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SPECIAL AND DIFFERENTIAL TREATMENT IN THE FTAA

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SPECIAL AND DIFFERENTIAL TREATMENT IN THE FTAA

The need to devise an appropriate mechanism for the meaningful participation of smaller economies in the Free Trade Area of the Americas (FTAA) has been recognized since the beginning of the process of integration in the Americas and was articulated in the Plan of Action and Declaration of the Summit of the Americas, held in Miami in December 1995¹. Since then, the San Jose Declaration² reiterated the commitment of the countries of the hemisphere to ensure the full participation of the smaller economies in the FTAA and increase their level of development.

The declaration states that “In designing the FTAA, we shall take into account the differences in the levels of development and size of the economies in our hemisphere to create opportunities for the full participation of smaller economies and to increase their levels of development”. Also in its paragraph 6, the same declaration states “We recognise that wide differences in the level of development and size of economies exist in our hemisphere and we will remain cognizant of these differences as we work to ensure their full participation in the construction of the FTAA”.

Similar commitments have been made more recently in the Toronto Declaration where it is stated in paragraph 5 “We recognise the broad differences in the levels of development and size of the economies in our hemisphere and we will remain cognizant of those differences in our negotiations so as to ensure that these receive the treatment that they require to ensure the full participation of all countries in the construction and benefits of the FTAA. In order to comply with this, we instruct the TNC to begin immediately to examine the ways in which these differences could be treated in the negotiations taking into account the treatment given to them in other forums and provide continuing guidance to the negotiating groups and report to us at our next meeting”³. Although the recognition of the special case of smaller economies is clear, the negotiations are still to define an appropriate mechanism to carry out the commitments repeated over the last five years to ensure that the smaller economies of the hemisphere participate fully in and benefit from the FTAA.

¹ See Summit of the Americas, 9-11 December 1994, Miami, Florida, Plan of Action

² Ministerial Declaration of San Jose, Summit of the Americas, Fourth Ministerial Meeting, San Jose, Costa Rica, 19 March 1998

³ Free Trade Area of the Americas, Declaration of Ministers, Fifth Trade Ministerial Meeting, Toronto, Canada, 4 November 1999

Traditionally, special and differential treatment has been the chosen mechanism to address differences in the levels of development and promote the participation of lesser developed economies into the world trading system. Not unlike the many declarations of the FTAA, the Preamble of the World Trade Organization (WTO) states that “Members of the World Trade Organization recognise that one of the objectives of the WTO will be to ensure that developing countries members, and especially the least developed countries, secure a share in the growth of international trade that is commensurate with their economic development needs. They also recognise that this objective will require a number of positive efforts from all members”. This paper will review briefly the special and differential treatment provided for developing countries in the WTO to address the issues related to the levels of development in a trade liberalisation context . This review is undertaken because of the relevance of the WTO’s approach to the ongoing negotiations of the FTAA and based on the fact that that approach formed the basis for special and differential treatment in trade liberalisation agreements throughout the world. The paper will then highlight some of the major characteristics of Caribbean economies and their trade and make a modest attempt to point out selected issues which require special attention and which may contribute to a strategy for smaller economies of the Caribbean in the ongoing FTAA negotiations.

I. THE SPECIAL AND MORE FAVOURABLE TREATMENT FOR DEVELOPING COUNTRIES IN THE WORLD TRADE ORGANIZATION

A. Special and more favourable treatment in the GATT: Background and evolution

Special and more favourable treatment was introduced into international trade rules to respond to specific concerns expressed by developing countries. One of these concerns was the high level of dependency on the exports of a narrow range of raw materials and basic commodities and the need for economic diversification. To achieve that diversification, it was generally believed that the protection of national markets and subsidisation of national industries would assist in the establishment of a strong and diversified industrial base, which in turn would lead to faster social and economic development.

Another concern was the high dependency in developing countries on imports needed for industrial development and the resulting chronic balance of payment deficits which, it was thought, needed to be corrected through the use of restrictive trade measures. Article XVIII of the General Agreement on Tariffs and Trade (GATT) responded to the concerns related to the diversification of the economies and the balance of payments problems. Its provisions allow developing countries to maintain sufficient flexibility in their tariff structures to be able to grant the tariff protection required for the establishment of a particular industry. The Article provides for the application of quantitative restrictions for balance of payments purposes in a manner which takes full account of the continued high level of demand for imports likely to be generated by their programmes of economic development. Also, Article XVI and Article XXVIII exempted

developing countries from the prohibition on export subsidies for manufactured products and allowed a more flexible use of tariff protection.

In addition, developing countries were concerned about the competitiveness of their products in the developed countries' markets where they were competing against products manufactured by long established industries. It was for this reason that they sought, through more favourable and non-reciprocal access to developed countries' markets, to redress the perceived imbalance between their export products and those of developed countries. This concern was addressed through the provision of waivers from GATT rules and then through the enabling clause which reinforced the waivers and gave them a legal basis in the GATT, by allowing: special and differential treatment with respect to tariff preferences accorded under the General System of Preferences (GSP) schemes, non tariff measures under the Tokyo Round codes and tariff and non-tariff preferences among developing countries in the framework of regional or global trade arrangements.

The asymmetrical treatment of developing countries in world trade rules, which allowed them to protect their industries and markets and subsidise key selected industries which in their view had great potential for growth, resulted in the establishment of a complex system of tariffs, subsidies, quotas, licensing requirements and foreign exchange restrictions. At the same time these countries benefited from more favourable and non reciprocal access to developed countries' markets through various preferential schemes, such as the series of European Union/African, Caribbean, Pacific (EU/ACP) agreements, Caribbean Basin Initiative (CBI) and numerous GSP schemes, which were granted under various waivers from GATT rules. The preferences given under the various GSPs were weak and unpredictable because they were granted unilaterally and depended on the goodwill of the developed countries, which could withdraw or modify them at will. In addition, countries were usually subjected to considerable pressure to abide by certain conditions not related to trade (i.e. labour and environmental stipulations) to continue to benefit from these preferences.

In addition to the well-known infant industry argument, the overall trade policy stance of developing countries was underpinned by solid intellectual arguments which held that primary exports were on a long-term decline and that developing countries had to protect their markets to develop strong indigenous manufacturing industries. Also, the exports prospects of developing countries were considered bleak because it was thought that the growth of these countries would require exports levels which could not possibly be absorbed by foreign markets⁴.

Many factors contributed to the failure in many developing countries of the strategy adopted vis à vis the international trade rules. The high level of protection in developing countries and non-tariff barriers implemented in developed countries' markets were among these factors. Protection in the developing countries created many inefficiencies in the economies which hampered the development of a competitive industrial sector in many countries. The markets of developed countries, despite the many

⁴ Prebisch, R (1952) "Problemas teoricos y practicos del crecimiento economico" ECLAC and Nurkse, R (1959) "Patterns of trade and development", Stockholm: Almquist and Wicksell.

schemes offering more special and more favourable treatment to the exports of developing countries, were in fact replete with non tariff barriers especially against those products of special importance to developing countries.

Tariff escalation in operation in many developed countries against exports of interest to developing countries have essentially prevented developing countries from increasing the levels of domestic processing of raw materials and created a bias against the countries' exports of processed goods. Even after the Uruguay Round (UR), the reduction of tariffs was generally greater in the earlier stages of processing of goods than in the later stages (see table below). The general implication of higher percentage reductions on raw materials or semi-processed goods is that effective protection in the next stage of processing does not decrease in the proportion to the normal tariff cuts on the finished goods. This is a strategy which has been used explicitly by developed countries to increase effective protection while meeting overall tariff reduction commitments⁵.

**Changes in tariff escalation on products imported by developed countries
from developing countries**

PRODUCT	Share of each stage	Tariff	
		Pre-UR	Post-UR
All industrial products (except petroleum)	100		
Raw materials	22	2.1	0.8
Semi-manufactured products	21	5.3	2.8
Finished products	57	9.1	6.2
All tropical products	100		
Raw materials	35	0.1	0.0
Semi-manufactured products	30	6.3	3.5
Finished products	34	6.6	2.6
Natural resource based products	100		
Raw materials	44	3.1	2.0
Semi-manufactured products	40	3.5	2.0
Finished products	17	7.9	5.9

Source: GATT (1994)

Tariff peaks constituted another significant impediment to the exports of processed goods from developing countries to developed countries' markets. These peaks

⁵ See Laird, S. "Multilateral Approaches to Market Access Negotiations" in Trade Rules in the Making, Challenges in Regional and Multilateral Negotiations, Miguel Rodriguez Mendoza, Patrick Low and Barbara Kotschwar, Editors

generally exceeded 12 per cent but were sometimes well in excess of 200 per cent in some sectors.

In the 1980s, in the face of unsustainable macroeconomic disequilibria and the failure to diversify their economies despite the protection and the subsidies, many developing countries implemented structural adjustment programmes which invariably included the liberalisation of trade policies. The questioning on theoretical and empirical grounds of the usefulness of special and differential treatment for the social and economic development of developing countries also played a significant part in the implementation of new more liberal trade policies. Empirical studies published from the 1970s onwards pointed out some of the weaknesses of the import substitution strategies which were effectively encouraged by the widespread use of special and differential treatment. These weaknesses included the creation of high levels of effective protection, currency overvaluation and a bias in the trade regime against exports⁶.

The liberalisation of trade policies was undertaken either unilaterally or under International Monetary Fund (IMF) and World Bank adjustment programmes, but always outside of the GATT framework. It became clear that many developing countries' trade policies were going against the measures under the special and differential treatment which they negotiated in the GATT. This new approach to trade policy led to the active participation of these countries in the Uruguay Round of trade talks which was launched in 1986.

B. Special and differential treatment in the Uruguay Round

The agreement which resulted from the Round indicated clearly a move towards more equality between developing and developed countries in international trade rules. These were reflected in many areas of the agreement. The tariff bindings commitment made by developing countries were more substantial than anything done in the past and was closer to the bindings undertaken by the more developed economies. Developing countries were also required to adhere, with some transitional arrangements, to the same rules as developed countries in the areas of import licensing, safeguards, Trade Related Investment Measures (TRIMs), subsidies, customs valuations and Technical Barriers to Trade (TBT).

Also, stricter discipline was put on the provisions allowing for the use of restrictive measures for balance of payments purposes (Article XVIII) with a view to making them less disruptive to trade. Price-based measures were preferred to quantitative restrictive measures. Developing countries would also have to adhere to the same standards and the same rules with regard to Trade Related Intellectual Property Rights (TRIPS) and services with some transitional arrangements.

⁶ See Little, I, Scitovsky, T and Scott, M (1970) "Industry and Trade in Some Developing countries" Oxford, Oxford University Press for the Organization of Economic Cooperation and Development and Krueger, Anne (1978) "Foreign Trade Regimes and Economic Development: Liberalisation Attempts and consequences" Cambridge, MA: Ballinger and Krueger, Anne (1997) "Trade Policy and Economic Development: How we learn" American Economic Review 87(1) 1-22

The Uruguay Round Agreements, however, continued to provide special and more favourable treatment to developing countries in a number of ways which could be grouped into five categories: (a) fewer substantive obligations; (b) longer time-frame of implementation of agreements; (c) preferential exemption from restrictive actions; (d) technical assistance; and (e) best endeavours commitments and recognition of interest. This section will describe under the numbered captions that follow the special and differential treatment given to developing countries in the various agreements of WTO.

1. Fewer substantive obligations

This is a category whose importance is clearly diminishing mainly because its usefulness is being increasingly questioned.

Agriculture: The WTO provides fewer obligations for developing countries on all the components of the agreement, namely market access, domestic support and export subsidies. The total aggregate measurement of support (AMS) which is to be reduced by 20 per cent over a six-year period in developed countries and 13 per cent over a 10-year period in developing countries includes a de minimis clause which favours developing countries.

Countries are allowed to exclude from the calculation of the AMS product specific support which does not exceed 5 per cent of the value of production of that commodity and non product specific support which does not exceed 5 per cent of the value of the country's total agricultural production. For developing countries, the de minimis level is 10 per cent. In addition, developing countries are allowed to provide subsidies to agricultural enterprises to reduce the costs of marketing exports, including handling, upgrading and other processing costs as well as the costs of international transport and international transport charges on the shipment of exports in terms more favourable than for domestic shipment.

Also, in terms of market access, the agreement requires the binding of all tariff lines with developed countries having to reduce their tariffs by an average of 36 per cent from the base tariff rate with a minimum of 15 per cent per tariff line over six years, while for developing countries the implementation period is 10 years and the required tariff reduction is two thirds of that of developed countries.

Technical Barriers to Trade: Developing countries are not expected to implement international standards which are not appropriate to their situation as a basis for technical regulations, standards and tests methods.

Trade Related Investment Measures: Developing countries are temporarily allowed to apply normally banned trade related investment measures for the protection of their industries. These include mainly local content requirements measures, which specify a particular level of purchase or use of product of domestic origin or trade balancing requirements which restrict the volume or value of imports to the level of exports.

Customs valuations: Developing countries may reserve the right to value imported goods on the basis of unit price of post importation sale if the goods have undergone further processing in the country of importation. Developing countries are also allowed more flexibility with regard to the hierarchy of the five methods of valuations agreed to, namely transaction value of the good itself, that of identical goods, that of similar goods, the deductive method and the computed method.

Safeguards: Developing countries are allowed to maintain safeguard measures for two years more than the eight years normally allowed for developed countries. In addition, developing countries have more flexibility in the reimposition of safeguard measures than developed countries.

General Agreement on Trade in Services (GATS): Developing countries are given more flexibility regarding the need to eliminate substantially all discrimination in the sectors covered in their economic integration agreements. Developing countries can also liberalise fewer sectors and fewer types of transactions than developed countries.

2. Longer time-frame for implementation

This is the most widely used special and differential treatment category in the WTO Agreements.

Agriculture: The reduction commitments on market access, export subsidies and domestic support are to be implemented by developing countries over a period of 10 years as against six years for developed countries.

Textiles and clothing: Developing countries are provided with a 60 days period after the entry into force of the agreement to notify their integration programmes.

Technical Barriers to Trade: Developing countries may be granted by the Committee on TBT specified time limited exceptions in whole or in part from obligations under the agreement.

Trade Related Investment Measures: Developing countries will have five years to eliminate all GATT inconsistent TRIMS, while developed countries will have two years. In addition, developing countries may have the period extended by a decision of the council of trade in goods.

Customs valuation: Developing countries not parties to the Tokyo Round agreement have a grace period of five years to implement the agreement and could request an additional period of delay in the implementation of this agreement.

Subsidies: Developing countries have eight years transition period to phase out export subsidies. This period could be extended by a decision of the committee on subsidies.

General Agreement on Trade in Services: Developing countries have more flexibility with regard to the establishment of the enquiry points which have to be established within two years by developed countries.

Trade Related Intellectual Property Rights: Developing countries have five years to implement the provision of the agreement which could be extended by another five years for areas of technology not so protectable in their territories.

3. Preferential exemption from restrictive actions

Subsidies: The level of subsidies has to be more than 2 per cent of the cost of the product of developing countries before attracting countervailing duties, as against 1 per cent for developed countries. Also, countervailing duties cannot be imposed on the subsidised imports of developing countries if their volume is less than 4 per cent of the total imports of like products in the importing country and if the total share of imports from developing countries which are less than 4 per cent is not more than 9 per cent of the total imports of the product in the importing country.

Safeguards: Developing countries cannot be subject to safeguard measures if their share of the total import of the product in the importing country does not exceed 3 per cent and all developing countries with less than 3 per cent do not exceed 9 per cent of total imports of the product concerned in the importing country.

4. Technical assistance

Technical assistance is provided for in most of the agreements especially in those related to sanitary and phytosanitary measures, technical barriers to trade, customs valuation, trade in services and dispute settlements. In the agreement on sanitary and phytosanitary measures, the facilitation of the provision of technical assistance to developing countries, either bilaterally or multilaterally, is provided for so as to allow them to comply with their trading partners requirements. Where substantial investment is required, in order for an exporting developing country to fulfil the sanitary and phytosanitary requirements of an importing developed country, the latter is to consider providing the necessary technical assistance.

With regard to the agreement on technical barriers to trade, the provision of technical assistance in the preparation of technical regulations, the establishment of national standardisation bodies and the participation in the work of international standardisation bodies is provided for. In addition, assistance in the establishment of the institutional and legal framework necessary to fulfil the obligation of membership or participate in international or regional systems of conformity assessment is provided for. Developing countries have the right to request and obtain technical assistance from developed countries, including training of personnel, assistance in preparing

implementation measures and access to sources of information regarding customs valuation methodologies.

The GATS gives the WTO secretariat the responsibility of providing technical assistance to developing countries. Developed countries are expected under the agreement on trade related aspects of intellectual property rights, to provide on request and on mutually agreed terms technical and financial cooperation in favour of developing countries. A qualified legal expert from the WTO technical cooperation services is expected to provide legal advice and assistance to developing countries under the understanding on rules and procedures governing the settlement of disputes.

5. Best endeavours and recognition of interest

Best endeavours commitments are widely used in the WTO Agreement. They are included in the agreements on agriculture, sanitary and phytosanitary measures, textiles, technical barriers to trade, antidumping, customs valuation, subsidies and countervailing duties, GATS, TRIPs and dispute settlements.

In the agreement on agriculture, it is stated that developed countries are to provide greater market access for agricultural products of particular interest to developing countries including the fullest liberalisation of trade in tropical agricultural products and products substituting for illicit narcotic crops. In the agreement on sanitary and phytosanitary measures, it is recognised that developing countries may encounter special difficulties in complying with the sanitary and phytosanitary measures of importing countries and thus have a limited access to external markets. Members are therefore urged to take into account the special needs of developing countries members in the preparation and application of sanitary and phytosanitary measures.

In the agreement on textiles and clothing, small suppliers are to be given meaningful increases in access possibilities while new entrants to trade in the sector must be allowed to develop commercially significant trading opportunities. Small textiles exporters subject to Multi-Fibre Agreement (MFA) quotas should move ahead one stage in the growth process agreed to, that is, 25 per cent in the first year instead of the 16 per cent normally agreed to. It is recognised that small suppliers should be provided with more favourable treatment in the application of quota base levels, growth rates and flexibility. In addition more favourable treatment is to be given to those countries which have a significant proportion of their exports in outward processing trade.

Under the agreement on technical barriers to trade, the special development, financial and trade needs of developing countries shall be taken into account in the implementation of the agreement and the preparation and application of technical regulations, standards and conformity assessment. In addition, the agreement states that reasonable measures are to be taken to facilitate the participation of relevant bodies in developing countries in the organization and operation of international standardisation bodies and international systems for conformity assessment. In the

agreement on the implementation of Article VI (Antidumping measures), it is stated that special regard must be given by developed countries to the special situation of developing countries when considering the application of antidumping measures.

The agreement on customs valuation states that there is a recognition that the agreement attempts to secure additional benefits for the trade of developing countries. The GATS agreement includes the statement that there is a desire to establish a multilateral framework of principles and rules for trade in services, which would expand trade as a means of promoting the economic growth of all trading partners and the development of developing countries.

The agreement expresses the desire to facilitate the increasing participation of developing countries in trade in services and the expansion of their services exports through, among other things, the strengthening of their domestic services capacity and its efficiency and competitiveness. In addition, there was a recognition of the rights of members to regulate the supply of services in order to meet national policy objectives and the particular need of developing countries due to the asymmetries existing with respect to the degree of development of services regulations in different member countries.

In the TRIPS agreement, only the special needs of the least developed countries are recognised in respect of maximum flexibility in the domestic implementation of laws and regulations so as to enable them to create a sound and viable technological base. With regard to the dispute settlement mechanism, members are exhorted to give special attention during consultations to the particular problems and interests of developing countries. Also, when the dispute is between a developing and a developed country, the panel shall include at least one member from a developing country. In the area of surveillance and implementation of the adopted recommendations, particular attention should be paid to matters affecting the interests of developing countries including the impact that the measures might have on the economy of the developing country involved.

II. SUGGESTED APPROACH TO SPECIAL AND DIFFERENTIAL TREATMENT IN THE FTAA

Caribbean countries are involved in the ongoing negotiations for the establishment of the FTAA with the objective of accelerating their economic and social development through full participation in the liberalisation of trade and investment in the Western Hemisphere. The issues related to special and differential treatment are bound to be discussed in the process. Although it is difficult to prejudge the outcome of the negotiations and the actual nature of the special and differential treatment to be agreed to, it is more likely than not that special and differential treatment will be included in the final agreement and that it will be largely based on the GATT's approach which was used in various subregional integration agreements. This section will briefly review the main characteristics of Caribbean economies and trade and then attempt to point out some of

the issues which could form the basis for the negotiations of special and more favourable treatment in the FTAA.

A. Special characteristics and vulnerabilities of Caribbean countries

In general, Caribbean countries have achieved moderate rates of growth during the 1990s but these will have to be increased substantially if these countries are to maintain the standard of living that their people have been accustomed to and deal effectively with the high rates of unemployment which have persisted in most countries. This is a challenging task which, if it is to be successful within an increasingly liberalised hemispheric economy, will have to include the design of appropriate policies to deal effectively with some structural characteristics of their economies which render them particularly vulnerable.

During the last two decades, Caribbean countries have recorded uneven rates of growth. In the 1980s, the OECS countries registered high levels of growth achieving an average growth rate for the decade of 5 per cent, while the economies of the larger countries of Jamaica, Guyana and Trinidad and Tobago contracted. In the 1990s the OECS continued to grow albeit at a slower rate while the larger countries recovered somewhat and resumed growth. Underlying the growth of the OECS was the prudent fiscal and monetary policy set implemented by the countries but also the preferential access to the European market of their main export of bananas and the growth of their services sector, mainly tourism.

Export earnings from tourism are generally higher in these countries than their exports of goods. Following the contraction of their economies in the 1980s, the larger countries implemented structural adjustment programmes including trade, exchange rates and financial sector reforms and their economies have, in fact, emerged from the slump of the 1980s. The growth process and its determinants in the Caribbean are inherently linked to the special characteristics and special circumstances of the countries⁷.

The characteristic which underpins all others and which determines to a large extent the economic and social progress of the countries of the Caribbean region is that of size⁸. These are small countries in both geographical and market terms. This means a small natural and human resource base and small markets. The implications of this characteristic is that these countries have more difficulties in attaining efficient scales of production and usually have high unit costs of production. In addition to the limited range of production possible and the high costs of that production, these small countries face high transportation costs which are associated with the low volumes exported and the low frequency of transport connections with the outside world.

⁷ LC/CAR/G.600 “The Caribbean in the decade of the 1990s” Summary, ECLAC/CDCC, 31 January 2000.

⁸ For further discussion of the characteristics of smaller economies and their implications for participation in free trade see Chapter 11 of LG/G.2071 (SES 28/3) “Equity, Development and Citizenship” ECLAC, 6 March 2000.

The lack of experience and familiarity with export markets, especially those for non traditional goods and services, makes it difficult for them to penetrate these markets and monitor the evolution of market demand to respond appropriately and in a timely fashion. While these high costs of production are important and determine, to a large extent, if a private sector investment is undertaken or not they cannot be a major consideration in investment in basic social and economic infrastructure whose non provision is not an option. Clearly the financing of these development facilities puts great pressures on the treasury and is one of the main reasons for the usual high dependency of small islands States on external financing. The shallowness of the financial markets constrains the mobilisation of domestic finance for development in these countries.

Roads, ports, airports, telecommunications services, schools and hospitals are essential for the development of the countries and have to be provided in small island States despite their usually high costs in per capita terms. The same is true of water and energy facilities which are essential components of the development process. Public administration is another area characterised by indivisibility which is essential despite its high costs in small countries.

Other characteristics which are related to size but have an importance of their own include the high concentration of exports on a narrow range of products and markets and high dependency on trade preferences. Caribbean countries are also highly dependent on imports for both production and consumption. This fact makes the countries some of the most open in the world where trade represents over 60 per cent of GDP in most of them. Closely related to this high level of openness is the high dependency on trade taxes for fiscal revenues⁹. The geographical location of these small island States and their topography expose them to natural disasters, such as hurricanes, volcanoes and earthquakes, with devastating economic and social consequences. The characteristics outlined are the sources of risks which the Caribbean region has to face continuously.

The high concentration of Caribbean exports on a narrow range of goods and services and their high levels of imports determine their external dependency and their economic vulnerability. The lack of diversification of these economies makes them particularly vulnerable to price fluctuations of both imports and exports and the loss of preferences, which is increasingly likely with the continuation of the trade liberalisation process. The recent view of offshore financial centres by the Organization for Economic Cooperation and Development (OECD) policy makers as a source of harmful tax competition has brought much uncertainty to this sector which generates significant revenues and employment in the Caribbean.

Although the cost of air and sea transportation has been on the decline world wide and the Caribbean is relatively close to the North American market, transportation remains a major cost for Caribbean producers because of low volumes and inadequate

⁹ Import taxes constitute more than half of tax revenues in Belize and the OECS countries. For a discussion of trade openness and the dependency of Caribbean countries on trade taxes see Harker, T, Ould El Hadj, S and Vinhas de Souza, L "The Caribbean Countries and the Free Trade Area of the Americas" in CEPAL Review 59, August 1996.

transportation links. It has been estimated by the United Nations Conference on Trade and Development (UNCTAD), based on data gathered in the 1980s for 30 island developing countries, that freight and insurance costs represented 13 per cent of imports of island States and only 10 per cent of imports of developing countries and 6 per cent of those of developed countries. The high cost of transportation combined with high unit costs of production decreases the price competitiveness of the products of the Caribbean.

In addition, production possibilities are severely constrained by the size and the topography of the countries and their limited natural, human and financial resources. Economic activities tend to be concentrated in specific areas and put great pressure on the scarce land and the fragile ecosystems, which are prone to destruction from uncontrollable developments. The concentration of tourism infrastructure on the coast, the intensive use of land for agriculture with the heavy use of pesticides and fertilisers and water disposal problems all have potential negative effects on the fragile coastal environment of the islands.

The heavy use of the Caribbean Sea by maritime traffic increases pollution levels and negatively affects the vital assets of the islands. The transportation of nuclear waste through the Caribbean is another fact of life, which is worrisome and poses even greater danger to the well-being of the islands and their people. The islands of the Caribbean are located in the hurricane belt and are prone to hurricanes which put at risk, on a yearly basis, the economic and social infrastructure of the islands. In addition to the loss of income and employment scarce resources have to be devoted to the reconstruction of the economies with negative implications for the fiscal and balance of payments accounts of the countries.

The limited human and financial resources and the weak institutional capacity of the countries negatively affect their economic and social performance in terms of increased costs of production. The overstretched public services affect negatively both the domestic management of the countries and their relations with the outside world. These negative effects include the difficulties faced by small countries to participate effectively in the numerous international negotiations which will determine the future rules and regulations governing trade and investment. The increase in criminal activities related to the drug trade constitute another serious threat to the future of the region.

B. Main characteristics of Caribbean trade

Manufactured products constitute the main component of Caribbean exports, however, the high share of manufactures is biased by the exports of the larger countries such as the Dominican Republic, Jamaica and Trinidad and Tobago. The share of manufactures in the exports of the Dominican Republic and Jamaica have been boosted by the operations of export processing zones established under the preferences granted under the United States customs codes 806/807. Exports of manufactured products constitute a small part of the exports of the smaller OECS countries, which are still largely dependent on the exports of agricultural products, such as bananas and sugar. The

exports of ores and non-ferrous metals and oil constitute a significant share of the exports of a number of countries, including Jamaica, Guyana and Suriname for bauxite and Trinidad and Tobago for oil. The services sector, mainly tourism, has been expanding rapidly in the subregion and constitutes a major export in many countries such as those of the OECS, Jamaica and Barbados. Other services of increasing importance in the subregion include financial services and informatics.

The destinations of Caribbean exports are mainly the European Union for the smaller countries of the OECS and Suriname and the United States for the other countries. These exports benefit from preferential treatment in the markets of the United States through the CBI and the market of the European Union through the EU/ACP Cotonou Convention. In addition Caribbean countries' exports also benefit from preferential treatment in the Canadian markets through CARIBCAN. There have been recent increases in exports with Latin America but the share of exports going to these countries remain relatively small. The bulk of the imports of the Caribbean comes primarily from the United States and the European Union although there are efforts to increase imports from the neighbouring Latin American countries¹⁰.

At the beginning of the new century Caribbean exports continue to be highly concentrated in a narrow range of products and markets. The trends in international trade indicate that the demand for basic commodities, such as those exported by Caribbean countries, except oil, is in decline. These are generally considered to be the least dynamic component of international trade and their real prices have been on the decline for years and are unlikely to recover. There is therefore an urgent need to accelerate the reorientation of the production of exports towards the more dynamic components of international trade, such as manufactures and services.

Import substitution policies have not been successful in the Caribbean as they have not led to the desired rates of growth, mainly because the economic expansion in the countries was constrained by chronic shortages of foreign exchange. Caribbean exports earnings have been relatively volatile and have not generally been responsive to the changes in demand in the exports markets. The traditional agricultural exports of the subregion have survived mainly because of the preferences offered to them in the developed countries' markets.

III. OUTLINE OF A STRATEGY FOR THE NEGOTIATION OF SPECIAL AND DIFFERENTIAL TREATMENT IN THE FTAA

The need to give a high priority to the development of stronger capacity in research and negotiations of trade issues cannot be overemphasised in the period leading to the establishment of the FTAA and beyond. This will require the allocation of both financial and human resources to national and subregional institutions. At the subregional level, the Regional Negotiating Machinery (RNM) is the beginning of the development of this capacity in the area of trade. However, it needs to be strengthened

¹⁰ See LC/CAR/G.592 "Recent Trade Performance of Caribbean Countries" ECLAC/CDCC, 30 December 1999

substantially and needs to be financed from domestic resources so as to ensure that it is shielded from any outside influence, and will work exclusively in the interests of the subregion which are more often than not different from those of the donor countries and agencies.

The strengthening of the negotiating capacity of Caribbean countries can work against donor countries' interests since the same donor countries will be negotiating in the FTAA with the countries which they have been assisting. Extreme care is therefore required in this regard and domestic financing and domestic ownership should always be considered to be the better option. The suggested research effort should focus, in particular, on the issues being negotiated in the FTAA and on the built-in agenda of the WTO. New issues, such as government procurement, competition policy and investment, which are under negotiations in the FTAA and not in WTO should also be carefully examined. In all cases, analytical studies should be undertaken to inform the approach to the negotiations by Caribbean countries.

In the area of market access, tariffs and other barriers to trade are still relatively high in both the Caribbean and some of the markets of destination of their exports. Further liberalisation in both markets should be beneficial to all the countries involved. Although Caribbean countries benefit from preferential treatment with regard to such products as agriculture, textiles and apparel, leather goods and footwear¹¹ etc., these will be constantly eroded because of Most Favoured Nation (MFN) liberalisation, the multiplication of preferential agreements and the implementation of the WTO agreement on textiles and clothing. Although it would appear that it is in the short-term interest of the Caribbean not to press for the liberalisation of these sectors, in the long run it would be desirable to make the preferential access more permanent through negotiated reciprocal concessions. The main reason being that these are relatively simple industries where the countries of the Caribbean could easily develop some competitive advantage.

The offer of the lowering of tariffs which are still relatively high within a period of six years could be exchanged against the lowering of tariffs in the countries of destination of their exports. Tariff peaks and tariff escalation should be part of the negotiations of this market opening. The market access negotiations are better conducted in alliance with other smaller countries or countries with similar interests, so as to have more leverage in offering access to a larger overall market to the other side. The fiscal reforms which have been undertaken in many countries with a view to reducing their dependency on trade taxes should be intensified and taken into consideration in the market access negotiations of the FTAA and their subsequent implementation.

Agriculture is another area where tariffs and subsidies are high and where preferential treatment confers a relatively big advantage to the Caribbean, at least for some commodities such as bananas, sugar and rice. They also benefit from the subsidised commodities, mainly foods which they import. In the long run, however, it would be desirable to seek increased market access in agricultural goods, decreased subsidies and

¹¹ The reduction of tariffs on these goods was substantially lower than the average tariff reduction on other goods in the Uruguay Round.

domestic support. In exchange, offers of liberalisation should be made but with a clearly defined transitional period of say 10 years negotiated as a special and differential treatment in this area, so as to make agricultural production more efficient or establish efficient production of new crops. Countries such as those which are members of the Cairns Group,¹² which are keen on agricultural liberalisation could be persuaded to support transitional arrangements for the Caribbean countries in exchange for a more determined push for further agricultural liberalisation.

Closely related to market access are the issues of technical barriers to trade and sanitary and phytosanitary measures. The countries of the subregion need to achieve two basic objectives with regard to these issues. The first is the need to build capacity in order to be able to comply with the requirements of the export market and the second is to develop a domestic system to ensure that imports comply with local standards and sanitary and phytosanitary requirements. A transitional period should be sought for the development and implementation of standards and SPS systems and technical assistance should be sought to assist in building the necessary capacity. The transitional period should be defined based on specific technical assistance activities in these fields for which finance has been secured.

In the area of services, the issue of recognition of qualifications should be of paramount importance to the Caribbean and the negotiations should include the recognition of educational achievement, experience obtained and licenses or certificates granted. This will be especially helpful for trade in services which is important for some of the countries of the subregion. A major impediment to trade in services from the smaller countries' point of view is the restriction on the movement of natural persons and access to technology and distribution networks. These should be addressed in the FTAA negotiations with the objective of easing the existing restrictions in the more developed countries of the hemisphere immediately after the coming into effect of the FTAA.

At the same time Caribbean countries should commit themselves to the implementation of a programme for the dismantling of the same restrictions within a period of five years, starting with the easing of these restrictions within CARICOM which more likely than not will bring immediate efficiency benefits to the countries. With regard to government procurement, all the issues being discussed in the working group on this subject at the WTO should be considered carefully. These include information on national legislation, prior information on procurement opportunities, tendering and qualifications requirements, conditions for fairness, accountability and integrity in evaluation procedures and surveillance and enforcement mechanisms. This is a new area which needs further study.

The negotiations should focus on the balance of the producers and users of technology in the area of intellectual property rights. Although the issue is mentioned in the relevant agreement of the WTO, which is presently being reviewed, the aspects related to the rights of the users are not developed enough. Efforts should be made to ensure that the rights of the users are given greater attention and may ask for a reduction

¹² The Cairns Group members in the Western Hemisphere are: Argentina, Brazil, Canada, Chile, Colombia and Uruguay.

of the duration of the protection of patents, the non patentability of known products, affordability of technology and its transfer. In addition, given the experience with the intellectual property rights agreement of the WTO, Caribbean countries should negotiate a longer period of implementation defined on the basis of the actual delivery of technical assistance for which finance has been secured to build the necessary capacity in this area.

With regard to the dispute settlement negotiations and drawing from the experience of the WTO dispute settlement mechanism, some flexibility should be introduced into the system for smaller countries such as those of the Caribbean. This is especially relevant for the implementation of panel decisions. The banana dispute is a case in point and, as noted by Professor Bhagwati, the strict timetables can sometimes result in substantial shock therapy imposed by legal means on third countries which cannot cope with rapid and substantial adjustment costs.

The dispute involved the United States and the EU but the countries which must bear the adjustment are the small island countries of the OECS. Professor Bhagwati goes on to suggest that the adjustment period (implementation period) must reflect the economic problems resulting from the finding and that the problems may be outside the economies of the parties directly involved in the dispute. The timetable should therefore be dictated by economic rather than legal considerations. It may also be useful to negotiate the establishment of a mechanism to provide assistance to cushion the transitional costs and offset the loss of real income¹³.

Another important issue is the access to the dispute settlement mechanism, which is an issue of great importance to the small Caribbean economies. The countries do not generally have the in-house expertise to be able to effectively participate in complex litigation related to trade issues. A suitable mechanism, including the provision of resources for technical assistance and training, needs to be put in place in the FTAA so as to allow smaller economies equal access to the dispute settlement mechanism to be put into place. The countries would however need to work in the meantime towards the creation of local expertise to ensure their effective participation in dispute settlement in the free trade area.

In the area of investment, the smaller countries of the Caribbean may want to give greater importance to the foreign direct investment instead of financial capital flows in general. Foreign direct investment is a crucial source of capital technology and management skills, which are all essential to the building of indigenous industries which can generate employment, revenue and foreign exchange earnings. In the meantime countries should strengthen their banking and financial systems so that they could better benefit from other financial flows and minimise the risks of banking crises.

Another issue to which countries of the subregion need to pay careful attention is the issue of antidumping. The use of this trade remedy has intensified greatly over recent

¹³ See Bhagwati, J (1999) "Some comments from an economic perspective on the dispute settlement mechanism" Note distributed at the Conference on the Next Negotiations Round: Examining the agenda for Seattle", Columbia University, 22-23 July.

years - a trend which is likely to continue with a majority of cases brought by developed countries against developing countries¹⁴. The complexities of the remedy and the cost of compliance with the required investigation are onerous for very small firms of the smaller economies which are generally engaged in export business. Two objectives should be sought in the negotiations of this issue, the first is to seek higher thresholds of exemptions than those allowed under the WTO and then simplify the procedures with the small firms in mind so as to allow them to be able to defend their interests.

In the area of subsidies, the smaller Caribbean countries should be aware that subsidies of production and exports tend to create a difference between domestic prices and world prices and shelter domestic firms from the trends of world prices and competition. They therefore tend to encourage inefficiency because they remove any incentive to improve the competitiveness of the products concerned. They are also costly to the countries' budget and ought to be kept to a minimum even though they can, in some instances, capture positive externalities in foreign markets i.e. subsidies of export promotion may make foreign buyers more aware of a country's exports and the returns from these subsidies may accrue to other exporters from the country. In countries where exchange rates are overvalued, subsidies can simulate devaluation and help correct the existing anti export bias in the country. Subsidies together with other incentives should generally be fairly uniform for the production of both export and import substituting goods.

With regard to the proposals for the inclusion of labour and environmental standards in the FTAA, the Caribbean should favour a treatment of these issues similar to that given to them in the WTO. The inclusion of these issues in the final FTAA agreement could pose a serious threat to the trade liberalisation and market access which the agreement seeks to achieve. The imposition of environmental and labour standards similar to those obtaining in developed countries would more likely than not be detrimental to the interest of the small Caribbean countries, since it will probably increase their costs of production and put added pressure on the competitiveness of their export products.

Technical assistance constitutes a crucial element for the smaller economies to support their efforts to adjust and transform their economies so as to allow them to participate effectively in the FTAA. Trade and trade policies play an important role in the development process of the countries. This is especially true for those countries where trade constitutes a high percentage of GDP, as is the case in many Caribbean countries. However many other factors are also important and it is the interaction of these factors with trade that determines the pace and pattern of development. The country's size, its natural resources, its infrastructure, its human resources and technological capabilities, its institutions, its fiscal, monetary and exchange rate policies, among others, are all crucial for the development process.

The proposed liberalisation of trade and investment in the FTAA seeks to provide opportunities for the participating countries to enhance their social and economic

¹⁴ According to the WTO Annual Report (1997) 143 antidumping cases were initiated against developing countries out of a total of 239 initiated during the year.

development through the benefits which could be derived from the free movement of goods, services and capital. However weaknesses in these countries' capacity constitute an obstacle to their ability to participate fully and benefit from the proposed free trade area. Technical assistance is clearly essential to complement these countries' own programmes aimed at increasing their capacity to take advantage of the opportunities offered by the FTAA. Technical assistance should focus on building the smaller Caribbean countries' capacity to implement the agreements and strengthen their ability to take advantage of the opportunities offered by membership in the free trade area.

Technical assistance needs to be turned into concrete projects with financing for specific activities over a limited time period to address the core issues subject of the agreed differential treatment such as capacity building, transfer of technology, technical barriers to trade, sanitary and phytosanitary measures, intellectual property rights, etc.. For technical assistance to have a reasonable chance of succeeding in stimulating trade development in the FTAA and responding to the concerns of the smaller Caribbean economies, it must be oriented towards the solving of specific and clearly defined problems focusing not only on trade negotiations and reforms but also on issues related to infrastructure, human capital development and institutional strengthening.

A specific structure, which could take the form of a technical assistance group, should be established within the FTAA process. The role of the group would mainly be to ensure that the technical assistance needs of the smaller countries are covered and that the projects elaborated to address these needs are adequately financed and efficiently implemented to correct the deficiencies identified in the capacity of the smaller economies to participate effectively in the free trade area.

VI. CONCLUSION

Although preferences have been of significant importance in the generation of exports, revenues and employment in the Caribbean, especially in the banana producing countries of the OECS, they have already been eroded significantly and are likely to be further eroded with the continuation of trade liberalisation policies around the world. With regard to the preferences offered to Caribbean trade with the Western Hemisphere, the establishment of the FTAA will certainly lessen the importance of these preferences or even render them irrelevant.

Special and differential treatment in the FTAA should not be used as special and differential treatment has been used in the past mainly as a permanent device to delay the implementation of needed reforms and the continuation of protection and financial support for inefficient industries. The promotion of competitiveness should accelerate instead of slowing down to take full advantage of the temporary nature of the preferences.

The adjustment necessary for membership of the FTAA and the competition this will lead to in the markets of the Americas will be significant and will require a substantial transformation of the production structures of the economies supported by

trade and economic reforms. The focus of the small Caribbean economies should therefore be on undertaking the necessary domestic reform and transformation process and seeking external support to that process to be able to participate effectively and benefit from their membership of the FTAA. The process of transformation and adjustment supported by external assistance will have to address the vulnerabilities of the countries reviewed briefly earlier in this paper.

The efforts by the countries of the Caribbean subregion need to be complemented by a wide-ranging programme of technical assistance for which a special structure should be established within the FTAA process with the specific objective of ensuring the actual delivery of technical assistance to the countries and their subregional institutions.

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