PRELIMINARY

CARICOM RESPONSES TO NAFTA: OPTIONS AND INDICATIONS

by

DeLisle Worrell
CENTRAL BANK OF BARBADOS

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DeLisle Worrell
Deputy Governor, Central Bank of Barbados
Spry Street, Bridgetown
BARBADOS

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A Defensive Strategy?

Caricom countries are already highly integrated with North America, in trade, tourism, travel, services, financial flows, investment, language, history and culture. North America provides two-thirds of Caricom imports, 80% of tourists visiting the region and accepts all major Caricom exports apart from sugar and bananas. North America is the source of most offshore business and the majority of large-scale investment. With few exceptions, major international financial institutions operating in Caricom are of North American origin. The US is the destination of flight capital and the source of its repatriation.

The US dollar is the universal standard of value in Caricom, the numeraire against which the value of currencies and assets is measured. For some countries it is used in transactions alongside the national currency. Remittances in cash and kind from North America are a useful source of foreign exchange in all countries and among the main sources in the less well off. The inter-relationship between the Caribbean and North America is cemented by long-standing commercial and personal relationships, by a shared language and by strong cultural affinities.

The Caribbean/North American relationship is strengthening at a pace which Governments in either region are powerless to arrest. Its momentum is maintained by established ties and technical changes such as jet travel and telecommunications which have drastically reduced the time and cost of sustaining relationships between the two regions. The evidence of deepening Caribbean/North American integration is pervasive and is not invariably to the Caribbean's liking. Non-US sources provided well over half of the English Caribbean's imports thirty years ago. Before the era of jets, tourists were as likely to be English as American. Thirty years ago, exports to the UK were as large as exports to the US; Caricom countries then belonged to the sterling area. Forty years ago, the UK was migrants' main destination and the place where the English Caribbean went in search of higher education.

The integration process proceeds at an accelerated pace. This is most obvious in the Americanization of the media and in the spread of Caribbean music and street festivals throughout the major cities of North America. Less remarked is the extent of Caribbean travel to North America - not merely by the affluent, but by West Indians from all walks of life.

Caribbean economic policy failures have accelerated integration. Impoverished Caricom nations have come to depend on remittances in cash and kind. Unstable currencies have been replaced in the asset portfolios of the well-to-do by US dollar denominated assets at home (where permitted) and abroad. Declining living standards and social conditions in a few large Caribbean countries have generated a massive exodus of skilled personnel.

Integration with North America threatens the Caribbean identity and quality of life because of the vastly unequal sizes of the two regions. There is a legitimate fear of polarization of economic activity to Caricom's disadvantage. Wherever possible, firms will provide goods and services to the Caribbean from established North American bases to reap economies of scale and scope. For example, US financial institutions now provide most services to the Caribbean from Miami. New establishments will tend to gravitate to established locations. The Caribbean will be left with resource-based activity only - minerals and tourism.

Examples of this tendency may be seen in the French West Indies, the US Virgin Islands and Puerto Rico. Unfortunately, Caricom cannot attain their living standards through similar integration mechanisms. Caricom citizens do not hold passports for admission to live and work in the United States and they are not entitled to unrequited transfers from the US Federal Government as is the case for Puerto Rico.

The Caribbean stands at a disadvantage because traditional exports are uncompetitive in their present guise. It is exceptionally difficult to break the mould of established production and trade. Singapore and Taiwan may be the exceptions that suggest the strength of this observation. They are the only non-resource based successful exporters without a large domestic market.

There is a strategy available to Caricom for managing integration with North America and world markets in the region's own best interest. Macro-economic stability, anchored on a fixed rate of domestic currency to the US dollar achieved through fiscal and monetary policy, attracts employment generating investment and removes the incentive for capital flight and currency speculation. In this environment, governments may provide incentives, institutional arrangements and innovative marketing to restore the competitiveness of traditional exports and tourism. Finance and technical assistance are necessary for non-traditional exports and services. These incentives should be provided by an efficient administration which makes decisions quickly and transparently. Government should implement a well-coordinated, professionally run national economic strategy which promotes these exports of goods and services. An essential element is the regional pooling of capital and skills towards the establishment of regional companies large enough to take on the North American market.

NAFTA is a threat to some Caribbean economies because of the better access it provides to the US market for Mexican garment producers. A Caribbean/North American Free Trade Area would be a threat to future Caribbean prospects if it is modelled on NAFTA. It would open the way for polarization; it would make no contribution to the strategy required for successful Caribbean development in a competitive world economy; there would be no provision to enhance exchange rate stability, no measures to increase productivity in exports and no assistance for penetrating non-traditional markets. It would undermine the beneficial Caribbean relationship with the European Community.

The Caribbean has no choice whether to join NAFTA or no. That decision is in the hands of the US Government and Congress. Whether the Caribbean joins as a region or individually, all countries will end up with the same treaty, to all intents and purposes. The US will not spare the time for separate negotiations. However, if Caricom negotiates as a unit, the content of the final treaty may be more favourable to its interest. Caricom's choices are to do nothing and to wait until the US presents the region collectively or individually with a document to be signed. Alternatively, Caricom may indicate an eagerness to join NAFTA, the outcome is likely to be much the same. Instead, the recommended course of action is to draw up an agenda for negotiation, and to appoint a full-time, highly skilled and specialized unit to manage this and other international economic negotiations on Caricom's behalf.

2. An Informed Response: Caribbean Development Priorities

Export-led growth is the way forward for Caricom. There is nothing new about that. Caribbean economic growth has always been export-led even in Jamaica and Guyana under their socialist regimes. Whenever exports failed to lead there was no growth. With economies as open as those of Caricom, this would not need repetition but for the views reflected in recent official documents of regional governments and the Washington institutions.

A first priority is to increase the competitiveness and marketability of traditional exports. It is neither feasible nor desirable to replace entirely the products in which the Caribbean has developed expertise. Improving market appeal, productivity and value added in traditional exports provides valuable lessons for exploring new products and markets, at the same time earning foreign exchange to finance diversification.

The Caribbean sugar industry has missed many opportunities in the past two decades for product diversification (ethanol, electricity generation), supplying new markets (brown table sugar as a health food), value added products (rum and liqueurs), and increased productivity (mechanization, research and development, reorganization). At last, late in the day, initiatives are underway in many of these areas. Market access for Caribbean sugar and its by-products is an important agenda item for any external trade negotiation including that with NAFTA.

Other traditional agricultural exports may have potential for growth. We should identify them and ensure they enjoy access on the North American market as well as the rest of the world. It may be possible to increase the market appeal of Caricom banana exports by improving quality and marketing their distinctive flavour. Rice exports appear to be competitive in the European Community. Jamaica has had success in coffee exports to Japan. There have been individual company successes in the export of cocoa products.

Minerals are set to remain an important source of foreign exchange for Caricom but they are plagued by price instability for oil, bauxite and alumina and gold. Any external trade negotiation should explore the possibilities of North American support for price stabilization arrangements.

Growth of tourism depends on many domestic factors including the quality of the plant, tourist facilities and marketing effort. There are, however, very important issues which should be raised in negotiation, for example, environmental effects and sustainability. Of particular interest in the Caribbean are international regulations governing waste disposal by cruise ships and funding for environmental protection.

The Caribbean has demonstrated the potential for growth in other traded services and there may be further potential based on the skills and talents of our people. The possibilities which may be identified for further exploration and documentation are: offshore businesses and finance; information services; the music industry; performing arts; sports; and professional services. They raise issues for negotiation including double taxation treaties, North American Government procurement in services, Caribbean access to the North American market and overcoming the barriers established by North American oligopolies.

The Caribbean's strategy includes the exploitation of niche markets in manufacturing and non-traditional agriculture. There is a considerable export of clothing and foot-wear under special provisions of the US Tariff Code. Efforts have been made to stimulate exports of winter vegetables, fruit, flowers and fish products - all areas of intense competition. Liqueurs, condiments, specialty products and food and beverages are also on the list of potentially growing exports from Caricom. The major issue for negotiation with respect to these exports is non-tariff barriers of all kinds. Caricom should negotiate for quick effective ways to strike these NTBs as they arise. The Canadian experience with NAFTA suggests that this will not be an easy task.

The extent of net capital inflow needed to sustain economic growth in Caricom has not been estimated. It may be much less than is commonly assumed but it is significant because it brings access to competitive modern technology and organization and to external markets. Foreign investment may have to be greater than is needed to cover current account deficits in order to acquire sufficient expertise and access. As it stands, NAFTA does not improve Caricom prospects for investment from North America. Most Caricom countries already boast an attractive environment for foreign investment with political and social stability, a salubrious climate, good social services and infrastructure, superior telecommunications and good human resources. The NAFTA arrangements make no provisions for those countries with deficiencies in these areas. Although two of the three largest Caricom economies attempted rigid financial and trade controls for many years in the 1970s and 1980s, these have now been relaxed for almost a decade. All others, except Guyana (now a relatively small economy in Caricom) have always maintained liberal trade and financial regulations with no current account restrictions, liberal capital account controls and only token financial regulation. Guyana's restrictions were dismantled over five years ago. The conditions precedent for foreign investment are therefore well satisfied. Such technical assistance as has been offered under the Enterprise of the Americas Initiative is essentially for fine-tuning and is useful but not critical. The agenda for negotiating a Caribbean/North American Free Trade Agreement must include financing for infrastructure and human resource development as well as stronger incentives for joint ventures.

If they are to have realistic prospects of growth, Guyana and Jamaica must secure additional debt relief. Debt burdens elsewhere are manageable even if higher than some governments would like. For Guyana, debt service absorbs so much of foreign exchange earnings and fiscal revenues that the restoration of infrastructure, revitalization of social services and restoration of functioning public administration have been stymied. Although Jamaica has reduced its external debt service to manageable proportions, interest payments crowd out essential services in Government's budget. No progress is being made in restoring crumbling infrastructure, badly deteriorated social services and alarming decline in the security of person and property. In both countries there is a core of debt owed to the multilateral financial institutions which is deemed inviolate and is therefore not an issue that has been raised in trade negotiations. It must be brought to the table and the assistance of the North American countries elicited in finding an equitable solution.

The issue of intellectual property rights is a prominent item in US preconditions for a Caribbean/North American Free Trade Area negotiation. Surprisingly, in light of a history of pirating of Caribbean music by North Americans, Caribbean negotiators appear to find nothing of interest to the Caribbean in this area. This is probably the result of a lack of information. Among the issues on which Caribbean negotiators must be become better informed are: the cost effective protection of Caribbean music and Caribbean festival arts; patent protection for Caribbean inventions and originals such as the steel pan, Jamaica cattle and black belly sheep; the protection of Caribbean brands of long-standing; and rules that facilitate the development of Caribbean software. Once Caricom interest in these areas have been clarified, a list should be drawn up for the agenda of Caribbean/North America Free Trade Area discussions.

Communications and transport are seldom mentioned in discussing prospects for the free trade area. Caricom faces problems which must be analysed with a view to bring to the table any aspects that bear on treaty obligations with North America. They may include uncertainty in the US airline industry and the effect this has on seat capacity to the Caribbean. Also of interest are telecommunications regulations and cost and the revenue sharing formulae between North America and the Caribbean.

Migration has not been raised as an issue in the negotiations presumably because no-one sees a realistic prospect of more liberal migrant admission policies by the US. However if this is so, North America should offer finance and technical assistance to reduce incentives for migration and to permit legitimate measures that will preserve jobs. These might include government finance for retraining, reorganization and firm restructuring and they should not attract sanctions under the free trade arrangements.

Narcotics smuggling is now widespread in the Caribbean because the region is so located as to provide a natural trans-shipment point for supplies to the US. Recent collaboration between the Caribbean and the US to improve interdiction has had no effect. Nothing seems likely to alleviate the problem so long as the US demand continues to rise. Caricom must require of the US effective measures to reduce that demand.

Caricom macroeconomic stability depends on the achievement of a fixed exchange rate. For countries committed to fiscal discipline but short of foreign exchange reserves, the US might be asked to provide conditional letters of credit sufficient to discourage short-term speculation. This is a possibility that should be discussed as part of the agenda for the negotiations.

3. Caricom Options and their Effects: Immediate and Ultimate

The first option is to do nothing. In this case, when the US is ready it will present a NAFTA package for Caricom to accept. In the meanwhile, Mexican garments will have an advantage over Caricom - mainly Jamaica - in exports to the US as of January 1995. This is expected to halt growth in garment production in export processing zones. Since garment manufacturers are notoriously footloose, Jamaica also expects to lose existing production to Mexico. Some commentary suggests the entire garment industry will shift from Jamaica to Mexico, but that is unlikely. Moreover, some shifts may be as a result of Mexico's lower labour cost rather than that country's better access to the US under NAFTA and are therefore inevitable.

The consequences of doing nothing are a reduction in Jamaica's clothing exports in the immediate term. However, ultimately, there will be little effect. Investment shifts will come to reflect relative costs, infrastructure and the investment climate. In due course, Caricom would be saddled with a NAFTA treaty that contains no special provisions for Caribbean development priorities and there would be no side agreements to take care of issues of Caribbean concern which did not fall directly under NAFTA.

The second option is to rush to join NAFTA. Caricom would probably secure accession no sooner than under the first option and on much the same terms. This option averts the shock to the Jamaican garment exports if eagerness to join NAFTA is rewarded with so-called "NAFTA parity" as a first step. Ultimately, the Caribbean/North America Free Trade Agreement to be foisted on Caricom countries would be just as insensitive to Caribbean requirements as under the first alternative.

Option No. 3 is to muster resources for careful, well-informed negotiations on a Caribbean/North American Free Trade Area. This is the preferred option. It would involve a full-time NAFTA task force to help the Heads of Government to define an agenda for the Caribbean/North American Free Trade Area negotiations, to conduct the negotiations for a draft on behalf of the Heads (simulating the effects of Caricom/North American Free Trade) to recommend the length of a transition period, and to safeguard benefits under the Lomé Convention, Caribcan and all other Caricom treaties. This option averts the immediate danger to the Jamaican garment industry and provides hope of more meaningful gains from a Caricom/North America Free Trade Area.

4. An Agenda for the Negotiation

Caricom economies are already very open and operate liberal trade and financial regimes. Tariffs are too low to constitute an effective barrier to imports of any kind. Non-tariff barriers have largely been dismantled. No country retains exchange controls on current account transactions and direct intervention in credit markets has been abandoned. Further moves in the direction of liberalization may have profound effects; they should therefore be introduced gradually with enough time allowed for their effects to be absorbed without precipitating an economic slump. The complete elimination of tariffs with North America would, in effect, mean the end of customs duty as a source of government revenue. Most imports come from North America and imports from the European Community would also have to be exempt from duty under the provisions of the Lomé Treaty. The fiscal implications have not been explored but such a thoroughgoing change in the basis of taxation requires an extended period of analysis and adjustment.

The Caricom/North American Free Trade Area should also phase in modifications in the regime affecting agricultural products because of the profound impact on domestic agriculture of heavily subsidized food exports from North America and other industrial countries. A timetable for liberalization should be related to fundamental reforms in world trade in agriculture.

The transition period should also take account of structural changes with which Caricom has to cope: the threatened termination of the banana regime; the perennial weakness of the market for bauxite and aluminum; low oil prices and volatile prices of other primary commodities. Having now removed the glaring sources of inefficiency and distortion, it may be time for Caricom to pause on the road of reform so as to address major structural changes which these circumstances require.

Sustainable tourism development requires finance, access to knowledge and technology, agreement on standards and enforcement of cruise ship operations, and active collaboration in the further investigation of tropical eco-systems. Specific programmes, issues, regulations and actions need to be identified and added to the agenda for Caricom/North American Free Trade Area discussions.

Swift, inexpensive and effective dispute settlement mechanisms must be written into the agreement. This is particularly important in securing market access for non-traditional Caribbean exports of goods and services. Caricom should identify specific goods and services for which greater access is being sought and the kinds of obstacle that stand in their way. There have been instances of sanitary regulations, stipulations about the ingredients of processed food and beverages, restrictions on rights of performers in North America and restrictions on professional activity. The negotiators should be informed by Caribbean experience, Canadian experience in the Canadian/US FTA and the record of compliance with GATT obligations. They should require arrangements which are binding, with enforcement mechanisms and provisions that will pre-empt costly legal challenges, and eliminate blocking orders and other delaying tactics.

Side agreements to a Caribbean/North American FTA should include the provision of finance and technical assistance to promote structural changes which Caricom countries must implement because of changing comparative advantage. These changes are needed in agriculture, manufacturing and tourism to diversify away from failing markets, increase productivity and quality and build market loyalty. Provision of skills and financing from North America would significantly increase the pace of implementation of new strategies and the chances of successful transition.

A Caricom/North American FTA should contain provisions or side agreements setting up institutions to assist Caricom in overcoming barriers to entry into North American and other export markets for non-traditional exports and services. The rationale for free trade hinges on well-informed, competitive markets in which there are no barriers to entry and where small Caricom firms are at no disadvantage in competing with large North American firms. Partners to the trade negotiations are therefore under obligation to rectify circumstances which violate these conditions.

A detailed list of Caricom concerns should be prepared to inform the negotiation. The list should be informed by experiences of the private sector in Caricom as well as by efforts to penetrate North American markets by non-Caricom countries. There may also be lessons to be learnt from the current US/Japan trade dispute. In particular, the US seems to have endorsed the notion of quantitative targets for export performance. That is a potentially useful tool for securing market access in areas of promise where Caricom has so far made little headway.

The Caricom/North American FTA should contain safeguards for Caricom production and employment which go beyond provisions for aggrieved parties to make representation for countervailing tariffs. Some of the safeguards might be in the form of conditional implementation of treaty provisions, for example, that subsidies are permitted until Caricom producers attain a sustainable level of exports to North America. Also, following the example of NAFTA there should be exemptions for sensitive sectors and offsetting arrangements should be made for unfair competition. Caricom needs to study the NAFTA and GATT agreements for precedents.

Caricom negotiators should seek provisions which will improve access for Caribbean suppliers of services to North America. The objective should be to accelerate growth in those activities where the Caribbean already has a presence (offshore financial and businesses services and information services) and to open opportunities in other areas - for example, through access to government contracts, professional services and educational services.

The negotiations with North America should respect the Caribbean's obligations under the Lomé Convention. The European Community should be fully consulted on Caricom intentions with respect to a Caribbean/North American FTA. The negotiators should introduce provisions to safeguard Caribbean privileges under Lomé. The phase-in of greater North American access to Caricom markets should take place over a sufficiently long time that it may be linked to greater EC access. A period of twenty years or longer should not cause difficulty for North America or the EC. The level of their market access in Caricom is already very high indeed. The additional provisions have mainly symbolic value for North America and the EC though they have fiscal implications and some impact on employment in Caricom.

Caricom should document its intellectual property which is at risk and negotiate for its protection. The region seems to have accumulated little information or expertise in this area. However, past and present experience suggests there are risks of exploitation of Caribbean intellectual property for the benefit of North Americans. Areas to be explored include Caribbean music, steel bands, indigenous flora and fauna, resources of the rainforest, swamp lands, the marine environment, festival arts, Caribbean design including architects and artifacts) and Caribbean brand names including provisions for truth in advertising.

A side agreement should be sought on debt relief for Jamaica and Guyana. Innovative approaches are required. It might be possible for the US, Canada and Mexico and to buy Guyana and Jamaica debt from the multilateral financial institutions with low interest securities to be held in Guyana or Jamaica dollars. It may also be possible to write down such debt against privileges that the lenders would be able to acquire in Jamaica and Guyana.

The negotiation should also explore the possibilities of accelerating the stability of the Guyana dollar, the Jamaica dollar and the Trinidad and Tobago dollar by the establishment of stabilization funds by the US, Canada and Mexico. These funds may be used to defend the exchange rate provided it is consonant with economic fundamentals. Access would be conditional on fiscal performance and monetary policy. After a probationary period, say three years, these funds might be consolidated to back the introduction of a Caribbean common currency as envisaged by the Heads of Government.

Other side agreements, protocols and understandings should be sought to cover narcotics smuggling, communications and transport and migration. Caribbean interests should be clearly indentified by the negotiating team. Reasonable proposals should be advanced for enhancing Caricom prospects of growth, adjustment and social justice.

5. Caribbean/North American FTA, Caricom Regional Integration and the GATT

Caribbean/North American FTA is not a replacement for Caricom. Rather, Caricom integration is vital if the region is to benefit from the FTA. Integration will marshal resources for the negotiation and will enable us, hopefully, to emulate the success of Lomé I when in a less arduous proposal joint negotiations brought a result which was to the Caribbean's advantage. Regionalism provides for the sharing of capital, skills and finance to build competitive firms that can exploit the North American market. It also musters administrative and professional resources to monitor the implementation of the FTA and to ensure that its safeguards effectively protect Caricom. The Caribbean /North American FTA is not envisaged as an integration treaty of the same depth as Caricom. It does not contemplate freedom of movement, transfer mechanisms or currency unification.

The negotiating team for the Caricom/North American FTA must be fully conversant with GATT, the proposed general agreement on trade in services and all their associated provisions. It is a generally accepted principle that all Western Hemisphere free trade areas should be compatible with GATT. That general intention should be converted into specific provisions to be negotiated, both within the FTA and for the implementation of the Uruguay Round. On some provisions the Caribbean may wish to make common cause with countries outside the Hemisphere which share their viewpoint and interests.

6. Recommendation

A full-time, high-level Caricom task force on Caricom/North American FTA negotiations and on the associatied EC and GATT issues should be set up with a minimum life of three years. Its mandate would be to draw up and document a comprehensive list of issues for negotiation; to discuss intensively with Caricom Governments and the private sector before finalizing the list; to establish an agenda for negotiation with North America, for discussions with the European Community and for negotiations within the framework of the GATT, the General Agreement on Trade and Services and the World Trade Organization. It should provide ongoing technical support in the conduct of the negotiations.