



United Nations

ECLAC

ECLAC SUBREGIONAL HEADQUARTERS FOR THE CARIBBEAN

FOCUS

Magazine of the Caribbean Development and Cooperation Committee (CDCC)



ECONOMIC DIVERSIFICATION

ISSUE 2 / APRIL - JUNE 2017

ABOUT ECLAC/CDCC

The Economic Commission for Latin America and the Caribbean (ECLAC) is one of five regional commissions of the United Nations Economic and Social Council (ECOSOC). It was established in 1948 to support Latin American governments in the economic and social development of that region. Subsequently, in 1966, the Commission (ECLA, at that time) established the subregional headquarters for the Caribbean in Port of Spain to serve all countries of the insular Caribbean, as well as Belize, Guyana and Suriname, making it the largest United Nations body in the subregion.

At its sixteenth session in 1975, the Commission agreed to create the Caribbean Development and Cooperation Committee (CDCC) as a permanent subsidiary body, which would function within the ECLA structure to promote development cooperation among Caribbean countries. Secretariat services to the CDCC would be provided by the subregional headquarters for the Caribbean. Nine years later, the Commission's widened role was officially acknowledged when the Economic Commission for Latin America (ECLA) modified its title to the Economic Commission for Latin America and the Caribbean (ECLAC).

Key Areas of Activity

The ECLAC subregional headquarters for the Caribbean (ECLAC/CDCC secretariat) functions as a subregional think-tank and facilitates increased contact and cooperation among its membership. Complementing the ECLAC/CDCC work programme framework, are the broader directives issued by the United Nations General Assembly when in session, which constitute the Organisation's mandate. At present, the overarching articulation of this mandate is the Millenium Declaration, which outlines the Millenium Development Goals.

Towards meeting these objectives, the Secretariat conducts research; provides technical advice to governments, upon request; organizes intergovernmental and expert group meetings; helps to formulate and articulate a regional perspective within global forums; and introduces global concerns at the regional and subregional levels.

Areas of specialization include trade, statistics, social development, science and technology, and sustainable development, while actual operational activities extend to economic and development planning, demography, economic surveys, assessment of the socio-economic impacts of natural disasters, climate change, data collection and analysis, training, and assistance with the management of national economies.

The ECLAC subregional headquarters for the Caribbean also functions as the Secretariat for coordinating the implementation of the Programme of Action for the Sustainable Development of Small Island Developing States. The scope of ECLAC/CDCC activities is documented in the wide range of publications produced by the subregional headquarters in Port of Spain.

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FOCUS: ECLAC in the Caribbean is a publication of the Economic Commission for Latin America and the Caribbean (ECLAC) subregional headquarters for the Caribbean/Caribbean Development and Cooperation Committee (CDCC).

EDITORIAL TEAM:

Director	Diane Quarless, ECLAC
Editor	Alexander Voccia, ECLAC
Copy Editor	Denise Balgobin, ECLAC
Coordinator	Sheldon McLean, ECLAC
Design	Blaine Marciano, ECLAC

Cover Photo: Courtesy Pixabay.com

Produced by ECLAC

CONTACT INFORMATION

ECLAC Subregional Headquarters for the Caribbean
PO Box 11113, Port of Spain, Trinidad and Tobago
Tel: (868) 224-8000
E-mail: spou-pos@eclac.org Website: www.eclac.org/portofspain



DIRECTOR'S DESK:

ECONOMIC DIVERSIFICATION

This issue of the Focus explores the economic diversification of Caribbean countries as a strategy for reducing income volatility which resulted from the unexpected decline in commodity prices, and from the fall in demand for services exports arising from stagnation in some markets. The concentration of exports in tourism, or in a few primary products, has historically made Caribbean economies extremely vulnerable to external shocks.

Indeed, the importance of economic diversification has gained renewed interest in the aftermath of the global economic and financial crisis of 2008-2009, particularly since the income loss incurred during the post-crisis years weighed heavily on countries. For these reasons, export diversification with a view to building the economic resilience of the countries of the subregion is critical.

This edition of Focus therefore reviews recent research undertaken by the ECLAC Caribbean team in areas that offer scope for diversifying the economic base of Caribbean countries. We begin with a conceptual piece that reflects on the critical elements that should be part of a country's industrial policy if it is to foster effective economic diversification; an optimum strategy for picking winners; fostering public-private partnership; the use of evidence-based criteria for measuring success, and the need for sunset clauses; the importance of promoting principles such as accountability and transparency.

The results of recent studies are then presented to stimulate thought and discussion on opportunities for diversification in the Caribbean. The first describes the trade performance of Belize, Suriname and Trinidad and Tobago with the European Union (EU) under the existing Economic Partnership Agreement (EPA). The study identified

challenges and constraints faced by exporters in these countries, and presented possible avenues for strengthening export expansion. The study concluded that industrial policy can be designed to facilitate economic diversification. Embarking on any industrial policy requires making choices, which means prioritising activities and facilitating the process of self-discovery. However, emphasis should be placed on activities which have spill-over effects, rather than merely impacting targeted sectors.

In order to develop a new industry, policy makers will need to take the right steps years, even decades in advance. The next article therefore identifies the diversification of production as a long term development priority, and a fundamental factor for successful development is human capital. In this regard, educating the labour force increases its efficiency and productivity, as well as its intellectual flexibility, which is key to adapting to new technologies and industries. Any government seeking to achieve diversification must therefore ensure that the education system is reformed to prepare students for participation in current and future industries targeted by industrial policies.

Furthermore, policy intervention should also be geared towards developing local capacity. The final article on local content policy (LCP) describes how this

can be used as a capacity development tool, insofar as it helps establish linkages between the natural resource extractive sector and the non-extractive sector. Indeed, local content policy (LCP) can increase the amount of value added captured domestically. LCP can be used to complement industrial policy to encourage the production of inputs, develop the competencies of human capital, strengthen the backward and forward linkages, and help economies build resilience to withstand unforeseen negative economic shocks.

It is important to address the Caribbean development dilemma in a holistic manner while fostering structural change and economic diversification. To do so, ECLAC proposes to focus on the development of sectors that will enhance growth and build economic resilience rather than achieve mere stabilization after each successive economic shock. This edition seeks to provoke deep thought on a way forward towards meaningfully strengthening the economic foundation of the Caribbean.

Yours in Focus

A handwritten signature in black ink, appearing to read 'Diane Quarless'.

Diane Quarless



DIVERSIFICATION AND INDUSTRIAL POLICY: SOME CONCEPTUAL CONSIDERATIONS AND A WAY FORWARD FOR THE CARIBBEAN

Dillon Alleyne

The calls for economic diversification have been expressed more frequently by Caribbean policy makers, since the global economic crisis of 2008-2009. Three main factors account for this.

First, there is widespread evidence that dependence on a narrow range of products and markets magnifies income volatility, widens the current account deficit and negatively affects medium term growth.¹ Second, the perspective that the market is the primary instrument of efficient resource allocation and growth has been undermined by success stories among developing countries that have used industrial policy to advance their development agenda. Third, the view that industrial policy is flawed because governments cannot pick winners has come under scrutiny as new evidence suggests that past industrialisation strategies have had some success.²

In discussing economic diversification, it is important to distinguish between horizontal and vertical diversification. On the one hand, horizontal diversification is a change in the primary export mix which implies that the number of export sectors has increased. Vertical diversification on the other hand involves contriving further uses for existing and new innovative commodities by means of value-added ventures such as processing and marketing. Diversification when mentioned in the

Caribbean context refers generally to both aspects in addition to changes in the domestic economic structure.³

WHICH KIND OF INDUSTRIAL POLICY?

It is now common to argue that changing the structure of exports requires changes in the structure of domestic production through industrial policy.

Such policies have had a chequered reputation in the past in Latin America and the Caribbean where they tended to entrench special interests and encourage inefficient patterns of production. The arguments for promoting industrial policy have been resurrected by Rodrick (2004) and others who argue that markets left by themselves will not produce the structural change necessary for development since there is a cost to self-discovery. Self-discovery refers to the ability of a firm to understand the cost structure of an activity which would allow that firm to be competitive. Furthermore, because the incumbent firm would not be protected from competitors, there would be no incentive to commence the self-discovery search process. The implication is that businesses need

some initial protection of their ideas to encourage them to invest.

While much of this analysis focuses on how to encourage new products, the empirical trade literature suggests that countries grow more by producing greater quantities of existing goods in new and existing markets (the intensive margin), rather than by generating new exports (the extensive margin). This notwithstanding, embarking on any industrial policy requires making choices, which means prioritising activities. Rodrick (2004) is careful to argue that what must be identified are not sectors but activities which have spill-over effects. Whatever the approach, some initial identification of activities must occur if a genuine industrial policy is to be pursued. This article identifies a set of inter-related strategies that could guide an industrial policy for the Caribbean.

PUBLIC AND PRIVATE SECTOR PARTNERSHIP

It is well recognised that bureaucracies in the Caribbean do not generally have a track record of efficiency (Anatol 2010).⁵

However, although it remains unclear

¹ Chris Papageorgiou and Nikola Spat. (2014) Economic Diversification in LICs: Stylized Facts and Macroeconomic Implications. I M F staff Discussion Note. December 14, 2012 SDN/12/13; Yvonne Tsikata, Emmanuel Pinto Moreira Pamela Coke Hamilton. Accelerating Trade and Integration in the Caribbean Policy Options for Sustained Growth, Job Creation, and Poverty Reduction. World Bank. 2009; ECLAC. Structural change for equality. An Integrated Approach to Development. Thirty-fourth session of ECLAC San Salvador, 27 - 31 August.

² Henry Burton, Import Substitution in Handbook of development Economics, Vol2.Ed; Hollis Chenery and T .N Srinivasan. (Amsterdam:North Holland, 1989) pp.1601-43.

³ This is important since Guyana has a wide range of exports but most in primary processing.

⁴ Danny Rodrick (2004) .Industrial Policy for the 21 Century. John F. Kennedy School of Government. Kennedy Street Cambridge, MA 02138. UNIDO.

⁵ Marlon, Anatol (2010) Survival: The necessity for industrial diversification in Trinidad and Tobago. Caribbean Dialogue, Vol. 15 Issue 3/4, pp. 1-13.

whether there is enough capacity to take on large scale industrial restructuring, due to lack of coordination among various activities, including marketing and research and development, there are opportunities which could give bureaucracies a push start, so to speak. First there has to be greater collaboration between the private sector (more broadly defined rather than confined to a few well established interest groups) and the public sector to seek out new activities and to share costs where necessary. The role of PPP can be critical to industrial policy since governments may lack financial resources and entrepreneurial talent to develop new business activities. In addition, governments as partners to the private sector, help to reduce private risks and encourage more investment. Moreover, collaboration creates learning opportunities for the public sector. However, given that not all projects will be successful, such collaboration must be transparent, and policymakers must be ready to abandon projects and ideas in the face of evidence of failure. At the same time, public servants must also have the flexibility to recognise opportunities and to act on them quickly. Under the current arrangements, in which the incentives for innovation and change by public servants are not usually encouraged, new institutional forms may be necessary to create a more dynamic public sector.

Rodrick (2004) makes the point that institutions tasked with implementing industrial policies must be the ones with a track record of success. In this case, the implementing capacity of the public sector may be even more restricted.⁶ One way in which public policy can be helpful is to use targeted public procurement policies to assist historically excluded groups such as women and

youth to improve their participation in government funded projects and programmes.

THE CHALLENGE OF PICKING WINNERS

The idea of picking winners by policy makers, is very contentious in the economic literature because it is recognised that the private sector will bear the cost of unwise investment while bureaucrats may only face reputational risks.

In addition, there is no reason to believe that the public sector has any more information than other groups with respect to what sectors or activities will be successful. For this reason, the preference is to focus on activities rather than on sectors. For example, governments can invest in improving marketing and information flows and implement quality standards, which raise the performance of a broad range of firms. They can also build facilities to encourage clusters of activities which encourage learning through agglomeration and attract the relocation of specialised skills.

It is also argued that the composition of a country's basket of goods matters as well as its areas of specialisation. In other words, producing potato chips is not similar to producing computer chips as the latter requires higher order skills. Depending on the type of diversification being pursued, industrial policy should focus on export competitiveness, product quality, and on activities having a certain amount of local content (human or material) or innovative capacity. For example, in economies which are foreign exchange constrained, the emphasis should be on import

substituting activities and firms that are able to use local inputs efficiently for exports. In general, all or some of these ideas could guide the list of activities to be supported by public policy.

SUNSET CLAUSES AND EVIDENCE BASED SUCCESS CRITERIA

It should be a principle of industrial policy design that all projects that have some support from the government should have a sunset clause that sets out the termination of that support (Rodrick 2004).

This creates an incentive for firms to improve their competitiveness in light of the certain removal of support. Critical to such an arrangement would be proper record keeping, which would be needed to stymie those operators who would seek to remain in the programme when they should depart. Any successful attempt to game the system will create distortions between those who are genuine performers and those who are not. For this reason, decision making must rely on evidence based procedures rather than on discretion.

► (continued on page 11)

⁶ The SDG agenda recognises both the need for industrial policy and diversification. Subgoal 8.2 of the SDG agenda, calls for the achievement of higher levels of economic productivity through diversification, technological upgrading and innovation, including through a focus on high-value added and labour-intensive sectors. In addition goal 9 calls for building inclusive and sustainable industrialisation.



IMPROVING EXPORT PERFORMANCE AND PROMOTING INDUSTRIALIZATION IN THE CARIBBEAN: THE CURIOUS CASE OF GOODS PRODUCING ECONOMIES

Sheldon Mc Lean

The World Trade Organization (WTO) Agreement (1995), and its predecessor, the General Agreement on Tariffs and Trade (GATT), ushered in an era of international commerce which has been characterized by the gradual removal and lowering of barriers to trade, as well as trade distorting measures such as quantitative restrictions, subsidies and tariffs.

With the gradual dismantling of trade restrictions, the WTO's policy regime established the basis for freer trade and improved market access for exports. At the same time the numbers of regional trade (preferential) agreements (RTAs)¹ has steadily increased since the establishment of the WTO, as groups of economies attempt to secure favorable improved market access conditions among themselves. This is regarded as necessary to generate additional demand to boost exports as well as to exploit opportunities for joint production.

In relatively small, open economies such as those in the Caribbean, the export sector plays a strategic role in fostering the diversification of a country's economic base and improving growth rates on a sustainable basis. This is possible due to a liberalized global trading environment, which offers significant opportunities for expansion

of economic activity via increasing exports. However, capitalizing on such opportunities calls for the development of focused policies and strategies, including those related to investments, as well as the provision of support services to enterprises in meeting the many challenges associated with international trade. Indeed, despite having relatively open economies and espousing a focus on export expansion, free trade has not truly become the integral vehicle of growth and development for Caribbean economies as originally envisaged.

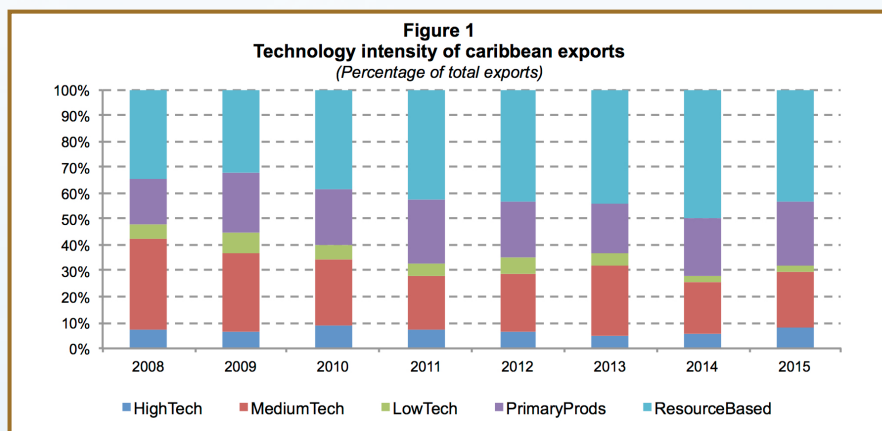
ECLAC Caribbean recently completed a study which focused on the identification of the challenges and capacity constraints faced by enterprises in the sub-region in exploiting trade opportunities provided by Free Trade Agreements (FTAs), and Partial Scope Agreements (PSAs). The research also sought to develop a strategic framework

aimed at addressing these challenges and constraints, thereby creating a platform for export expansion and diversification.

The study was limited to the goods sector, using Belize, Suriname, and Trinidad and Tobago in a case study. For each country, two trade Agreements were selected as the basis for trade performance analysis – a Free Trade Agreement (FTA), and a Partial Scope Agreement (PSA). This article explores their recent trade performance under the selected trade agreements; identifies challenges and constraints faced by their respective exporters, and presents possible avenues for strengthening export expansion of new and existing products.

This type of analysis is useful in identifying missing elements of a strategy for expanding the region's exports. So, for example, examination of the technological sophistication of Caribbean exports reveals that the sub-region's exports have been mainly primary products and goods with relatively low levels of technological intensity in production. See Figure 1.

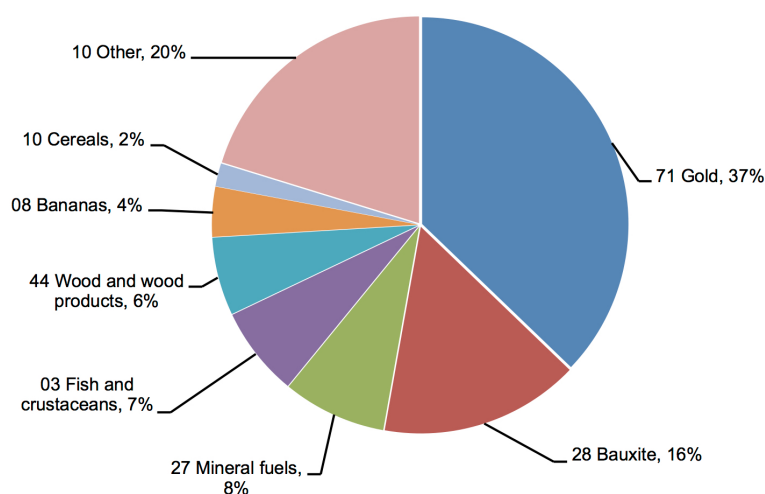
On average, about 98 per cent of the exports of both Guyana and Suriname fall in either the category of primary products or in that of a relatively low level of technological intensity in production. With respect to Belize and Trinidad and Tobago, these two categories make up 73 per cent and 66



Note: Antigua and Barbuda, the Bahamas, Barbados, and Dominica have no data available.
Source: COMTRADE via WITS.

¹ A regional trade arrangement (RTA) is a free-trade agreement, customs union or common market consisting of two or more countries.

Figure 2
Suriname Top Global Exports by HS2 Product Clusters, 2015
 (Percentage)



Note: Antigua and Barbuda, the Bahamas, Barbados, and Dominica have no data available.
 Source: COMTRADE via WITS.

per cent of all exports, respectively, on average. This highlights the need for the economies of the subregion to move further up the value chain and into the production of more manufactured goods as well as to enhance the value-added in existing goods. ECLAC Caribbean has therefore increasingly focused on the economic transformation of Caribbean economies, with a view to guiding the region along a sustainable path towards comparative advantage-based industrialization and production integration.

OVERVIEW OF THE CASE STUDY FINDINGS

The research revealed that where trade with the European Union (EU) under the Economic Partnership Agreement (EPA) was concerned, the Agreement had not triggered any significant change for any of the countries studied.

The basket of exports remained virtually unchanged. It was also revealed that the global recession of 2008 generally had a more pronounced effect on trade performance than the coming into force of the Agreement. Specifically, there was significant fall off in export earnings post-recession when compared to the period prior to 2008. In the case

of Trinidad and Tobago, with respect to its PSA with Colombia, significant growth in exports was discerned in the period leading to the global recession in 2008, but with sharp declines thereafter, reflecting the depressed prices of energy related products. Opportunities to increase Surinamese exports to the Cuban market and Belizean exports to the USA market with respect to fresh fruits and vegetables were also explored.

Based on consultations with exporters and trade related institutions, key challenges and constraints to export expansion were linked primarily to the need to enhance the export enabling environment, particularly with respect to trade facilitation services and trade capacity development for individual exporters and export enterprises. If we take a closer look at the export performance of the individual countries a number of observations can be made.

THE CASE OF BELIZE

In the case of Belize, in 2015, the top five exports accounted for three quarters of the total exported value (74.2 per cent) with each product earning over US \$20 million.

Moreover, in 2015, banana replaced

crude oil as the top export at US\$73 million, followed closely by sugar at US \$70 million. The combined exported value of these two products was US \$143 million or 43 per cent of the total for the year. The other top four exports were citrus juices, preparations of vegetables and fruits, fish and crustaceans, and mineral fuels (see figure 2).

With regard to the impact of the CARIFORUM-EU EPA, with the exception of orange juice, all of Belize's top exports enjoyed duty free access to the EU market under ACP preferences prior to the coming into force of the EPA. Accordingly, the ECLAC study found that market access would not have been a factor in explaining the observed increases in export levels of some of the top exports. However, the data suggest that some of the country's exports of orange juice to the US were diverted to the EU market on the coming into force of the EPA to take advantage of the improved market access – going from 5.7 per cent ad valorem equivalent tariff prior to the EPA in 2008 to duty free entry post EPA.

The analyses also highlighted that for Belize, consideration of export to the US market should be given for agricultural products such as hot pepper, cucumber, cabbage, fresh and chilled vegetables, beans, peas, yams, chick peas, pigeon peas, sweet potatoes, papaya, coconuts, lemons, mandarin, watermelon, avocado and frozen fruits. In addition, orange as well as grapefruit juice should be considered for increased exports to the EU given the increasing competitiveness in this market.

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IMPROVING EXPORT PERFORMANCE AND PROMOTING INDUSTRIALIZATION IN CARIBBEAN: THE CURIOUS CASE OF GOODS PRODUCING ECONOMIES

However, increasing exports at the intensive margin, that is expanding existing exports, may not necessarily address the vulnerability of the economy's export earnings to volatility. There is high concentration of the export basket among five products with the top two markets, bananas and sugar, accounting for approximately two thirds of the total exported value. This exposure is compounded by the fact that most of these are commodities and as such are subject to commodity price cycles.

THE CASE OF SURINAME

Suriname has a relatively diversified export market with eleven trading partners accounting for 94 per cent of the country's exports in 2015.

The top market destinations in 2015 were: Switzerland (25.6 per cent), India (17.6 per cent), Belgium (11.3 per cent), the US (11.2 per cent) and France (9.6 per cent). Suriname's global exports are however concentrated, in the top six product clusters accounting for 78 per cent of the total. In 2015, gold was the most exported item accounting for 37 per cent of total value of exports at US\$1,400 million. The other products were inorganic chemicals at 16 per cent of total exports, mineral fuels (8 per

Specifically, Suriname's bauxite exports declined by 17 per cent versus a decline of 5 per cent for world imports, while cereal exports declined by 5 per cent compared to the decline of 2 per cent for world imports. In the case of bananas, Suriname's export increased by 1 per cent compared to an increase of 5 per cent for world imports, while exports of beverages remained unchanged as compared with a growth of 1 per cent for world imports.

Moreover, Suriname's gold, fish and wood exports have outperformed global imports, suggesting that there exists considerable potential for expanding exports of these commodities, all of which are primary products.

With regards to Suriname's trade with the EU under the EPA, the ECLAC study concluded that, to date, there appears to be no discernible effect of the EPA on exports, either in terms of growth in exported value or in the composition of the export basket. With respect to the performance of mineral exports both lower production levels and softening of prices appear to have contributed to declining export earnings. However, in the case of agricultural related industries, the rice sector experienced a significant

indicates strong similarities in terms of the product composition of the export basket as well as trade performance over the years of analysis, 2004 -2015.

In both cases, the products comprising the top ten exports, in value terms, were dominated by hydrocarbon based products. As a consequence, export performance was largely driven by a single factor, i.e., the movement in energy prices. Accordingly, in both cases export showed rapid growth over the period 2004 – 2008 and a subsequent sharp decline over the 2008 – 2015 period.

Trinidad and Tobago's export performance trends over the period 2004 – 2015 underscore the vulnerability to commodity price swings when the basket of top exports is narrowly concentrated. This is exacerbated by the fact that the majority of its exports is comprised of energy-based products whose performance is essentially driven by one factor, i.e., energy prices. While there doesn't appear to be an EPA-effect on the country's exports to the EU, the data seem to suggest that Trinidad and Tobago's exports to the EU are primarily driven by fluctuations in industrial demand within the EU, particularly since the majority of

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