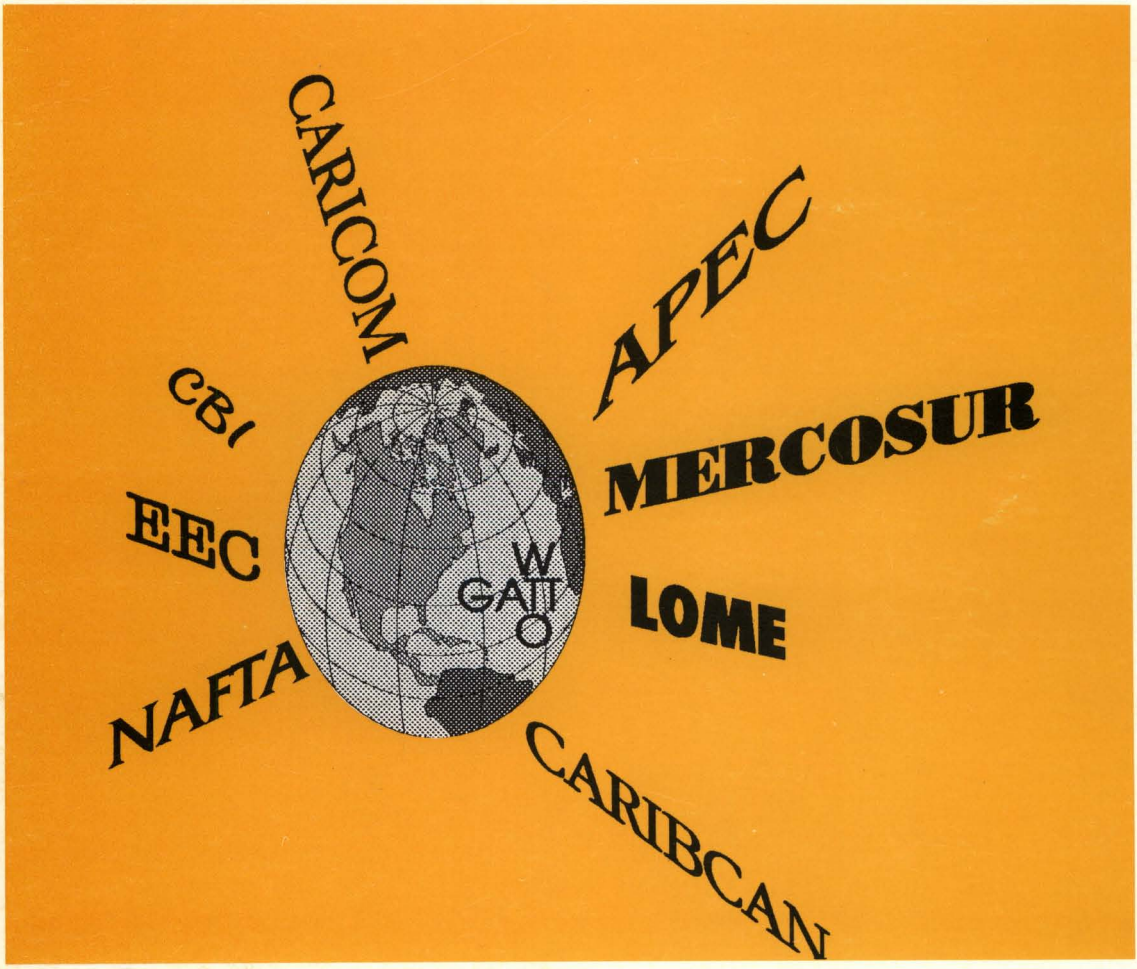
Ninth ADLITH BROWN Memorial Lecture

The Caribbean Caught in the Crosscurrents of Globalization and Regionalism

Richard L. Bernal



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RICHARD L. BERNAL

REGIONAL PROGRAMME OF MONETARY STUDIES
INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH
UNIVERSITY OF THE WEST INDIES
INSTITUTE OF DEVELOPMENT STUDIES
UNIVERSITY OF GUYANA

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THE LATE DR. ADLITH BROWN

The Adlith Brown Memorial Lecture honours the memory of Dr. Adlith Brown, co-ordinator of the Regional Programme of Monetary Studies from 1980 to 1984.

Although born in Jamaica, she could truly have been described as a Caribbean woman. Her sense of regionalism was nurtured on the Mona campus of the University of the West Indies where she did her undergraduate work for the B.Sc. (Economics) offered by the University. She subsequently completed her Masters (with distinction) as well as her doctorate degrees from McGill University.

Adlith returned to teach at the University (St. Augustine campus) in 1969 and in 1971 was transferred to the Mona campus where she taught Monetary Economics Research in 1976 and was one of the main anchors of its research programmes. She co-ordinated first the Caribbean Public Enterprise Project and from 1980 the Regional Programme of Monetary Studies. In this period she was also promoted to Senior Research Fellow and in 1982 to the position of Acting Deputy Director, which she held up to her death. These latter years demonstrated most her capacity for intellectual leadership and for creative management.

Adlith revelled in the realm of ideas. It is therefore understandable that she was fast developing a reputation of being an outstanding economic theorist as her writings attest. Indeed, she was an ideal person to co-ordinate the Regional Programme of Monetary Studies, given her passion for regionalism, her intellectual standing and her understanding of the process and problems of policy-making with which her colleagues in the central banks had to cope.

Each year the Open Lecture at the conference of the Regional Programme of Monetary Studies is sponsored by Caribbean central banks and designated the Adlith Brown Memorial Lecture.

HIS EXCELLENCY DR. RICHARD L. BERNAL
AMBASSADOR of JAMAICA to the United States
Permanent Representative to the
Organization Of American States

Dr. Richard L. Bernal, an Economist (B.Sc., M.A., Ph.D.), Banker, University Lecturer, and Diplomat, has been Jamaica's Ambassador to the United States of America and Permanent Representative to the Organization of American States since May 6, 1991. Prior to his present assignment, he was Chief Executive of a commercial bank. He is also a former member of the Regional Programme of Monetary Studies.

Ambassador Bernal has served the Government of Jamaica in various capacities in the Central Bank, the Planning Institute of Jamaica and the Ministry of Finance. He has played an important role in the formulation and implementation of policies regarding Jamaica's debt management, structural adjustment, and economic reform. Dr. Bernal has worked extensively on trade and debt issues of developing countries with an emphasis on Latin America and the Caribbean.

Dr. Bernal has been Chairman of the Organization of American States' Working Group on the Enterprise for the Americas Initiative and the Preparatory Group of the Special Trade Committee.

Ambassador Bernal has been a lead participant in several negotiations on Jamaica's behalf. These include, Debt Reduction Agreements, a Bilateral Framework Agreement between CARICOM and the USA; US/Jamaica Bilateral Investment Treaty, US/Jamaica Intellectual Property Rights Agreement; and loans from multilateral financial institutions (IMF, World Bank, IADB) and the US government on programme and project financing for Jamaica.

Ambassador Bernal is the author of numerous policy studies for the Government of Jamaica and papers on economic issues for scholarly publications, including the debt problem, economic adjustment in developing countries, regional integration, US/Caribbean relations, foreign policy and trade policy. Dr. Bernal has published over sixty articles in scholarly journals, books, and monographs. He has also published numerous articles in business and financial periodicals and newspapers, including opinion editorials in the Washington Post and Journal of Commerce.

INTRODUCTION

The Caribbean is being confronted with profound changes in the world economy, which have serious implications, some of which are adverse, and which will require adjustment of a fundamental nature.

The most prominent changes are "globalization" and "regionalism", which are interrelated but in some respects contradictory. They are interrelated because regionalism in the form of regional trade blocs is a transition from a world economy of nation states to a truly globalized world economy in which national economies have given way to trans-national economic processes. However, regional trade blocs, while potentially creating the basis for globalization also have characteristics which could delay this inevitable process.

The dilemma of the Caribbean economies is that both these processes are accompanied by the erosion of preferential trade arrangements for developing countries compelling them to participate in international trade on the basis of reciprocity. Given the traditional dependence of Caribbean economies on preferential trade this transition to reciprocity will require, not merely structural adjustment but also structural transformation in a relatively short period. The process will require strategic global repositioning, which, in the short run, can be facilitated by complementing internal economic reform with simultaneous participation in several trade blocs.

I. TRENDS IN THE GLOBAL ECONOMY

The major trends in the global economy are globalization and regionalism as manifested in the form of regional trade blocs.

1. GLOBALIZATION

In recent years, international trade and capital flows have grown at a faster rate than world Gross Domestic Product (GDP). This reflects the progressive globalization of production and finance, which is pressuring governments to minimize, harmonize, or eliminate national barriers (e.g., tariffs, quotas, exchange controls) to the international movement of goods, services, capital, and finance. The driving force impelling globalization is transnational corporate integration through mergers, strategic corporate alliances, and take-overs. Efficiency in resource allocation and profit maximization, on a global scale, cannot be attained within a world economy fractured into national economies whose policies constrain the degrees of freedom. Transnational corporate integration

impels multi-country market integration, initially in a regional context, both as ex-post economic rationalization and as a defence by the nation-state against the inevitable relinquishing of the vestiges of economic sovereignty.

Progressive globalization of production and finance is rapidly sweeping away national barriers to the movement of goods, services, capital, and finance. This is evident in the fact that, in recent years, international trade has grown at a faster rate than world GDP. The speed and extent of the flow of goods, services, capital and finance throughout the global economy require a degree of freedom which national impediments do not allow. These fundamental economic developments constitute the impetus for the dismantling of national barriers and the movement to regional groups which provide a common market for capital and goods. Regional integration, which is not limited to trade liberalization within a customs union is designed to defend against marginalization from the global economic process and to create or enhance participation in the global economy. The formation or emergence of trade blocs as a transitional mechanism accommodates the needs of globalization and facilitates concentration of economic activities. Other motivations for regional economic integration include countering exclusion from trade blocs and an attempt by countries to give their private sectors the benefits and stimulus of larger economic spaces.

The institutional dimension of this global integration is reflected in corporate mergers, which transnationalize ownership and require multi-country market integration. Global corporate integration is one of the driving forces of regional economic integration because it is a step towards the minimizing of differences arising from national variations in monetary policy, taxation, and regulatory regimes.

2. REGIONAL TRADE BLOCS

The world economy is experiencing a renewed emergence and consolidation of trade blocs. Trade blocs are not a new phenomenon. The history of international trade is replete with examples of eras in which trade blocs dominated the international trading system. While there are examples in antiquity, it was during the mercantilist era from the 17th to the mid-19th century that the membership of countries in trade blocs was most comprehensive. The dissolution of the Spanish, Dutch, and Portuguese colonial empires in the 19th century, together with the emergence of the free trade economics of Adam Smith and David Ricardo led to the wane of mercantilist trade doctrines. Great Britain's economic superiority, following the Industrial Revolution, enabled it to propagate free trade ideas of which Britain became the principal beneficiary.

British global hegemony, however, was replaced by that of the United States and free trade within the multilateral framework of the General Agreement on Tariffs and Trade (GATT) became the order of the day. Although the United States was the main proponent of free trade and the progressive liberalization of the multilateral trading system in the post-World War II period, its policy, in recent years, has become increasingly susceptible to protectionist pleas from domestic sectors that find it difficult to compete with imports.

The transition to a world market is taking place by way of national economies merging and amalgamating into trade blocs. Trade blocs are created by (a) deliberate policies of integration among groups of like-minded Governments or (b) by market-induced concentration of trade and investment among countries, often creating a commonality of economic interest. The deepening of the integration process in the European Economic Community (EEC) and the conclusion of the North American Free Trade Agreement (NAFTA), are manifestations of this trend. The formalization of the EEC as a common market added impetus to the nascent trend toward the emergence of economic blocs by setting in motion a defensive, reactive response to counter this development by forming a rival bloc. This trend toward regionalism could lead to a global economy compartmentalized into regional trade blocs consisting of 1. Europe, 2. North America, 3. Asia and 4. Latin America and the Caribbean.

1. Europe

In January, 1994, the EEC was enlarged to form an European Economic Area which has a market of 372 million and an aggregate GDP of US$6.6 trillion. The European Union (EU), as it is now called, consists of 12 industrialized western countries namely Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Spain, and the United Kingdom. This regional trade bloc comprises the world's largest trading entity and is responsible for absorbing over 25% of total US exports of goods and services, as well as approximately 43% of total US direct foreign investment. The implementation of the single market by the EU in 1992 has created a more cohesive market through the breaking down of internal barriers to trade. This is an important shift in the development of regional trading blocs. Although it would appear easier to believe that the establishment of the single market would have resulted in increased barriers to trade, the converse is actually true. The removal of internal barriers has not only allowed for increased access for the EU's trading partners, but also has fostered a more efficient allocation of investment among the member states thereby improving their competitiveness.

NAFTA, encompassing Mexico, Canada, and the United States, came into effect on January 1, 1994. The NAFTA countries constitute a market of 363 million people and has a combined GNP of $6.5 billion. A Western Hemisphere Free Trade area could potentially develop out of NAFTA, which would have a combined GDP of US$6.8 trillion and a market of 719 million. NAFTA will create approximately 180,000 more jobs in the US alone, and increased US merchandise exports to Mexico will generate an additional 200,000 jobs as a result of the agreement. It is the most comprehensive free trade agreement which has ever been negotiated between regional trading partners outside the Communist bloc. NAFTA incorporates and supersedes the Canada-US Free Trade Agreement and provides for preferential treatment among the member countries of the North American continent.

NAFTA will place in motion the phased elimination of virtually all non-tariff barriers by the year 2003. Additionally, the agreement will establish rules in areas such as intellectual property rights, services, and government procurement. Overall, NAFTA broadens and deepens the market access benefits and protection already enjoyed under GATT, particularly as they pertain to international trade. In a sense NAFTA eliminates tariffs and virtually all quantitative restrictions. In addition, it establishes rules to end discrimination to trade through rules for government procurement, investment, and business services. These market access and investment provisions are much more liberalizing than those found in the Canada-US Free Trade Agreement.

In order to ensure compliance with the provisions of NAFTA the parties agreed to establish time tables for eliminating most remaining restrictions on foreign investment implemented by Mexico in 1973. Another important requirement of the NAFTA is the modernization of Mexico's legal framework, which includes agreements to establish more modern regimes to govern intellectual property rights.

The side agreements which the United States, Canada, and Mexico agreed to implement cover areas such as environment, workplace safety, and labour laws. These agreements will be enforced through various cooperation councils which will determine whether a country is failing to enforce its environment, workplace safety, or labour laws in the production of a traded good, prescribe remedial action and impose fines and tariffs if the recommended action is not taken.

3. Asia

Although not well recognized, regional arrangements in economic, security, political, and other areas are firmly established and quite advanced in Asia. A free trade zone or arrangement linking the countries of South East Asia or a grouping which includes Japan is a distinct possibility. In October 1992, the member countries of the Association of South East Asian Nations (ASEAN) formally announced their intention to form an Asian Free Trade Area (AFTA) with the objective of creating a single market in 15 years. The Muslim countries of Asia formed the Economic Cooperation Organization in November 1992 and there is a proposal for an Islamic free-trade area. An Asian Economic Group consisting of Japan, and the ASEAN countries (Indonesia, Malaysia, the Philippines, South Korea, Hong Kong and Taiwan) would encompass 33.9 per cent of the exports of these countries. Japan and the newly industrialized countries of East Asia have a combined GDP of US$3.2 trillion and a population of 199 million.

APEC

The Asia Pacific Economic Forum is made up of 17 countries including the six ASEAN countries, Korea, Mexico, Taiwan, The Peoples Republic of China and Hong Kong. These countries together grew at an average of 6.8 per cent annually and constitute 25 per cent of worldwide GDP as compared to only 8 per cent three decades ago. The major guiding principle for the Asia Pacific region has been the concept of "open regionalism". Several regional arrangements including NAFTA, AFTA and the Australia-New Zealand Closer Economic Relations Agreement (CER) coexist with APEC. The coexistence of these regional trading arrangements within a single region illustrates the fact that regional trading blocs need not be perceived as the antithesis to the overall globalization of trade. APEC provides an arena which allows for trade and investment cooperation among member countries. It has resulted in a growing cohesion of economic activities, integration of economic policies among private sectors, and extensive cooperation among trade and investment officials.

ASEAN

The Association of Southeast Asian Nations consists of Indonesia, Malaysia, the Philippines, Singapore, Thailand and Brunei which have a combined GDP of over $345 billion. The ASEAN countries have shown dramatic growth over the past 10 years, recording annual growth levels of up to 7 per cent. As a further

step towards economic integration, the members agreed to establish the Asian Free Trade Area (AFTA). Under this agreement, tariff rates on imports of certain goods will be reduced among member countries to 5 per cent or less over a 15 year time period.

AFTA is expected to strengthen regional economic cooperation through increased trade,facilitated by the lowering of tariffs.

CER

In an attempt to enhance and expand trade between their two countries, Australia and New Zealand established the Closer Economic Relations Trade Agreement (CER) in 1983. CER has abolished all border restrictions on trade in goods, including tariffs, quantitative restrictions, import and export prohibitions, export incentives, and export restrictions. Since the implementation of the CER agreement, trade between the two countries has grown at an average rate of 14 per cent annually and total bilateral investment has grown from $A1,500 million to $A10,000 million.

4. Latin America and the Caribbean

There has been a resurgence of interest in regional trade liberalization, integration, and cooperation in the Caribbean and Latin America. This resurgence of interest in regional trade arrangements and regional integration has been influenced by the need for a response to the formation of trade blocs in a "regionalized" world economy. Regional integration is viewed as a potent response because of the strengthening of bargaining power and the coordination of external policies.

a) MERCOSUR

Argentina and Brazil have sought to liberalize their trade periodically since the late 1930s, most recently, between 1985 and 1989. On March 26, 1991, Argentina, Brazil, Paraguay, and Uruguay signed the Treaty of Asuncion which establishes a South American Quadripartite Common Market (MERCOSUR) by December 1995. These countries already have reduced tariffs on trade among themselves and are discussing the establishment of a common external tariff. Trade within MERCOSUR had grown 44%, from U.S. $6 billion in 1988 to US$10.5 billion in 1991. The MERCOSUR countries account for an estimated 35% of intra-Latin American trade. Trade among these countries increased from nearly $1.9 billion in 1990 to over $3 billion in 1991. MERCOSUR, when it is fully implemented, will create an internal market of over 193 million people, with a combined GDP

of approximately $445 billion and an average per capita GDP of nearly $2300. The maximum rate of the common external tariff being negotiated by the MERCOSUR countries is expected to be 20% with certain exceptions on duty reductions which may be phased in over several years. Additionally, the MERCOSUR countries are in the process of developing a common MERCOSUR policy with regard to the implementation of certain integration measures such as the free movement of the factors of production between member states, the coordination of macro-economic and sectoral policies, and the harmonization of legislation in specified areas.

b) Central American Common Market

The Central American Common Market (CACM), which was created in 1961, includes Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. Panama holds observer status in this organization due to its geographic proximity and the integration process as a whole. Work towards regional integration in Central America commenced as early as 1951 and the Central American Common Market (CACM) was established soon thereafter. By 1969, nearly all trade within CACM had been granted duty-free status. However, CACM declined during the 1970s because of economic, political and ideological differences among the governments, and today continues to face such problems.

In 1992, the value of intra-regional exports was 40% below the 1980 level. The resuscitation of intra-regional trade has been delayed by the uneven pace of adjustment among the member countries. In July 1991, the CACM countries agreed to re-energize the common market. In addition, El Salvador, Guatemala and Honduras have signed an agreement to establish a free trade zone. The CACM, including Panama, will create an internal market of over 29 million people, a combined GDP of over $30 billion, and an average per capita GDP of approximately $1,000. The eventual creation of a common market in Central America would allow countries outside the region to treat all members of CACM as a single market. Thus far, several of the Central American nations have jointly implemented measures to liberalize and harmonize their trade regime under CACM. The common external tariffs range from 5 per cent to 20 per cent on products of non-CACM origin.

c) Andean Common Market

The Andean Common Market, established in 1969, includes as members, Peru, Bolivia, Venezuela, Columbia and Ecuador. The Andean Common Market has not functioned as well as anticipated, partly because of the varied economic

policies of member countries. Since May 1991, the members have implemented a number of measures to eliminate restrictions and to standardize various regulations, including an effort to reduce external tariffs to between 5 per cent and 20 per cent. Within the framework of the Andean Group, Columbia and Venezuela signed a partial free trade agreement covering 6,000 goods, which came into effect on February 6, 1992. The Andean group has pledged to establish a common agricultural policy and to harmonize exchange and fiscal policies.

The Andean Pact countries jointly represent an internal market of over 94 million people, a combined GDP (in 1991) of over $160 billion, and an average per capita GDP of approximately $1,800. Under the auspices of the Pact the Andean countries have undertaken a significant process of trade liberalization and investment enhancement. Free trade in a number of products has been instituted among Andean countries since the early 1980s, with both Colombia and Venezuela having implemented a bilateral Free Trade Area (FTA) effective since January 1, 1992. In addition to this development, Colombia and Venezuela are presently concluding negotiations with Mexico for a trilateral free trade area.

The countries of the Andean Pact have registered an increase in intra-regional trade from $1.8 billion in 1991 to $2.2 billion in 1992. A common external tariff is currently being negotiated among these countries, but has not yet been implemented. It proposes to subject non-Andean products to *ad valorem* duties of 5 per cent for raw materials, 10 to 15 per cent for intermediate goods, and 20 per cent for finished goods. Each Andean country will maintain some exception to its tariff schedule. The development of a free trade area with a common external tariff which would include all five members will not only improve terms of access for exporters through the facilitation of commercial transactions but also will significantly expand sales opportunities throughout the region.

d) CARICOM

The Caribbean Common Market (CARICOM) was established in 1973 to supersede the Caribbean Free Trade Area (CARIFTA) and includes the following countries: Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago. CARICOM has a combined GDP of over $13 billion and an average per capita GDP of approximately $1,800. In 1992, member states agreed to reform and implement the Common External Tariff (CET), which would include a reduction of maximum rates on non-agricultural tariffs to 20 per cent and on agricultural products at 40 per cent over a six year period. A fully implemented common market would enhance significantly the

market potential of countries in the CARICOM trading bloc and therefore should be pursued expeditiously.

II. COMPATIBILITY OF REGIONAL TRADE BLOCS AND MULTILATERALISM

Trade blocs are by definition, not harmful to the world economy. Indeed, it is estimated that if the European Community and North America both liberalized trade instead of embracing protectionism, world income would rise by over $600 billion.

1. Institutional Framework of Multilateralism

GATT is the main vehicle for advancing and promoting international trade liberalization. In this scenario, the World Trade Organization (WTO) would be the institutional and regulatory framework for international economic transactions. The difficulties experienced in completing the negotiations of the Uruguay Round of GATT reflect the decline of U.S. hegemony and the existence of a multi-polar global economy. Without GATT and the WTO there could be a proliferation of bilateral trade arrangements and intensification of the tendency to form various regional trade blocs. Regionalism potentially could result in an escalation of protectionism against exports from other blocs and non-member countries.

The process of establishing an updated, expanded GATT and WTO could be jeopardized by the failure of the U.S. Congress to ratify the final draft act of the Uruguay Round. The main impediment is the need to raise betweem $10 and $14 billion over the next five years and perhaps as much as $40 billion over the next decade to compensate for the revenue lost by the tariff cuts required by the Uruguay Round Agreement. Budget rules require this to be achieved by expenditure reduction or increased taxes. The alternative is a congressional waiver to be granted on the grounds that the US would raise more revenue through increased trade than it would lose by the tariff cuts. A waiver must be authorized by 60 votes in the Senate and a majority in the House. Attaining the requisite number of votes could be a formidable task.

2. Multilateralism and Regionalism

While Europe throughout its modern history has operated trade blocs, the United States traditionally has opposed regional economic arrangements if they were perceived as excluding or diminishing its exports, or making market access

more difficult through protectionism. This was the case with regard to Latin America in the 1950s and early 1960s. Proposals prior to 1945 for the creation of a European union were considered to be "detrimental" to U.S. interests and were viewed with suspicion. However, in the aftermath of World War II the United States vigorously supported Western European economic cooperation and integration for a combination of economic, political, strategic, and security reasons. The trend continued into the latter part of the 1980s, when the United States became an advocate of regional trade starting with the Canada-US Free Trade Agreement. In 1990, NAFTA was proposed, reflecting the importance of markets in the hemisphere at a time when the U.S. economy had a large persistent trade deficit, and economic growth had become more dependent on exports. NAFTA coincided with the consolidation of the EEC, the apprehension over the outcome of the Uruguay Round of the GATT, and access to the Japanese market.

Many involved in the US trade policy-making process regarded the employment of bilateral and regional trade agreements as both a strong signal and a means of increasing leverage in securing liberalization and expanded coverage in the multilateral trade system. The Canada-US FTA provided a lever by indicating to the EEC and Japan, in particular, that the U.S. was prepared to pursue other avenues if the Uruguay Round of the GATT failed to improve liberalization. Advocates of "aggressive bilateralism" or "forceful unilateralism" justify the use of sanctions such as those provided in Super 301 to lower or dismantle protectionist barriers which hinder US exports in several countries, most notably in Japan or to deter or compensate for unfair practices that are not adequately regulated by GATT. MERCOSUR will propose a bloc-to-bloc trade accord with the European Union, which, if consummated, would be the first such agreement.

3. Trade Blocs and Protectionism

The United States traditionally has advocated and used its influence to promote free trade in multilateral trading systems, but since the mid-1970s has increased its willingness to "manage" trade by resorting to protectionism for selected endangered industries. Bhagwati has argued that "the overall ethos favorable to protectionism came from the national psychology produced by America's relative decline in the world", what he calls the "diminished giant syndrome". The justifications for protectionism include preventing the demise of strategic industries such as iron and steel, preserving the level of US wages from "cheap labor" imports, maintaining jobs such as textiles and apparel, as a sanction

against protectionist barriers to US exports, and as a bargaining chip to secure market opening. There is a growing acceptance that strategic and selective application of protection promotes exports, reduces trade deficits, and retards de-industrialization. Support for managed trade is regarded not as short-sighted protectionism, but as a practical, patriotic defense of the national interest.

The growth of protectionist sentiment is also linked to a growing recognition that free trade is an ideal that is desirable to approach, but from which the real world diverges to a growing extent each day. The argument that free trade is the best option was based on the Ricardian-Hecksher-Ohlin theory of comparative advantage, derived from very restrictive assumptions. The validity of the theory came increasingly in question as the reality of real world trade progressively invalidated the assumptions, underlying the theory. There is a growing recognition that in an environment of imperfect competition, free trade is not necessarily and automatically the best policy. Government policy to strengthen the competitive position of domestic producers in world markets may generate higher levels of national welfare than would result from free trade.

III. IMPLICATIONS FOR THE CARIBBEAN

A world economy compartmentalized into trade blocs creates an atmosphere for international economic relations in which negotiated reciprocity and trade-offs is the order of the day. This is rationalized by the philosophy that in the pursuit of the optimum of free trade, all countries are better off through negotiations at the multilateral, plurilateral, or bilateral levels. Corporate integration also adds pressure for the standardization of regulatory regimes throughout the world. There is less sympathy and tolerance in developed countries for preferential trade arrangements for developing countries or for exemptions or differentials in GATT. The result is either (a) a shift towards reciprocity, as is evident in the differences between the Caribbean Basin Initiative (CBI), and NAFTA and the approach to the Enterprise for the Americas Initiative (EAI) or (b) an expansion of preferences from a select group to a larger number of countries.

Associated with these trade liberalizing developments is a trend towards the expansion of the number of countries eligible for trade preferences both under the LOME Convention and the Caribbean Basin Initiative, thereby eroding existing trade preferences. Already the benefits of CBI have been extended to the Andean Pact countries. Similarly, NAFTA will provide benefits to Mexico

in terms of conditions of market access which supersede those granted to the CBI.

Given the structure of trade in the region, the impact of the NAFTA will be substantial. Fifty to seventy per cent of exports of CBI countries go to the United States, Canada and Mexico — the three NAFTA countries. Furthermore, the United States accounts for approximately 50% of CBI exports. With such a significant proportion of the region's trade taking place with the United States, and given the importance of trade to economic growth, there is justified concern about NAFTA. NAFTA could convert the CBI into a "depreciated asset". It would erode CBI provisions and thereby place the small, undiversified economies of CBI countries at a competitive disadvantage in terms of access to the US markets as it provides Mexico with removal of tariffs and quotas over specified adjustment periods. This would inadvertently create a situation in which Mexico, which already has inexpensive labor, cheap energy, lower transportation costs and economies of scale, now would have a further advantage over the CBI countries. Although Mexico does not compete with the CBI region in all of its exports, a relaxation of import barriers for Mexico could cause a reduction in many of the Caribbean's most valuable exports.

On a regional economic level, there could be an erosion of the economic gains of the past decade since NAFTA could cause the following: 1. trade diversion; 2. investment diversion; 3. relocation of production capacity; and 4. contraction of economic activity.

1. Trade Diversion

The elimination of quota and phase-out of tariffs on Mexican products could remove or at least reduce the advantage enjoyed by CBI exports to the United States. This could cause a diversion of U.S. demand from suppliers in CBI countries to firms in Mexico, thus reducing CBI exports and aggravating the balance of payments difficulties of Caribbean economies. There are two effects which will result from NAFTA both of which will divert trade away from Caribbean economies.

(a) The "competitive effect" will occur when Mexico receives duty-free and quota-free treatment for products which the CBI now export to the U.S. under those conditions. This means that products which now enjoy a preference over Mexico will, after a transition period, have to compete with Mexican products on the same terms and conditions of access to the U.S. market.

(b) There will be a "discrimination effect" as Mexico will, after product-specific transition of up to 10 years, be able to export to the U.S. free of quotas

and tariffs, while similar products from the Caribbean, which are excluded from the CBI (e.g., apparel) will continue to face both quotas and tariffs. This discriminates against CBI products by giving Mexico preferential treatment. One of the best examples of this potential for displacement is in the area of textiles. Under NAFTA, Mexican textiles and apparel will benefit from progressive tariff reduction over a ten-year period. This would introduce a new dimension of competition, creating a situation whereby CBI-produced garments made from U.S. textiles would have to compete at a price disadvantage against Mexican apparel made from Mexican textile. This would displace both CBI apparel producers and US textile manufacturers.

2. Investment Diversion

As trade prospects deteriorate with the reduction in relative trade advantages of the Caribbean, investors are likely to begin to redirect their funds to Mexico, thus slowing down investment. This diversion of investment, which is already evident from investment patterns throughout the region could slow investment. The ratio of direct foreign investment to gross domestic capital formation is almost 10% in some countries. This effect has already been documented as investors evaluate the provisions and implementation of NAFTA. The United States International Trade Commission (ITC), in a recent report concluded that "NAFTA will introduce incentives that will tend to favor apparel investment shifts from the CBI countries to Mexico".

3. Relocation Of Production Capacity

Existing productive enterprises, which were originally located in the Caribbean to take advantage of the access to the US market, could transfer or close operations in preference for Mexican locations, which have the advantage of better access to the US market. NAFTA discriminates in favor of Mexico against the CBI region.

4. Contraction Of Economic Activity

The loss of trade and investment opportunities would precipitate a decline in business confidence and economic activity, undermining development prospects throughout the Caribbean. Caribbean governments inevitably would find it more difficult to sustain their own economic reform and structural adjustment programs. Ultimately, a large number of jobs which depend on US-Caribbean trade would be lost and the loss of export opportunities would aggravate the present trade deficit of Caribbean economies.

IV. PARTICIPATION IN MULTIPLE TRADE PACTS

Growth in small, developing economies of the Caribbean will depend to a considerable extent on export expansion. This will be significantly influenced by access to markets, particularly those of industrialized countries, and participation in or access to trade blocs. Countries in the Caribbean must either join one of the large regional trade blocs or establish relationships which permit simultaneous access to as many blocs as possible. At present, Caribbean countries have preferential, non-reciprocal access to the EEC through the LOME Convention; to the United States through the CBI; and to Canada through CARIBCAN. These preferential trading arrangements all co-exist under Article 36 of the GATT Agreement, which recognizes the need for special and differential treatment of developing countries. But, it is quite likely that a future convention to succeed LOME could be based on reciprocity rather than preferential trade and could involve conditionality related to good governance, human rights, and democracy. Though consistent with GATT principles, such conditionalities surpass the present coverage of the GATT. Other elements of conditionality that could be included in a future convention, however, might go beyond the GATT.

The NAFTA, although embodying provisions on labour rights and the environment, is GATT-compatible because it is viewed as a free trade arrangement permissible under GATT Article 24. The NAFTA meets the Article 24 criteria because it covers substantially all trade and does not escalate protection against non-members. Therefore, Caribbean participation in NAFTA, LOME or future European conventions based on reciprocity would be compatible with GATT. Non-economic conditionality involving human rights, worker rights, and the environment could coexist with GATT. They would not breach the fundamental principles of GATT despite being beyond the ambit of GATT.

DILEMMA OF NAFTA AND LOME PARTICIPATION

If Caribbean countries that are members of the LOME Convention opt to join NAFTA either through an accession clause or through separate free trade negotiations they would continue to enjoy preferential, non-reciprocal treatment under LOME, and at the same time be involved in a reciprocal trade arrangement with NAFTA. Entrance into NAFTA may pose a dilemma for Caribbean countries because under Article 174: 2(a) of the LOME Convention, parties are obliged to provide no less favorable conditions to the EEC than those

provided to any developed country. Specifically, if Caribbean countries provide reciprocity to the United States and Canada by virtue of an FTA or NAFTA membership, then the Caribbean countries would be obliged to provide reciprocity to the EEC under the terms of the LOME convention.

Two options exist to handle such a situation. Firstly, the EEC countries could treat the participation of Caribbean countries in NAFTA in a way which obviates the enforcement of most-favoured-nation status. The EEC could permit a waiver from the reciprocity obligation. This would be a difficult proposition to market politically in the EEC, but it is certainly a possibility which should be investigated. Secondly, the Caribbean countries would have to grant reciprocity to both NAFTA partners and the EEC. There would have to be a synchronization of the arrangements for the transition to reciprocity between the Caribbean and the EEC and between the Caribbean and NAFTA. That synchronization would relate to what constitutes reciprocity, the coverage of the agreements, and the adjustment period.

RECIPROCITY

In recent years, there has been a decisive reorientation of trade policy of industrialized countries towards developing countries from a willingness to provide concessions in the form of preferential arrangements to a demand for reciprocal trade conditions. The shift to reciprocity has its origins in the current trend toward trade liberalization, which is sweeping away national barriers to the international mobility of goods, services, capital, technology, and information. Observance of the reciprocity requirements is also motivated by the perception in industrialized countries that many developing countries, particularly the newly industrialized ones continue to maintain protectionist barriers while benefitting from preferential access for their exports. The US trade deficit has persisted and is becoming more difficult to finance. This, coupled with the frustration of accessing markets in Europe and Asia, has given rise to charges of unfair trade, resulting in a shift in US trade policy from unconditional to conditional most-favored-nation treatment in trade. In this context, the United States has insisted on reciprocity, and has escalated the measures to ensure compliance, moving from retaliation for withholding access, to the imposition of sanctions.

The United States has espoused both the principle and practice of "graduation" by disqualifying certain advanced developing countries from the Generalized System of Preferences.

The Clinton Administration has stated that reciprocity will be the basis of any future trading arrangements with countries in the hemisphere, including the small Caribbean economies. Similarly, there is an increasing momentum in Europe in the direction of reciprocity and away from preferential arrangements for developing countries. The Caribbean must face the fact that future trade arrangements will be based on reciprocity. In the past, the Caribbean region postponed adjustment, because it was able to gain resources, transfers, and concessions on the basis of traditional obligations, small size, and security considerations. This luxury no longer exists. The Caribbean countries must adjust quickly if they wish to avoid becoming economic dinosaurs.

APPREHENSION

The notion of differential treatment is deeply entrenched, particularly in the smaller, less developed countries, which receive longer adjustment periods even within their own regional trading arrangement, CARICOM. It will be difficult to disabuse these countries of this tenet of their philosophy of development, but there can be little opposition to the concept of phasing out differences in obligations over a long period, perhaps twenty years.

The Caribbean's apprehension of reciprocity in terms of trade derives from an exaggerated fear that reciprocity will be immediate and complete. Concerns center around the social and economic costs of structural adjustment. This is a valid concern because in these economies, structural adjustment implies both (a) "resource allocation" from extinct to emerging sectors and (b) "resource creation" for the instalment of new or upgraded productive capacity. There are risks and difficulties involved in improving quality, quantity, and price in order to survive and compete in the vast hemispheric market with a range of competitors, which include giant multi-national corporations. Many of these multi-national corporations have assets and sales that dwarf the combined GDP of the Caribbean countries. Daunting as this appears, improvement in the terms of trade of the Caribbean countries can be accomplished because the fragmentation of the production process into smaller discrete processes provides opportunities and there are specialized niches in the international division of labor which can be filled by relatively small scale operations.

V. TRANSITION FROM PREFERENTIAL TO RECIPROCAL TRADE

In today's world characterized by an atmosphere of globalization with rapid changes in trade, demand and technology, the only certainty is change. Adjust-

ment is not only imperative, it is the norm. The Caribbean has to recognize that adjustment is not a special period brought on by economic difficulty, but an ongoing part of economic life. It is a principle which encompasses not only developing countries but industrialized countries as well. The Caribbean, therefore, must approach adjustment from a proactive point of view with the assistance and involvement of both the private and public sectors.

The extension of NAFTA-like concessions to other Caribbean countries could proceed by granting parity with Mexico as a transitional arrangement. Through parity, the Caribbean countries would have a period when they would be granted the same treatment as Mexico receives without having to reciprocate. After such a transitional period in which parity is given without reciprocity, there could be a period of phased reciprocity over a suitable adjustment period. A suitable adjustment period must take into account the differing levels of development, export structures and size among the various Caribbean countries. Asymmetrical adjustment between the developed and less developed members of this arrangement must be provided. Similar transitional arrangements would have to be designed for trade with the EEC.

MANAGING RECIPROCITY

The Caribbean should not be intimidated by the prospect of reciprocal trade. Although the changes required are not necessarily easy, reciprocity can be managed.

Firstly, reciprocity can have a range of connotations. Reciprocity need not mean only equivalence in the lowering or removal of tariffs. It also can mean imposition of modified or conditional "most-favored-nation" treatment. Reciprocity is not merely tariff reduction. The reciprocity principle is much broader, encompassing investment regimes, environmental issues, and intellectual property rights. Some of the trade-offs involved in reciprocity can be in these non-tariff areas in exchange for trade concessions.

Secondly, Caribbean countries have already provided substantial reciprocity in trade conditions. Trade liberalization and economic reform programs in recent years have substantially lowered tariffs and quotas. Indeed, the ironic situation exists where the United States has quotas on many exports from developing countries while developing countries do not reciprocally impose quotas. For example, the United States has quotas on many exports from Jamaica, but Jamaica has no quotas on any goods entering from the United States, except firearms.

Thirdly, reciprocity can be managed by Caribbean and other developing countries if a transitional mechanism and an adequate adjustment period is instituted. The Canada-US Free Trade Agreement or the NAFTA, for example, grant parties 10-15 years to phase-in elimination of tariffs in some sensitive sectors. These adjustment mechanisms are made even more palatable to parties making the transition through safeguard measures. Safeguard rules allow a country whose domestic industry is injured or threatened with serious injury to reimpose tariffs or discontinue tariff reductions for a specified period. For example, Article 702 of the Canada-US Free Trade Agreement permits, under specified conditions, the imposition of a temporary duty on fresh fruits and vegetables. Such action may be taken only once in each industry, and the exporting country is entitled to compensation.

Moreover, a Free Trade Agreement does not preclude the invoking of Article XIX of the GATT, which also provides emergency safeguard actions on imports of particular products. Also, for selected products and sectors there can be some special measures either to protect or exclude them from free trade agreements in cases where production is concentrated on a narrow range of goods and services, and exports consist of a few primary products. Finally, the conclusion of a free trade agreement does not necessarily mean free trade, but liberalized trade. It is important to note however that too long an adjustment is self-defeating. The Caribbean countries, for example, have been making adjustments to maximize efficiencies in their markets for sugar and bananas for the past 30 to 40 years. An extended adjustment period can be just as bad as too short a time frame.

Fourthly, asymmetrical adjustment is one way to recognize and compensate for differences in the levels of development.

VI. STRATEGIC GLOBAL REPOSITIONING

The Caribbean can make the transition from preferential to reciprocal trade through a combination of proactive adjustment and strategic repositioning in the global economy. This will require the following:

(1) Abandonment of traditional thinking and immediate formulation of new development strategies. For example, the Caribbean countries, instead of focussing on the export of manufactured goods, could turn their attention toward the export of services. After all, services rather than manufactured goods are increasing more rapidly as a component of international trade.

(2) A focus on non-traditional exports, such as, bio-technology, data processing, tourism, banking, and insurance. The back office operations of multilateral corporations are moving globally. Swiss Air moved its accounting and data processing departments from Geneva to Bombay, India. There is no reason why the Caribbean cannot capitalise on these opportunities.

(3) Development of new exports, including offshore medical services, to provide new opportunities. The health care industry in the United States is expected to experience a boom. The Caribbean should prepare itself to take advantage of this development.

(4) Cooperation between the public and the private sectors. In order to effectively carry out strategic planning and targeted implementation. What is needed is a marriage which harnesses the vision and expertise of both the public and private sectors. This cooperation has been an effective development strategy in the Asia-Pacific region.

(5) Amassing the capital, technology, and marketing skills necessary for effective competition in the global marketplace. These inputs, which are necessary to development, can be garnered through corporate integration, by joint ventures and other strategic corporate alliances. Corporate integration is unavoidable as a fundamental aspect of the globalization process. It necessitates a whole-scale reorganization of corporate structures and the conduct of business.

(6) Increasingly, the world economy will be dominated by knowledge-based industries, making the quality of human capital a critical factor. The Caribbean has produced more than enough human capital to take the region successfully into the twenty-first century. Most of this capital, however is, outside the region. Every effort must be made to repatriate it. Just as incentives and special programs exist for foreign investment, similar incentives must be provided to the region's professionals to increase productivity, management, and entrepreneurship.

The Caribbean is well-equipped to take the requisite steps. The countries of the region however, need to ensure that it is done in a proactive way. Caribbean countries cannot wait for events to befall them.

1. PROACTIVE ADJUSTMENT

The countries that will succeed in the new globalization are those that pursue "pro-active adjustment", that is, they adjust quickly, in anticipation of, and in response to global changes in demand and technology. Those countries that pursue "reactive adjustment", that is, react to events late and defensively, by focusing on protectionism are not going to survive and will not achieve growth.

It is not possible in this new globalization to insulate production or demand from global competition and changes. Therefore, it is not possible for countries in this hemisphere to achieve growth if they opt for the route of protectionism. There must be pro-active adjustment which improves competitiveness in the global market place. President-elect of the United States Bill Clinton understands this, and has stated this during his election campaign and since his electoral victory.

In this new global phase no product will be made entirely in one country, because the production process will be spread over several countries. The various aspects of the industrial production process are spread very logically throughout the hemisphere. Different stages are carried out in different parts of the hemisphere where they are most cost effective. The spread of the production process through different countries is the most efficient mode of production and beneficial to all the countries involved. US producers which undertake production in the CBI countries using US machinery and using Caribbean labour, produce a final product which is competitive in the global marketplace.

Without this complementarity of production between the United States and CBI countries US firms and Caribbean producers would not be able to maintain their market share or their competitiveness in the global market place. For example, the production of apparel in the CBI region is complementary to production in the United States. Of the apparel produced in Jamaica, 80% of the finished goods consists of US raw material, machinery and other inputs and most of this is made for US firms. US garment producers maintain competitiveness in the global market place by having different stages of the production process dispersed within the hemisphere, involving CBI producers. In the future, as globalization progresses, it is not going to be possible for any single product, firm or country, to stay competitive unless the production process is dispersed throughout the hemisphere so that each aspect is undertaken where it is most cost effective.

2. ADJUSTMENT IS TRANSNATIONAL

In today's highly interdependent global economy it is less and less meaningful to view adjustment as a purely national phenomenon. Indeed, adjustment is a transnational phenomenon because of the globalization of production, investment and finance and the reduced ability of national governments to control economic activity. National adjustment is increasingly incompatible with international (or transnational) economic activity. Adjustment must be conceived by governments, including the United States as a combination of domestic and

international economic policy. Adjustment by the private sector can only be understood, formulated and implemented in an international context, given globalized production and preeminence of multinational corporations. Many Caribbean countries are implementing programmes of market oriented reforms and the success of this adjustment process will largely depend on increased investment and export growth. Several CBI countries are well advanced in a process of economic adjustment which will enable them to compete more effectively in the global market. Domestic economic reforms can be enhanced and brought to fruition by improved export market access for new and traditional exports. Legislative and other action should be taken to ensure that the CBI countries retain their relative advantage in the United States and Canadian markets in the medium term.

3. GLOBALIZATION, RATIONALIZATION AND COMPETITIVENESS

The globalization of production is a rationalization of resource use on a global scale that is more efficient in terms of cost than production confined to national economies. The spread of the production process through many countries reflects the location of discrete aspects of the production process in different countries in order to undertake each process where it is executed most efficiently and most effectively. The globalization of production reflects the allocation of economic activity by the global market on the basis of comparative advantage. There is no point in resisting or attempting to reverse this process since it is driven by the logic emanating from profit making.

Defensive and reactive adjustment, which has as its objective the preservation of industries or the retention of aspects of production which can be accomplished at a lower cost in other countries, is self-defeating. In the short run, it reduces competitiveness and exports and provides higher priced goods to the national market, reducing demand and increasing inflation. In the long run, entrepreneurs will find ways to import cheaper alternatives and will relocate uneconomic aspects of production to other countries in order to retain international price competitiveness and national market share. For example, garment production in which machine intensive textiles made in the United States are cut and sewn into garments in the CBI countries where labour costs are more appropriate ensures the survival and competitiveness of US firms in both the national market and the global market place. The future of the United States and Caribbean industry is inextricably bound by an interdependence representing comparative advantage and competitive markets.

4. ECONOMIC TRANSFORMATION FACILITY

If the Caribbean is not to repeat its experience in LOME, CBI and CARIBCAN - that is, not fully utilizing the preferential trade arrangement and changing the structure of their exports— then a new facility has to be created, which could be called an Economic Transformation Facility (ETF). The ETF would concentrate on:

(a) reorienting economic structures in individual countries, with a particular emphasis on developing new exports; (b) improving overall export competitiveness in both new and existing export markets; (c) establishing special programs to facilitate the replacement of non-profitable or threatened exports, particularly those in the agricultural sectors; and (d) increasing lending to the public sector for infrastructure development and to the private sector for investments. The ETF would be funded by the NAFTA members and the EEC through the funds provided by section 936 of the US tax code as well as through development assistance.

CONCLUSION

The countries of the Caribbean are caught between the process of globalization and regionalism through strategic global repositioning. The region must face the fact that preferential trade arrangements, such as, the CBI, the LOME Convention and CARIBCAN will not exist indefinitely. The region must adapt to the erosion or elimination of preferential trade regimes. In order to cope with this profound change, these economies must continue the process of adjustment and reform, to ensure that in the not too distant future they will be able to compete effectively in quality and price in the global marketplace. With or without amendments to the CBI, CARIBCAN, and LOME, these countries must realize that the world economy is changing, globalization is taking place and there is an onus on Caribbean countries to re-double their efforts for adjustment in their own countries. They must seek ways to improve and enhance their productivity and efficiency to enable them to compete more effectively, not only in the hemispheric market but in the global marketplace. The Caribbean countries have rich potential and are capable of succeeding and competing in the global market place. An important aspect of Caribbean development is the creation and expansion of new exports.