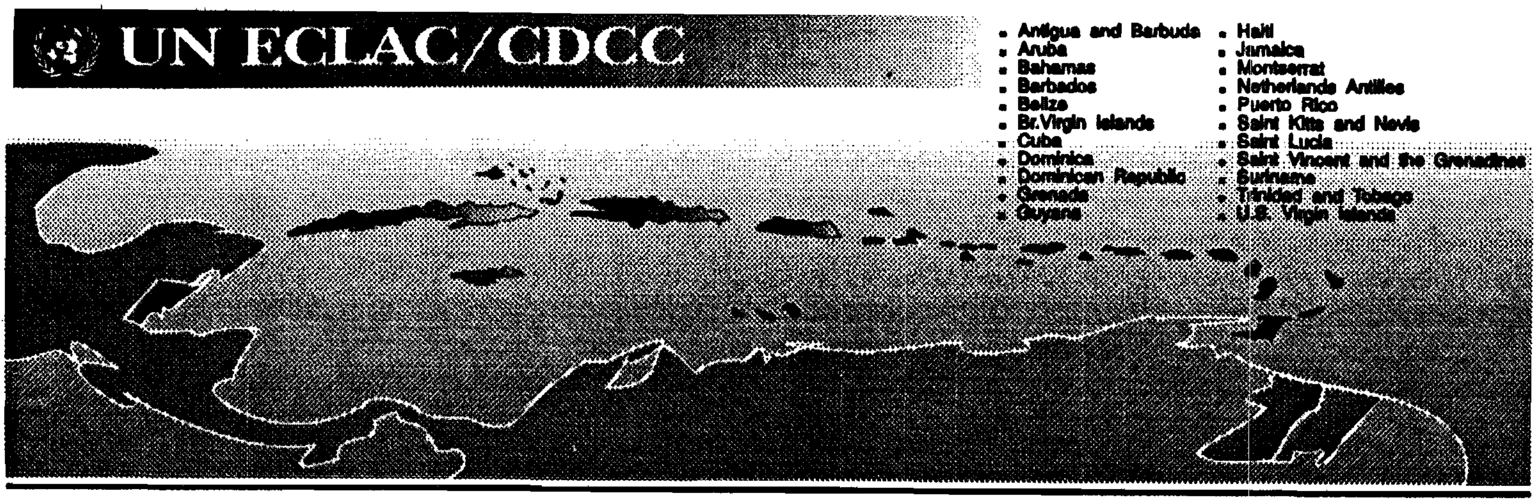

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PROPOSALS FOR THE LIBERALIZATION OF TRADE AND INVESTMENT IN THE ASSOCIATION OF CARIBBEAN STATES (ACS)

UNITED NATIONS
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Introduction

Wide-ranging economic reforms, including the liberalization of trade and investment regimes, have contributed to the increased pace of global economic integration. Notable among them were the implementation of the results of the Uruguay Round of trade talks, which included an agreement on trade related investment measures, the continuation of unilateral trade policy reforms and the establishment or revival of numerous trade and integration arrangements. All of these developments have contributed to a more liberalized global trade and investment regime and, in turn, have reinforced global economic integration, as was evident from increasing rates of growth of world trade and investment.

The volume of world trade grew by 8.9 per cent in 1995, or more than double the growth rate of global output, which stood at 3.5 per cent for the same year. In Latin America and the Caribbean, exports of goods grew by 21.6 per cent in 1995 while imports grew by 12.3 per cent in the same year[1]. In 1995, global investment flows grew by 40 per cent to reach a total value of US$315 billion. Most of these flows took place among the industrial countries. Inflows to developing countries amounted to US$100 billion in 1995 and were highly concentrated in Asia. China was the largest recipient of these inflows accounting for 40 per cent of the total. In Latin America and the Caribbean, foreign direct investment grew by more than 5 per cent between 1994 and 1995, to reach an estimated total of US$27 billion with Mexico being the largest recipient in the region and the rest accounted for mainly by Argentina and Brazil. Foreign direct investment originating in developing countries also increased, from US$39 billion in 1994 to US$47 billion in 1995. In Latin America and the Caribbean, outflows of foreign direct investment amounted to US$3.8 billion in 1995, with Brazil and Chile being the largest sources[2].

The convergence of trade and investment policies and the establishment of more liberalized trade and investment regimes were also evident in the Western Hemisphere. Most countries were undertaking wide-ranging trade and investment reforms and were actively participating in the multilateral trade and investment liberalization efforts, as well as in subregional and hemispheric efforts designed to promote further integration.

Member countries of the Association of Caribbean States (ACS) were also participating in activities aimed at the liberalization of trade and investment, globally. In addition, they were engaged in efforts to further integrate their economies at the hemispheric and subregional levels. The latter efforts were taking place at several levels and reflected in the revitalization of the Central American Common Market (CACM), the Caribbean Common Market (CARICOM), the Organization of

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[1] ECLAC: Preliminary Overview of the Economy of Latin America and the Caribbean, 1996.

[2] United Nations: World Investment Report: Investment, Trade and International Policy Arrangements, 1996.

Eastern Caribbean States (OECS) and the Andean Pact. Notable also were the signing of numerous bilateral and multilateral trade and investment agreements of various types as well as the establishment of the Group of Three and the North American Free Trade Agreement (NAFTA). Most of the countries were also involved in preparations for the negotiations of the Free Trade Area of the Americas (FTAA) which was scheduled for the year 2005. These arrangements had differing objectives, ranging from the relatively simple liberalization of trade on a selected number of goods, to a free trade area which covered most trade in goods and services, investment and incorporated commitments to the protection of intellectual property rights. Some of the agreements sought to achieve deeper integration through the creation of a common market or an economic union. Nevertheless, despite the complex network of hemispheric activities, some ACS member countries do not belong to any particular grouping and have not been involved in any of these developments. However some of these countries, notably Cuba[3], have signed bilateral agreements with both members and non-members of the ACS.

Since none of these integration or bilateral agreements include all the member countries of the ACS, it is incumbent on it and consistent with its objectives to seek to promote the type of cooperation and integration which involves all its member countries, some of which do not have traditional trade and investment relations. This absence, together with the similarities of the production structures of some of the countries, the existing barriers to trade and investment, the undiversified composition of their exports and the general orientation of their trade towards industrial countries are all responsible for the pattern and level of intra-ACS trade, which has been found to be generally low and highly concentrated among few countries and on a few commodities[4].

Gradual and progressive economic integration among its member countries, including the liberalization of trade and investment, transport and other related areas is one of the mandates assigned to the ACS. This paper examines the liberalization of trade and investment in the ACS area, identifies some of the probable obstacles to trade and investment and makes some suggestions to encourage the gradual liberalization of trade and investment in the Caribbean basin.

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[3] Cuba has signed agreements with Venezuela, Colombia, Mexico, Brazil, Peru and Uruguay.

[4] See LC/CAR/G.478 "Intra-ACS trade: An overview of CDCC trade with non-CDCC groupings.

I. THE LIBERALIZATION OF TRADE AND INVESTMENT IN THE ACS

Most member countries of the ACS have undertaken substantial unilateral trade liberalization programmes as well as liberalization programmes undertaken as part of their commitments to the regional integration agreements to which they belong. Although it was clear that the pace of trade liberalization accelerated towards the end of the 1980s, liberalization programmes have taken many forms and proceeded at different rates, with some countries liberalizing their trade much faster than others . The tariff for Latin America and the Caribbean fell from an average of 40 per cent in 1985 to an average of 15 per cent in 1995. Although the average tariff level in Latin America and the Caribbean has decreased substantially, the countries' individual tariff levels still display wide differences varying from an average of about 19 per cent in Honduras and the Dominican Republic to about 11 per cent in Colombia and Haiti. The level of tariff dispersion in the region has also decreased, from an absolute level of 20.9 per cent in 1985 to 7.9 per cent in 1995. In general, tariffs tend to be higher on consumption goods than on capital goods, with differences amongst the countries with regard to tariffs applied to the various types of goods. For example, the average tariff for capital goods in Colombia was less than 10 per cent while it was more than 10 per cent in Mexico and less than 5 per cent in Central America and the Caribbean[5].

The liberalization programmes also included the dismantling or lowering of non-tariff barriers which were widely used in the region. Liberalization in this area included the outright abolition of quantitative restrictions or their replacement by tariffs or tariff quotas, which were subsequently lowered or eliminated. It also included the elimination of licensing requirements and import prohibitions or their limitation to a narrow number of goods and the withdrawal of monopolies for the import of particular goods. A number of ACS member countries, for example, Guyana, Jamaica and Trinidad and Tobago had implemented wide-ranging financial liberalization programmes, including the liberalization of payments on both the current and capital accounts of the balance of payments. Exchange rate liberalization had also taken place in some countries. All these measures served to reduce the restrictions on international payments and create an environment conducive to the development of both trade and investment in the area. Privatization programmes have also been widely implemented in a number of countries and this has contributed to the recent increase of foreign investment in some ACS member countries.

In addition to the unilateral liberalization policies implemented by most of the countries, ACS member countries were also party to several integration agreements which invariably included trade liberalization. These agreements included the CACM, the Andean Community, the OECS, CARICOM, the Group of Three and NAFTA. There were also agreements between Mexico and the CACM countries and between the latter and both Colombia and Venezuela. Agreements also exist between CARICOM and both Venezuela and Colombia. Agreements were being negotiated between Mexico and Belize and Mexico and Panama. The Dominican Republic is planning trade links with the Central American countries and negotiations are planned between CACM and CARICOM countries

[5]Inter-American Development Bank; Economic and Social Progress in Latin America and the Caribbean, 1996 Report.

for the establishment of a free trade area. Several ACS member countries have also entered into bilateral agreements with non-member countries. These agreements included Mexico-Uruguay, Mexico-Peru, Mexico-Argentina and Mexico-Chile, Colombia-Argentina and Colombia-Chile, Venezuela-Argentina and Venezuela-Chile.

The contents of these agreements, as well as their approaches to trade and investment liberalization varied. Some identified a specific list of goods in which trade was to be liberalized, others identified the lists of sensitive products to be excluded from trade liberalization, leaving the rest to be liberalized. Other agreements applied only to specific sectors or specific industries, while others were wider in scope and covered trade in goods and services as well as investment.

The liberalization of investment rules and regulations has proceeded both unilaterally and within integration and bilateral agreements. Nevertheless, bilateral agreements have generally given more importance to investment than the integration agreements. They tend to seek to extend most favoured nation status and national treatment to investors from the participating countries although they do not usually contain provisions dealing with investment protection against expropriation, or similar risks. However, protection of investment is generally included in the bilateral investment agreements which ACS countries have with the industrial countries.

All these trade and investment agreements tend to be more liberal than their predecessors and may be better suited to reaping the benefits expected from integration arrangements. These benefits include more trade creation, more competition and more efficiency in the production of goods and services in the participating countries. They also include better possibilities for economies of scale and better prospects for overcoming small size and the human and physical capital limitations which may be hampering economic growth and development. However, the inherent exclusionary effects of the agreements reflected in either their membership or their trade coverage could diminish the overall level of liberalization actually achieved and the benefits which could have accrued to the members.

The proliferation of these agreements may also be introducing distortions into their economies and fostering a sub-optimal allocation of their resources. They also increase the risk of creating rents for those sectors, industries or firms which gain protection resulting from the negotiation of these agreements. In addition, it may be difficult for some of the countries, especially those with limited human resources capabilities, to administer present agreements, let alone negotiate future ones. At the same time, the increasing number of these agreements could also make it more difficult to negotiate an all-encompassing integration agreement, should the movement towards such an agreement be favoured by ACS member countries.

The multiplicity of bilateral agreements can also affect the destination of investment. Investments tend to go to those members of the agreement with the bigger markets and those which are party to the largest number of agreements, since they will presumably be expected to give foreign investors access to a larger market for both exports and imports. Also, membership in any integration agreement which provides access to a larger market makes the countries involved more attractive to foreign investment.

The liberalization of trade and investment has usually been accompanied by a wide range of trade and investment promotion activities, at the national level as well as at the level of the integration agreements. At the national level, the promotional activities vary among the countries but tend to include the provision of trade information, preferential access to imported inputs, partial or total exemption from local taxes, refinancing systems at preferential rates, credit to exporters, subsidized interest rates and the provision of credit and insurance schemes. Some countries have also introduced export processing zones as a means of promoting exports. These zones provide special incentives for firms investing in them, while absolving the countries from having to change the overall structure of their trade policy regime. In some of the regional integration arrangements, export promotion activities consist of the provision of trade information and the financing, under certain conditions, of the activities of private firms geared towards the penetration of new markets or the development of new products.

Investment promotion has also taken many forms and takes place both at the national level as well as at the level of some integration arrangements. At the national level, investment promotion takes the form of a series of fiscal incentives including import duties exemption on raw materials and equipment brought into the countries for the production of goods. It also includes the exemption from local taxes and licensing requirements. Some countries direct their incentives for investment at specifically targeted industries, i.e. manufacturing , agro-industries, tourism or technology-intensive industries. At the regional level, attempts are usually made to harmonize the incentives offered in the member countries to lessen the negative effects of competition for investment among them.

II. OBSTACLES TO TRADE AND INVESTMENT

The liberalization of trade and investment is now generally accepted as desirable for economic growth and development. Although trade liberalization policies have been widely implemented in the ACS area, there are differences in the approach to that liberalization and the extent of the liberalization attained, as well as the commitment to the pursuit of the liberalization process. The contribution of foreign investment to economic growth and development in the countries of the area, under appropriate conditions, is widely acknowledged. That acknowledgment led most countries to undertake policy reforms specifically aimed at creating a favourable environment for investment. Most countries also engage in promotional activities designed to attract foreign investment. This section examines some of the possible obstacles to trade and investment in the ACS area.

a. <u>Trade</u>

The ACS includes countries at various stages of development with differing technological capabilities and resource endowments, as well as other national attributes which are significant in the determination of the countries' exports. Those of the countries with similar production structures and which produce similar goods for export will tend not to have a great deal of trade among themselves except when intra industry trade is generated; while those with production structures which are dissimilar and which produce different goods for export, will tend to have more trade.

The influence of the production structures, combined with the implementation of the inward looking trade policies of the past, have not been generally conducive to the development of trade among ACS member countries. Policies have tended to restrict market opportunities for exports in the area and created an anti-export bias, thus discouraging the production and development of non-traditional exports. This has, in turn, increased their dependence on the import of intermediate, capital and consumer goods from the industrial countries. Apart from the production of primary commodities, which were essentially exported to the industrial countries, the general orientation of trade and industrial policies had encouraged the development of products essentially geared towards local markets. In turn, this biased physical infrastructure towards serving the domestic market instead of encouraging the production and sale of exports.

Tariffs and non-tariff barriers of differing magnitudes usually designed to protect special domestic industries, still exist in the ACS area. These barriers exist at the national level as well as within those integration arrangements whose objectives were the establishment of a free trade area or a common market. Tariffs and non-tariff barriers can distort trade and the allocation of resources, while at the same time limiting a country's ability to respond to the rapidly changing conditions of the world trading environment. They also tend to impede the development of trade in the wider ACS area. In addition, the recession of the 1980s, which hit most of the countries, and the slowed growth of income in some of the ACS member countries in the 1990s have not encouraged the growth of trade in the area.

The ACS area contains a number of preferential trading arrangements, one objective of which was the liberalization of trade among the members of the arrangements. However, policies were also traditionally biased towards the protection of locally produced goods at the national and