional economies) - two drivers of growth-inducing structural change.

The industries which stand to benefit most from modernized regional trade related infrastructure and which present the greatest opportunities for the Caribbean to achieve the much needed greater participation in Global Value Chains (GVCs) encompass include tourism — esuch as traditional, education, sport and multi-dimensional initiatives.; professional services; creative industries; financial services; off shore services — such as Information Technology, Business Process and Knowledge Process Outsourcing; environmental services; energy services; down-stream energy products; renewable and bio-energy; electronics — such as intermediate inputs; food and Beverage; and light manufacturing.

In addition, investment in innovation, research and development is important for closing the technology gap, and should be seen as crucial for enhancing Caribbean Community-wide total factor productivity with a view to expanding employment among women, youth and the rural community. Innovation and R&D help shape the basket of goods and services that the region produces and exports, facilitating entry into tertiary industries, and by extension influencing the velocity of its structural change. Hence establishing mechanisms for encouraging private sector investment in innovative production activities, promoting innovation and technology creation is therefore fundamental.

## A. The regional public goods – aid for trade nexus

Given that a decidedly neoliberal approach to regional economic integration has thus far not worked,<sup>54</sup> the Caribbean integration initiative may now need the not so invisible hand of regional governments and international development partners to reinvigorate the process. In this regard, trade-related development funding, Aid for Trade (AFT),<sup>55</sup> has a crucial role to play in delivering the regional public goods fundamental to redressing structural rigidities and transforming regional production systems.

<sup>51</sup> Moreira M., Volpe, C., and Blyde, J. 2008 estimated that logistics costs in the Caribbean represented 20% of product costs, compared to a world average of 10%.

<sup>52</sup> The Single Electronic Window (SEW) is an IT based electronic one stop shop where private stakeholders and approving government agencies collaborate to process necessary trade and business facilitation-related permits and approvals (e.g. Certificates of Origin) online. The Ministry of Trade, Industry and Investment of Trinidad and Tobago launched its SEW in 2009 in March, 2012.

<sup>53</sup> The region's production and trade (goods) continues to be dominated by primary products; its intra-regional trade in intermediate goods is low when compared to MERCOSUR, Central America and the Andean Community; and inter- industrial trade in intermediate goods with Latin America and the Caribbean, the US, the EU and ASEAN is marginal.

<sup>54</sup> Girvan, N., et.al, Is the Caribbean Community in danger of Collapsing, Inter-American Dialogue's Latin America Advisor.

<sup>55</sup> Aid for Trade is a sub-set of official development assistance. In the broadest sense it refers to the flow of development finance/aid from developed countries and multilateral funding agencies to developing countries to enhance their participation in the multilateral trading system.

Hence there must be a willingness on the part of regional governments to work together, along with their International Development Partners (IDPs) and the private sector to collectively address the key drivers of regional productivity and competitiveness in a coordinated and coherent manner. In this respect, the subregion should view that Aid for Trade resources as playing an important role in unlocking the existing potential for trade to become a positive driver of subregional development.

From a policy-setting perspective, it is imperative to note that expansion in global production and trade has increasingly been fuelled by global value chains (GVCs),<sup>56</sup> thereby fragmenting the production process and offering up opportunities for participation in segments. This has made innovation, as well as information, communication and technology drivers of trade performance. Hence the subregion should see the production of public goods in the priority areas highlighted earlier as a necessary lever for removing production constraints in many territories and fostering the regionalization of production,<sup>57</sup> and in so doing ensure that the Caribbean generates the critical mass of specialized production activities that will allow value chain (VC) participation.

Not surprisingly therefore, the Caribbean Community's Regional Aid for Trade (AFT) Strategy 2013-2015,<sup>58</sup> highlighted public goods which are fundamental to not only on productive diversification but also addressing the Region's systemic supply-side constraints, which have served as formidable barriers to trade. The Strategy also outlines the essential elements of a consensus approach to optimizing AFT resource mobilization, monitoring, coordination and implementation. The AFT projects contained therein cover a multiplicity of activities and require differing types of investment thereby providing a large number of options for donors, investors and development partners including sovereign or non-sovereign lending, public-private partnerships and grants.<sup>59</sup>

What is more important is that the Strategy, consistent with the recommendations made earlier in this paper, also suggests that the leading Aid for Trade priorities, which are critical to redressing several supply-side capacity constraints that have restricted the Region's ability to tap into its true export potential, lie primarily in the provision of regional public goods or in initiatives that have public goods aspects or generate positive externalities. Securing complementary resources or identifying public-private partnerships for upgrading key economic infrastructure has been identified as a principal objective of the Strategy.

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<sup>56</sup> Which account for an estimated 80% of global trade.

<sup>57</sup> The industries which present the greatest opportunities for the Caribbean to achieve the much needed greater participation in GVCs encompass include tourism – e.g. traditional, education, sport, multi-dimensional etc.; professional services; financial Services; off shore services – e.g. Information Technology, Business Process and Knowledge Process Outsourcing; environmental services; energy Services; down-stream energy products; renewable and bio-energy; electronics – e.g. intermediate inputs; food and Beverage; and light manufacturing.

<sup>58</sup> The primary goals of the Regional AFT Strategy are (i) Upgrading Key Economic Infrastructure; (ii) Enhancing Competitiveness and Facilitating Trade Expansion and Diversification; and (iii) Deepening Regional Integration and Maximizing gains from External Trade Agreements.

<sup>59</sup> Mc Lean, S., 'Aid for Trade and Value Chains: Caribbean Imperative for Connecting to value Chains', prepared for the participation of the Caribbean Community Secretariat at the Fourth Global Review of Aid for Trade, Geneva, Switzerland, WTO Head Quarters, 8-10 July 2013.



## VI. The way forward

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An assimilation of the foregoing analysis and discussion suggests that the leading trading partners of the Caribbean countries themselves are not natural trading partners.<sup>60</sup> The intuition is that regional integration initiatives and/or free trade agreements between countries which possess robust and increasing trade complementarity and comparative advantage structures generally create more trade and boost welfare.<sup>61</sup>

However, in the Caribbean, when selecting countries for deepening trade and economic relations, there evidently has been insufficient consideration of trade complementarity and the attendant differential cost structures, necessary for sustainable trade creation. Inattention to the development of trade complementarity between Caribbean economies and with the rest of the world has bedevilled efforts to increase intra-regional trade, expand the region's share of global commerce and achieve convergence.

Consequently, regional merchandise exports are still precariously built on a fragile foundation of limited products which have narrow intra-Caribbean, and even slimmer extra-regional, trade complementarity. In moving forward, fostering structural transformation must be recognized by regional policy makers as the most appropriate tool for leveraging Caribbean-wide economic development and economic convergence. Bridging the subregion's structural gaps in the areas of areas of productivity, competitiveness and interconnectivity, through the production of key regional public goods, is essential for fostering the regionalization of production and upgrading of the product-set of the Caribbean.

The development of the Services sector to capitalize on inherent comparative advantages as well as diversification of Services exports is also fundamental to repositioning domestic economies within the global economy and multilateral trading system.<sup>62</sup> This is becoming increasingly necessary since despite

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<sup>60</sup> The notion that two countries are defined as natural trading partners if they tend to import what is the prospective partner exports, which was introduced by Maurice Schiff in his paper entitled "will the Real "Natural Trading Partner" Please Stand Up?", Development Research Department, World Bank, June 1999.

<sup>61</sup> Schiff, 2001.

<sup>62</sup> Mc Lean, S. (2012) "Caribbean Community Regional Aid for Trade Strategy 2013-2015, Caribbean Community Secretariat.



the existence of a comparative advantage in the area of services, the Region's services export base remains relatively narrow with tourism being the dominant sub-sector. Further, tourism's<sup>63</sup> contribution to GDP exceeds 40 per cent in Antigua and Barbuda (74 per cent); Barbados (47 per cent); The Bahamas (47 per cent); and St. Lucia (46 per cent).

As a corollary, a programme strategic trade-related policy intervention and development cooperation, including AFT resources, which is conditioned by the coupling of an accelerated production of regional public goods with appropriate sectoral regulatory reform, is central to the structural transformation of the Caribbean.

Generating export-led economic growth requires fostering private sector development, through *inter alia* placing emphasis on rationalizing and broadening domestic manufacturing to ensure that the requisite comparative advantage and trade complementarity targets are achieved.<sup>64</sup> This may require the Region and national economies to institute a harmonized production-investment-export-innovation policy framework geared at supporting private sector development. Such an undertaking will go a long way to generating efficiency gains across the entire value chain.

This paper also posits that the subregion adopt a new dais of regional integration, which favours deeper trade and economic integration with countries which are the region's natural trading partners. This would, however, necessitate greater intervention by regional governments and private sector in the production of regional public goods that are crucial for structural transformation towards sustainable development of the subregion. Under such conditions, the nexus of RTAs, FTAs and regional integration frameworks advanced here can be expected to be net trade creating, efficiency enhancing and welfare gains optimizing.

It is also advanced here that the wider Caribbean (particularly the Dominican Republic, Cuba, the British Virgin Islands, Turks and Caicos Islands, Anguilla, Cayman Islands, Bermuda, Sint Martin, Curacao, French Guiana, Guadeloupe and Martinique); SICA (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama); and subsequently Latin America (e.g. MERCOSUR and Chile) are central to this new model for Caribbean convergence. CELAC can possibly act as the institutional mechanism for advancing the notion and imperatives of this neo Pan Caribbean-Latin American regionalism endeavour.

Instituting essential elements of the development framework outlined here is important if the International Community and regional governments are to nudge the subregion in the direction of structural change for sustainable development. This framework should address key issues such as:

- Provision of export financing and promotion and market intelligence
- advancing the development of cross-sectoral clusters (e.g. clusters between renewable energy, food, creativity, maritime and tourism sectors)
- reforming the institutional, legislative and regulatory regime to make it more amenable to attracting FDI, and improving the ease of doing business
- promoting innovation, R&D as well as technology creation and absorption geared at increasing production capacity and productivity and cross-sectional competitiveness and investment in educating, training and re-tooling of the labour force.

<sup>63</sup> i.e. direct and indirect contribution of travel and tourism as reported by the World Tourism and Travel Council's Travel and Tourism Economic Impact for 2011.

<sup>64</sup> Expanding exports does not require the Region to be competitive in everything that it produces but rather in a wider range of products and services.

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