Prospects and Challenges for the Caribbean

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LIST OF ACRONYMS

CARIBCAN	Caribbean Community/Canada Technical Cooperation Agreement
CARICOM	Caribbean Community Secretariat
CBI	Caribbean Basin Initiative
CGCED	Caribbean Group for Cooperation in Economic Development
DOD	Debt Outstanding and Disbursed
DBMC	Dominica Banana Marketing Corporation
ERP	Economic Recovery Program
EU	European Union
FDI	Foreign Direct Investment
FTAA	Free Trade Area of the Americas
GALs	Guaranteed Access Levels
GDP	Gross Domestic Product
GNFS	Goods and Non-factor Services
GNP	Gross National Product
GSP	Generalized System of Preference
IDA	International Development Association
IDB	Inter-American Development Bank
IMF	International Monetary Fund
NAFTA	North America Free Trade Agreement
OECD	Organization for Economic Cooperation and Development
OECS	Organization of Eastern Caribbean States
SITC	Standard International Trade Classification

INTRODUCTION

A TRAVEL POSTER OF TOURISTS in an unspoiled tropical lagoon shows one side of the Caribbean, but not the side where most of the region's 20 million people live—struggling close to or below the poverty line. Although a few countries are realizing their potential as business locations and tourist destinations a few hours from Miami and New York, most of the region faces many of the problems typical of poor countries everywhere.

Fortunately, the economies of these countries are small, so major improvements of living standards would not require massive investment or huge export marketing opportunities. Moreover, the Caribbean's close economic and communications links with Europe and North America, and the large expatriate communities there, could provide the necessary resources and market niches for goods and service exports. To some extent they already do.

On the other hand, their small size and convenient location are not unmixed blessings for Caribbean countries. Proximity to North America makes it easy for financial capital and human capital—the best educated young people—to move out if things look even temporarily sour at home. And location between South and North America attracts criminal activities, drugs, and money laundering on a scale that threatens to overwhelm some local governments and societies. What's more, the small populations and narrow economic bases magnify the severity of these threats.

The challenge for the people and policymakers of the region is to promote sustainable growth at a pace that will realize the opportunities while avoiding the dangers, and thus close the gap with North America and Europe. Improving the governance and growth in the Caribbean will benefit not only the 21 million residents, but will also improve the prospects for protecting the environment and fighting international crime. This has disproportional importance to the rest of the world because of the ecological diversity of the region and its strategic location astride the routes between South and North America.

For the most part, the political basis to meet this challenge has important strengths. In recent years peaceful transitions from one elected government to another have deepened democracy in

the English-speaking countries, and some Caribbean countries have had political transitions to democracy where it was weak or absent. Sustaining these political successes will require sustaining economic development.

Tourism, other service exports and manufacturing are leading the Caribbean growth. In none of these areas, however, is the region growing as fast as the world market. And overall, the region is growing only slowly—growth per capita is slower than in East Asia, Latin America, and even the high-income countries. The danger now is that growth might slow further, widening the gulf between incomes in Caribbean and in Europe and North America. The end or decline of traditional preferential trade arrangements and the expansion of Mexico, Cuba, and other competitors threaten to undermine the bases for even the modest growth achieved recently. To prepare for these eventualities, Caribbean countries need to speed up implementation of the investments and policy adjustments that will facilitate diversification of the private sector.

Improving policies in the Caribbean will continue to bring benefits no matter what the rest of world does, but the benefits will be greater if the industrial countries liberalize their imports of non-traditional Caribbean products. The advent of the North American Free Trade Agreement (NAFTA) in 1994 produced high hopes that it would lead to a similar agreement for the Caribbean, but such an agreement has not materialized and is not near the top of the post-1996 election agenda in the United States. Some Caribbean countries have also been looking to expand economic relations with South America, which have been minimal in the past, and with Europe. Apparel, shoes, and sugar are the main products for which NAFTA gives Mexico an advantage over the Caribbean, with apparel being the most important. In the early 1990s, Caribbean apparel exporters increased their market share in the United States, but growth slowed in 1994–96 to about the same pace as the market. Mexican apparel exports to the United States, in contrast, were already growing faster than the Caribbean in the early 1990s and have further accelerated since NAFTA was signed.

The trade agreement came at a time when the major industrial countries were reducing aid flows and emphasizing export development in their assistance strategies. The countries of the Caribbean have accepted this new reality and have made many of the changes necessary to open their economies. To realize the full long-run of opening in the Caribbean, however, the main industrial trading partners must further improve the export opportunities for non-traditional products from the Caribbean and must taper off their financial assistance in a way that does not make excessive debt-servicing demands on the heavily indebted governments of the region.

Caribbean countries, particularly the larger ones, continue to attract private investment from the rest of the world, but it is not enough to offset the decline in official aid over the past decade. Although governments of smaller economies continue to receive positive capital flows, often very large per capita, the net repayments from governments of larger economies put a serious burden on public saving. Private foreign direct investment (FDI) has grown since 1992. This is a favorable change of composition, because experience elsewhere indicates that FDI is less liquid and volatile, is the most likely to increase efficient investment and growth, and is the least likely to finance unsustainable government spending or exchange-rate overvaluation. Getting more growth will require more investment, which will require making the opportunities more attractive for private saving and financing from abroad and at home.

The increased openness of most Caribbean economies over the past decade, the improved macroeconomic stability and the growth of foreign direct investment are reasons to hope that overall growth will accelerate in the future. To realize this hope will require continued increase in trade openness, improved labor and financial market systems, and more efficient public sectors, focused on human resource development, law enforcement, and facilitation of private-sector growth. It will also require more innovative and export-oriented private sectors. These developments to raise labor productivity will be necessary to keep exports growing along with real wages.

1 RECENT TRENDS

IN THE LAST FEW YEARS the common trait of most Caribbean countries—democracy—became even more widespread in the region.[1] Democracy was restored in Haiti, and a peaceful, if tense, election brought in a new president—the first time ever that one elected president had succeeded another there. Elections also brought in new governments in Barbados in 1994; in Dominica, Grenada, St. Kitts and Nevis, and Trinidad and Tobago in 1995; and in the Dominican Republic and Suriname in 1996. A new prime minister was chosen in St. Lucia in early 1996. Thus, the majority of independent Caribbean countries have new governments since 1994. The turnover of governments through the constitutional process, which is a hallmark of true democracy, is much in evidence in the Caribbean.

There also are less welcome political developments, however, especially relating to international drug-trafficking and money-laundering operations, which have sought to buy safe havens in the region. The 1992 report by the West Indian Commission, *A Time for Action*, said that "Nothing poses greater threats to civil society in CARICOM countries than the drugs problem." The democratic process has thus far resisted wholesale incursion in most countries, but the location of the Caribbean on the flight path from South America to North America, and the small size of the economies, makes them exceptionally vulnerable to a threat that continues and would increase with any decline in the general economy. This threat highlights the importance of the Caribbean to the fabric of international law and order.

The Caribbean countries have widely varying economic situations. (See Annex I for a statistical overview.) Income levels range from low in Guyana and Haiti to upper-middle in Barbados and some countries of the Organization of Eastern Caribbean States (OECS). All the coun-

tries have service-export industries, including tourism, but their importance varies. In Barbados, the Bahamas, and some of the OECS countries, where service industries have developed most strongly, people now enjoy the highest per capita incomes in the region. Rising labor incomes are gradually pricing these countries out of traditional agricultural export activities, but during their economic transition they have been able to use migrant labor from other, lower-income islands. Thus the export-diversification strategy of moving into services, a strategy to which most countries have subscribed in their medium-term plans, has succeeded where it was pursued. Countries that moved slowly with this strategy, however, now need to implement it more expeditiously in order to prepare for the accelerating changes in the world economy.

GROWTH

Growth in the Caribbean in the 1990s has been positive in all countries except Haiti and, with Haiti excluded, has been slightly faster on average than in the 1980s. (See Table 1.1.) Exports have grown in most countries, although very strongly only in the Dominican Republic, Grenada and Guyana.

In per capita terms, however, the growth for the Caribbean as a whole was slightly negative for 1991–95. Haiti had the worst growth performance, but even in the rest of the region per capita growth averaged barely 1 percent per year. (See Table 1.2.) This is poor by world standards; annual per capita growth of gross domestic product (GDP) for the period was 7.6 percent in East Asia, 2.0 percent in South Asia, 1.3 percent in the high-income countries, and 1.1 percent in Latin America. The Caribbean out-performed the Middle East, Africa, and Eastern Europe-Central Asia, where growth was negative on average, but this hardly addresses the aspirations of the Caribbean.

External conditions partly, but only partly, explain the recent growth outcomes in the Caribbean: Hurricanes and tropical storms retarded growth in St. Lucia in 1994–95 and in Dominica, St. Kitts/Nevis, and Antigua/Barbuda in 1995–96. Continued growth in Europe and the United States, however, has kept the

Table 1.1
GDP at Factor Cost and Export Growth Rates, 1981–95
(average annual percentage changes)

	GDP[1]		
	1981–1990	*1991–1995*	*Exports 1991–1995 (curr US$)*
Antigua & Barbuda	6.3	1.9	2.0
Belize	4.7	4.6	3.0
Barbados	1.0	–0.4	1.0
Dominica	4.5	1.3	2.0
Dominican Republic	2.6	2.8	9.0
Grenada	4.7	2.3	9.0
Guyana	–3.1	7.3	12.0
Haiti	–0.1	–5.5	–8.0
Jamaica	2.5	1.0	6.0
St. Kitts and Nevis	5.8	3.6	2.0
St. Lucia	5.3	3.8	5.0
St. Vincent and the Grenadines	6.7	3.0	0.0
Suriname	0.6	1.6	–4.0
Trinidad & Tobago	–3.5	0.6	–1.0
Region	2.7	2.0	2.7
Region w/o Haiti	2.9	2.6	3.5

Sources: World Bank's economic and social database; IMF's Recent Economic Development Reports; and World Bank Staff Estimates.
[1]annual average % change calculated from GDP at factor cost.

Table 1.2
Growth and Integration, by Region

Region	*Real per capita GDP growth, 1995–95*	*Growth of real exports per capita, 1991–95*	*FDI inflows as a percentage of GDP, 1993–95*
East Asia	7.6	14.1	3.1
South Asia	2.0	8.4	0.3
High income	1.3	5.0	n.a.
Latin America & Caribbean	1.1	7.2	1.1
Caribbean	1.0[a]	1.6[b]	4.4[c]
Middle East & North Africa	–0.5	0.4	0.4
Sub-Saharan Africa	–1.6	–1.6	0.9
European & Central Asia	–8.6	1.0	1.4

n.a. Not applicable.
a. Excludes Haiti.
b. Includes Barbados, Dominican Republic, Guyana, Jamaica, Suriname and Trinidad & Tobago, which had more than 70 percent of the region's exports in 1994.
c. 1992–94, excludes Haiti and Suriname.
Source: World Bank, *Global Prospects and the Developing Countries* (Washington, DC, March 1996); World Bank data.

Caribbean tourist industry growing, if not in high boom. Higher world mineral prices helped exporters of oil (Trinidad), nickel (Dominican Republic) and bauxite (Guyana, Jamaica, and Suriname). Sugar exporters (in most islands; see Table A1.1) faced mixed news, as world prices improved. But the reform of the Common Agricultural Policy in Europe, where most Caribbean sugar is sold, brought the European price closer to the world price and thus lowered the effective value of the preferential access. For countries like Guyana that can produce more at the lower price, opportunities will improve because expansion of the European Community is leading to increased sugar quotas for the Caribbean. Banana exporters (Belize, Jamaica, and the Windward OECS economies) now must compete in Europe with bananas from Central and South America; the current quota system restrains the quantity of competition, but that restraint is slated to drop in 2001. The recent preliminary WTO decision against the European Union will probably hasten the decline. Banana growers in the Windward Islands, especially Dominica in 1995, were also hit hard by the storms.

POLICY REFORM AND GROWTH PROSPECTS

The effects of external factors, however, did not seem to persist as much as the effects of economic policy and of private-sector entrepreneurship. St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines have continued their good policies and growth from the 1980s, but the pace has slackened as their tourist sectors mature and as sugar and banana export revenues plateau. Barbados, the Dominican Republic, Grenada, and Trinidad and Tobago undertook varying degrees of structural adjustment in the 1980s and early 1990s and are now enjoying the fruits. Guyana has stabilized its macroeconomic situation, completed part of the needed structural reforms, and had strong growth in the 1990s as the economy rebounded from the disastrous effects of earlier policies. Haiti and Suriname also rebounded in 1995, on the first hints of reform. In the last three countries, this growth seems likely to continue only if structural reforms, such as privatization, trade liberalization, civil service reform and regulatory reform, improve the environment for the private sector. Other countries, have experienced stagnation or declining growth. In some countries, such as Belize and Jamaica, this is because the necessary adjustment programs are not complete; in others, such as Antigua and Barbuda, it is because such programs need to be initiated.

Most Caribbean countries have made substantial progress on macroeconomic stabilization in the 1990s. Inflation rates are now below 20 percent annually everywhere, indicating that the

Caribbean economies are sharing in the success of most Latin American and OECS economies in achieving more macroeconomic stability. (See Table 1.3.) Fiscal deficits have also declined in most countries and even turned to surpluses in a few.

Most Caribbean economies have substantial trade and financial relations with the rest of the world, but some barriers remain, even between the CARICOM countries. Table 1.2 shows that FDI inflows per capita in the Caribbean have been substantial, even greater than for East Asia, as Chapter 3 will discuss in more detail, but exports per capita have grown slowly in the 1990s.[2] The Caribbean economies have always been very open in the sense of high export and import shares of GDP, because of the smallness of the economies, but openness in the sense of foreign-exchange convertibility and lack of price distortions from world prices has come more recently and more slowly. Exports as a share of GDP were already high and have increased in the last decade in most countries, but the aggregate change is not large for the region. The composition of exports has changed greatly since the early 1980s. Whereas primary products dominated the region's exports until the mid-1980s, manufactured exports have grown considerably and are now the leading non-service exports to the U.S. market.

Given the trends of greater economic stability, smaller government deficits and more open trade regimes in most Caribbean countries, what are the prospects for future growth, compared with the recent deceleration? Recent worldwide research shows that when low- and middle-income countries open their economies and integrate with the rest of the world, they tend to have faster than average growth rates. In the open developing economies, per capita real growth between 1970 and 1989 averaged more than 4 percent and was at least 2 percent in each. The growing disparities in the distribution of world income resulted from the exceptionally poor growth performance by most countries that were not integrating or were becoming more closed. Among 27 countries that opened after 1975, per capita growth increased from slightly negative rates on average in the three years before the opening to positive rates in the year of reform and the next two, and after that average growth rose further.[3]

Table 1.3
Inflation and Fiscal Deficits in the Caribbean, 1980–95 (annual averages)

	Inflation		*Overall Fiscal Balance, % of GDP*	
	1981–90	1991–95	1980–89	1990–95
ANTIGUA	...	4	...	–6
BAHAMAS, THE	6	4	–2.5	–3
BARBADOS	6	3	–5	2
BELIZE	4	2	–7.5	–7
DOMINICA	5	3	–10	–11
DOMINICAN REP.	25	16	–1	–5
GRENADA	5	3	–28	–5
GUYANA	18	8	–48	–37
HAITI	7	25	...	...
JAMAICA	15	40	8.5	1
ST. KITTS	3	3	–4	–2
ST. LUCIA	4	4	–4.5	–2
ST. VINCENT	4	3	–3	–8
SURINAME	13	133	–17.5	–19
TRINIDAD	11	7	–5	1
Region	9	17		
Region w/o Suriname	9	9		

Sources: Ministries of Finance and Central Banks; IFS database and IMF's Recent Economic Development Reports; World Bank Staff Estimates.

So why has growth performance in much of the Caribbean been disappointing? Trade liberalization has begun but has not been completed and has not yet had a strong effect on growth. Contrary to the experiences of most countries that liberalized in the 1960s and 1970s, where the growth of output and exports responded quickly to trade liberalization, the response in the Caribbean to the liberalizations of the late 1980s and 1990s has been slower. The immediate cause of the difference seems to be that the countries with early successful liberalizations made and sustained a real depreciation of the exchange rate, which played a crucial role in stimulating and reorienting growth.[4] None of the Caribbean countries did this.

Another reason for the modesty of the growth response to trade liberalizations is that oligopolies of local trading companies still dominate the economy and policies in most Caribbean countries. In a variety of ways they limit the dynamic development that new entrants to the export sectors might lead. The traditional private sector has learned to live with and profit from most of the restrictive policies and procedures that discourage investment and growth. The restraints to fresh entrepreneurs include alien-landholding laws and various investment regulations that in law or practice require special ministerial approval in order to proceed. The remedy is not usually the abolition of all regulations. Investors want clear, published, and nondiscretionary regulations that provide adequate protection against breaches of contract or abuses of the environment and other resources, but that also allow desirable investment on a routine basis. The agenda for modernizing the public sector must include reorientation of its internal incentives so it provides a legal and regulatory environment that facilitates private-sector activity.

The business environment also needs to be improved by making labor markets more flexible and less contentious, upgrading economic infrastructure, especially telecommunications, and improving supervision and regulation of the financial sector. The rise of foreign direct investment, documented in Chapter 3, may indicate that past reforms are starting to pay off.

Many potential investors and entrepreneurs who would accelerate growth are often not involved in the economy prior to policy reform. Their potential employees, suppliers, and other beneficiaries are often unaware of what they are missing and are certainly not organized politically. So generating support for the reforms requires the political leadership to get out in front with a vision of economic development that would draw new and dynamic entrants into the process, benefiting their future employees and the economy at large.

2 NAFTA AND THE CARIBBEAN

TOURISM IS THE LARGEST EXPORT earner for the Caribbean, and minerals remain important for most of the larger countries. But manufacturing is second- or third-largest in most countries, and it is growing faster than minerals. More than 60 percent of Caribbean merchandise exports go to Canada and the United States; the share is even larger if one excludes sugar and bananas, which mostly go to Europe on preferential programs. So it is not surprising that Caribbean countries have sought free access for their goods to the North American market. They have followed with great interest the emergence of NAFTA and are actively promoting a Western Hemisphere Free Trade Agreement (WHFTA). Given the small size of their home markets, the best long-term growth opportunities for Caribbean countries would be with a large trade area to which they could export freely for various niche markets, and from which they could obtain low-cost, duty-free imports. The latter would increase competitiveness of Caribbean exports and tourism.

This chapter summarizes the aspects of NAFTA and the U.S. trade-preference regime that are relevant to the Caribbean. Although NAFTA has not yet had its full effects, patterns are emerging. This analysis concentrates on apparel exports to the United States, which are quantitatively the most important and for which detailed and recent information is available.

Trade-Preference Programs

The United States has several trade-preference programs that benefit the Caribbean. (See

Annex 2.) The Generalized System of Preferences has since 1976 granted the Caribbean and most other developing countries preferential access compared with other, mostly industrial, countries. **The Caribbean Basin Initiative (CBI),** implemented in 1983, offers even better tariff treatment for some products from the Caribbean and Central America, although it excludes many important Caribbean exports, like petroleum, sugar, textiles, clothing, and footwear. Canada has a similar program called the Caribbean Community/Canada Technical Cooperation Agreement, or CARIBCAN.

The U.S. Program for Production-Sharing Agreements, commonly known as the 807 Program, after its number in the tariff code, helps U.S. firms compete with labor-intensive foreign manufactures by allowing U.S. producers of partly finished goods, like cut cloth for clothing, to ship them abroad for assembly (sewing) and then to re-import them. Duty at the standard rate of 19 percent is levied only on the value added abroad. The program applies to many developing countries, not just the Caribbean, but proximity to the United States makes the program relevant mainly for Mexico and the Caribbean.[5] For most countries the program does not exempt these products from any existing quota or other non-tariff barriers. Although the program encouraged the growth of textile trade in the 1990s between the Caribbean and the United States, quota limitations impeded further growth for some countries. Accordingly, in 1986 the Reagan administration, under the umbrella of CBI, expanded the 807 Program to improve the Caribbean's access to the U.S. market. With the **Special Access Program** (CBI) and the **Special Regime Program** (Mexico), countries can increase their quotas as long as they demonstrate that they actually have the capacity to produce. Although this was an improvement and seems to have encouraged export growth, the quotas still discourage major new investments, because firms are reluctant to invest in a large factory for which the existing quotas do not allow profitable exports.

With the inception of **NAFTA** in 1994, Mexico, Canada, and the United States granted each other a number of reciprocal trade advantages, including progressive tariff reductions and immediate quota elimination. The Caribbean did not lose any of the special programs described above, but their relative value diminished. For most products, the CBI already provides Caribbean countries equal or better treatment than what Mexico receives under NAFTA. But Mexico now clearly has an advantage in two important areas—textiles and footwear. Prior to 1994, Mexico and the countries of the CBI received the same treatment on textile exports to the United States. Now NAFTA allows Mexico's apparel and footwear exports to enter totally duty-free, as long as these products are manufactured under the Special Regime Program; Caribbean exports under this program, meanwhile, must continue to pay some duty, putting them at a disadvantage. Understandably, Caribbean officials are concerned that NAFTA provisions for the trade of these products will have a negative impact on the region's trade.

Indeed, there are indications that it already has. New data on U.S. imports of apparel indicate that the Caribbean is losing some of its market share. In 1995, when U.S. apparel imports were growing at 10 percent, sales from Caribbean producers (mainly the Dominican Republic and Jamaica) grew at 13 percent. In 1996, the U.S. imports growth slowed to 5 percent, and Caribbean sales grew less than 1 percent. (See Figure 2.1.) Meanwhile, Mexican sales of apparel to the United States grew 61 percent in 1995 and 39 percent in 1996, despite the stagnant U.S. demand.

The CBI countries have sought to obtain NAFTA parity by way of the Caribbean Basin Free Trade Agreements Act. If implemented, this parity would grant CBI countries the same privileges that Mexico has attained through NAFTA. It would last 10 years, at which time countries would have to decide whether to join NAFTA, to form independent bilateral agreements, or to return to the original CBI trade policies. NAFTA parity would not be the same as joining NAFTA, in that parity would not obligate the Caribbean to give reciprocal treatment to Canada, Mexico, and the United States. To date, NAFTA parity has not passed the U.S. Congress,

although there is strong support from some officials. It was not an issue in the 1966 election, which avoided stirring up opposition but also left it out of the top spots in the post-election agenda of the president and the Congress.

EXPORTS OF THE CARIBBEAN COUNTRIES TO THE UNITED STATES

In 1980, about 98 percent of Caribbean exports to NAFTA countries (excluding goods manufactured in free-trade zones) went to the United States; in 1994, despite increased trade with Canada, the U.S. share was still 86 percent.[6] Moreover, *non-traditional* Caribbean exports to the U.S. market—led by apparel—almost quadrupled between 1983 and 1994, measured in current U.S. dollars (see Table A2.2). In 1983, textile apparel exports constituted only 6 percent of the exports of the Caribbean countries to the United States, but by 1994 their share reached 39 percent. About 80 percent of these exports entered the United States under the 807 Program, mostly from free-trade zones in the Dominican Republic and Jamaica.[7]

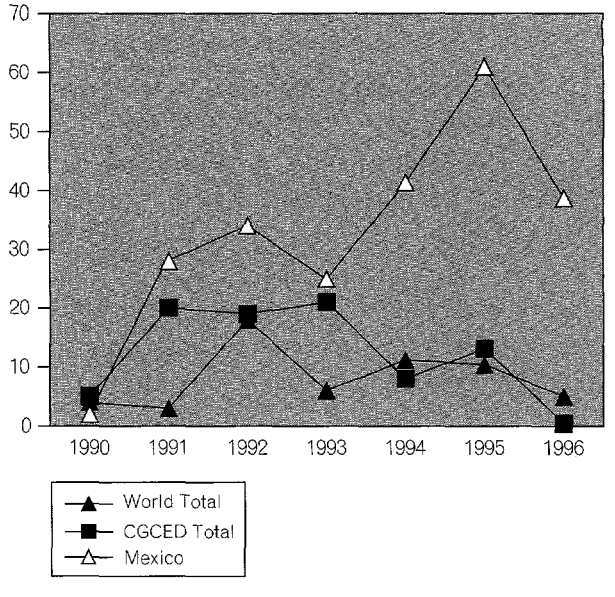
Within the free-trade zones, manufacturing is subject to minimal taxation. Material inputs and machinery enter duty-free, and investment is freed from most regulations, although the national environmental and labor regulations still apply. Consequently, the growth rate of apparel exports from the Caribbean to the United States in the early 1990s was higher on average than the growth rate of all such imports by the United States (see Figure 2.1). Between 1989 and 1994, apparel exports from the Caribbean to the United States increased by about 94 percent in current dollars, while total U.S. imports of textiles increased by only 49 percent (see Table A2.3).

The Dominican Republic and, to a lesser extent, Jamaica are the leading exporters of apparel and footwear to the United States among the Caribbean countries. By 1994, Dominican Republic apparel exports to the United States were US$1,572 million—more than double the 1989 figure—and Jamaica's were US$454 million, double the 1989 figure.[8] But this robust growth of apparel exports from the Caribbean countries to the United States slowed in 1994 and 1995 and virtually stopped in 1996.

In Jamaica in 1995–96, 23 factories in the apparel sector closed. Approximately 15,000 people lost their jobs. This translates to approximately J$1.2 billion in payroll and about J$300 million in taxes lost to the government. In 1996 Jamaican textile and clothing exports to the United States fell 5 percent.[9]

A look at Mexico offers a contrasting situation. Mexican apparel exports to the United States have grown faster than those from Caribbean countries since 1991, and in 1994 and 1995, after NAFTA took effect, they grew three to four times as fast. Between 1989 and 1994 Mexican apparel exports to the United States more than tripled, from US$500 million in 1989 to US$1,597 million in 1994. In the first year of NAFTA, 1994, the volume of such exports from Mexico to the United States grew by 41 percent, compared with 8 percent for apparel imports from the Caribbean countries and 11 percent for total U.S. imports of apparel. In the first nine months of 1995 the growth of Caribbean exports to the United States rebounded to 16 percent, while similar Mexican exports grew by 68 percent. In this same period, the value of Mexican apparel exports to the

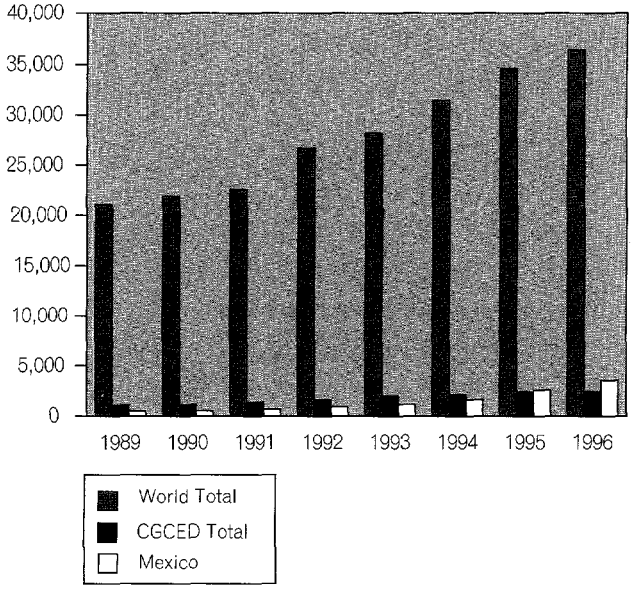
Figure 2.1
Growth of U.S. Apparel Imports from CGCED, Mexico and the World, 1990–96 (Percent Growth, US$)



United States surpassed for the first time the value of similar exports from the Caribbean.

The spectacular growth rates for Mexican textile exports must be considered in light of the small base from which they started, as Caribbean textiles also grew fast from a small base starting in the 1980s. Both Mexico and the Caribbean still have scope to increase their market shares, as one can see from Figure 2.2, which shows the absolute levels of U.S. apparel imports from the world, the Caribbean, and Mexico.

Figure 2.2
U.S. Apparel Imports from the World, CGCED, and Mexico (US$ millions)



RESPONSE STRATEGY

U.S. apparel imports from Mexico have accelerated because NAFTA makes them duty-free. Similar exports from Caribbean countries to the United States are subject to 19 percent duty on the value added in assembly, which is around 33 percent of the exports' total value. In other words, U.S. firms producing apparel and other products under the 807 Program may choose between outsourcing assembly operations to the Caribbean and paying an average 19 percent duty on the value added, or outsourcing to Mexico and paying no duty on the assembly value added. On the face of it, that is not a difficult choice—especially considering that apparel assembly operations are mobile geographically, because the required fixed investment is minimal and easy to transport.

Caribbean countries could offset at least part of this disadvantage if they made themselves more attractive than Mexico in other ways. Some advantages of the Caribbean—actual and potential—are economic: production quality and speed, education of the labor force, transportation costs, local costs of production, and transaction costs. Other advantages of the Caribbean are broader, including the long record of democracy and generally better governance and judicial systems. It would be self-defeating for the Caribbean to try to compete with Mexico, Central America, and Asia solely on the basis of low real wages, for the resulting emigration and social unrest would offset any gains in competitiveness. While avoiding real appreciation of the exchange rate is important, gaining competitiveness along with real income growth would require better investment in human resources and in economic infrastructure and improved policy environments for business. While it would be good for the Caribbean economies to improve in these ways, opportunities for closer integration with the larger regional trade blocks—NAFTA, MECOSUR, and eventually the Free Trade Area of the Americas—would also encourage apparel manufacturers to increase the share of value added in the Caribbean and help economic development generally.

To varying degrees the Caribbean countries have started moving away from trade policies of the past that relied on preferential market agreements, protected domestic economic activities from import competition, and perpetuated the concentration of Caribbean exports. Whatever the industrial countries do about past preferential arrangements and future opening to the Caribbean, it will be more based on geopolitical considerations than on any reciprocal trade concessions that the Caribbean might grant. Thus, it would benefit the Caribbean countries to complete the opening process quickly so that they could advertise themselves, for both manufacturing and export services, as attractive business locations near to Miami, Caracas, Toronto, Omaha, and even London or Brussels, via air or Internet.

3 FOREIGN CAPITAL AND AID

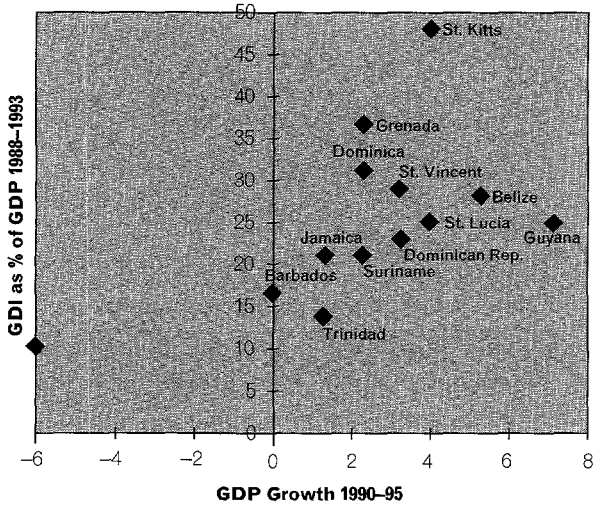
ECONOMIC ASSISTANCE TO THE CARIBBEAN has declined markedly since the early 1980s. In 1982 Caribbean governments received US$1.4 billion in grants and net loans from bilateral and multilateral donors and lenders, but by 1994 these net flows had declined to US$341 million.[10] Net flows to governments from commercial sources also declined, from more than US$200 million in 1982 to a negative level in the 1990s, with net repayments of averaging $169 million in 1993–95. (See Table 3.1.) The reversals have been more dramatic for some countries than others, as discussed below. The decline of official assistance resulted from the coincidence of three trends—the declining aid flows worldwide, the declining geopolitical importance of the Caribbean with the end of the Cold War, and the necessity of repaying the structural adjustment lending from the 1980s. The difficulty of this sea change has been mitigated by the shift of bilateral aid from loan to grant terms, in order not to repeat or exacerbate the problems that were emerging because of net repayment on earlier lending.

How has the Caribbean dealt with this decline of assistance? And what can the governments and the international donor/lender community do to help the economies obtain adequate resources for growth?

When aid flows first dropped after 1982, most of the economies contracted, with lower investment and growth. Then the countries mobilized more saving from other sources—domestic and foreign—to restore investment and

growth in the late 1980s and to offset further declines of aid in the mid-1990s. Figure 3.1 shows the relation of growth in 1990–95 with the average share of investment in the five-year period, starting two years earlier in order to allow the supply effect to be felt.[11] Investment rates in the range of 10 to 30 percent of GDP are positively correlated with subsequent growth rates. Investment rates above 30 percent do not seem to have led to more growth than rates in the 20–30 percent range, but in the Eastern Caribbean States this may reflect productive but lumpy infrastructure investments.

Figure 3.1
Investment and Growth in the 1990s



Source: IEC Database

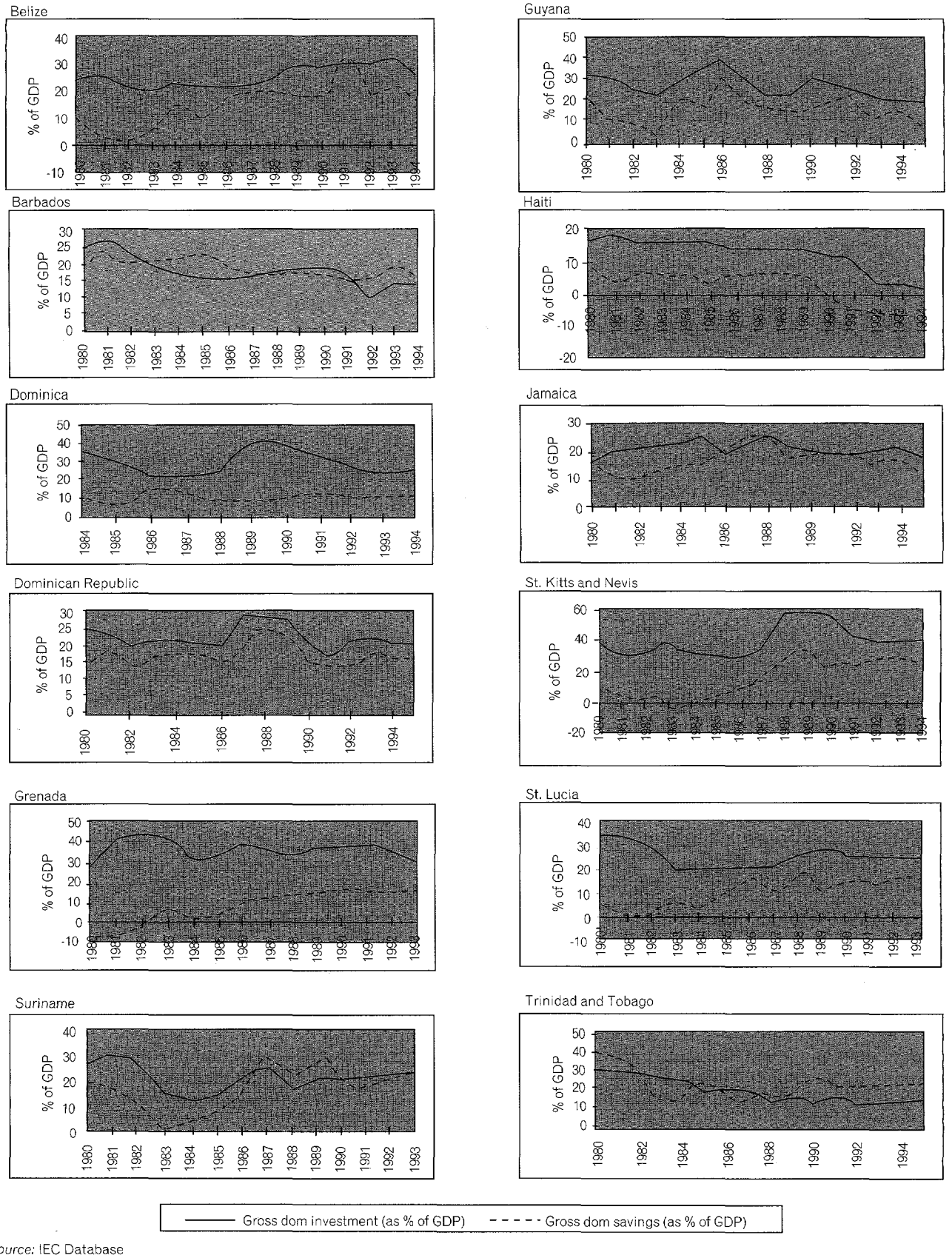
Despite the importance of adequate investment for growth, investment rates are not rising in the Caribbean. Given the greater global availability of capital in the world, compared with a decade ago, the stagnation in the Caribbean mostly reflects a lack of demand and opportunities for private investment, rather than shortages in the aggregate supply of financing. Figure 3.2 shows the trends of domestic saving and total investment (which is also total saving) as shares of GDP for the various countries for which comparable data were available. In most countries the trends of investment have not been clearly up or down, but in three countries, there has been a secular decline on investment rate. In Guyana this reflects elimination of unproductive investment, for the rate now is not especially low, and growth has been strong for several years. In Barbados and Trinidad/Tobago—not coincidentally the countries with the highest per capita income but low growth in the early 1990s—investment rates have sunk too low for adequate growth, although both countries have enjoyed some recovery in the past two years.

Domestic saving rates have followed a different path from investment in most countries. In Belize and the OECS countries other than Dominica (and probably Antigua) domestic saving rates show a clear upward trend, moving up to finance most of domestic investment. In Guyana and Haiti domestic saving became negative in the early 1990s, which clearly cannot last. Barbados and Trinidad/Tobago have experienced a less dramatic but longer term decline in domestic saving rates. Those trends probably reflected a shortage of attractive investment opportunities, since domestic saving nonetheless exceeded investment in the early 1990s. Since most public-sector deficits declined in the last decade—usually meaning increased public saving—private domestic saving was stable as a share of GDP. This probably resulted from the same factors that kept investment from rising.

These overall trends suggest that the Caribbean economies have adapted to declines of aid since the early 1980s by a combination of reducing public deficits and investing more efficiently, so that they can sustain modest growth with the diminished resources from abroad. Such growth rates will not suffice, however, to reduce poverty quickly or to close the income gaps with the high-income countries. Adequate growth for these objectives will require increasing domestic private saving, along with further increases in the efficiency of investment and in foreign private financing.

While private domestic saving was stable or declining in the region, more foreign saving (net external flows) went to the private sector in 1993–94. Net foreign direct investment rose from US$500 million on average in 1988–92 to US$1,235 million in 1994. This shift in composition of liabilities of the private sector bodes well for the region. FDI is less liquid than private lending and bank deposits and is thus less likely

Figure 3.2
Savings and Investment in the Caribbean



Source: IEC Database

Table 3.1
Overview of Net External Financing to CGCED, 1982–95
(US$ million)

	1982	*1983–87*	*1988–92*	*1993–1995*
Public Sector	1645	944	719	815
Loans	1345	601	115	–184
Multilateral	546	221	118	154
Bilateral	597	239	75	–169
Commercial	202	141	–78	–169
Grants[1]	300	343	604	999
of which debt forgiveness	0	0	91	131
Private Sector				
Loans (private non guaranteed)	...	...	–214	–17
Foreign Direct Investment (net)	271	177	500	883
Total Net Resource Flows	1916	1121	1005	1681

[1]Includes technical coop. grants

... = Not Available

Source: 1997 World Bank's Global Development Finance publication, formerly World Debt Tables

to cause sudden swings in the balance of payments. Also, because the service on FDI is profits, it would tend to adjust automatically with the performance of the economy, while debt service comes due on a fixed schedule. Overall, the rise of external funding to the private sector has almost matched the decline of external funding to the governments. This helped finance the growth of the private sector, increasing the tax base from which governments could raise resources, although in some countries the government borrowed more domestically, tapping through the local banking system some of the funds flowing in from abroad.

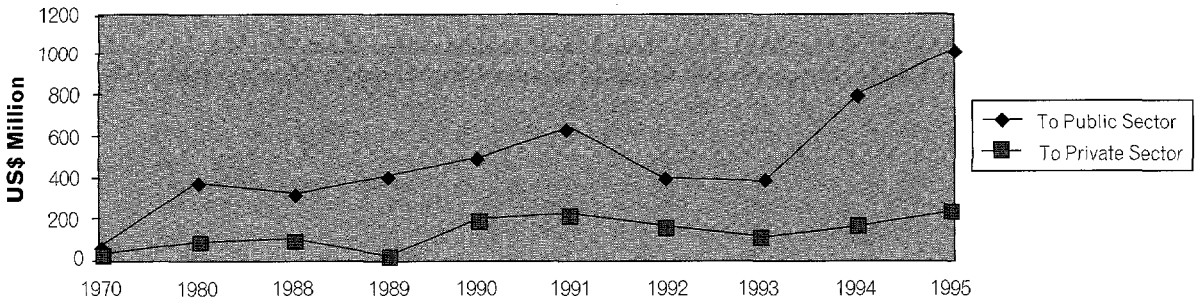
COUNTRY CAPITAL FLOWS

The patterns for individual countries and their governments and for individual sources differ substantially from the aggregate capital flows for the region. A clear pattern emerges if the countries are divided into two groups: smaller economies and larger economies. The smaller economies have very small populations (i.e., the members of the OECS), very low per capita income (Guyana, Haiti and Suriname), or small populations and middle income (Belize). The larger economies have either middle income per capita and relatively large populations (the Dominican Republic, Jamaica, and Trinidad and Tobago) or small populations with high per capita income (Bahamas and Barbados).[12]

Smaller economies. The smaller economies still receive positive net aid flows to their public sectors, and the flows are substantial, at least in per capita terms, and have increased in the last five years. (See Figure 3.3.) The amount of capital going to these economies' private sectors has grown, with private transfers (typically remittances from emigrants living abroad) being the largest subcategory, but with FDI holding steady at around US$ 200 million since 1990.

In **St. Kitts and Nevis**, **St. Lucia,** and **St. Vincent and the Grenadines**, the governments have limited borrowing to what they can obtain on concessional terms, although guarantees for private borrowing have caused some problems. The private sector in the islands has also received substantial inflows of direct investment. The other OECS countries and Belize, however, have managed less well. Governments in **Belize**, **Dominica,** and **Grenada** resorted to non-concessional borrowing, and typically they have to repay more in principal than they are receiving in new loans; grants help keep their total capital flows positive. Moreover, foreign

Figure 3.3 Net Flows to Smaller Caribbean Countries



direct investment to these three countries has typically been lower than to the other OECS countries. FDI is smaller than private transfers, which are typically remittances from individuals who emigrated to find jobs. In **Antigua and Barbuda** the government has been running arrears, so actual credit flows are about zero, but accruals of additional debt for unpaid interest have been substantial and probably exceed the small flow of grants still coming to Antigua. Direct foreign investment to Antigua in 1992–94 was less than half of what it averaged in the previous five years. The lesson emerging from this group is not new: These small economies are too vulnerable to allow the government much borrowing on commercial terms or much guaranteeing of private borrowing, which is where most of Antigua's arrears originated. With proper fiscal management, none of these governments should have needed to borrow commercially, because almost all were receiving well over US$100 per capita per year in official development assistance in 1993–95. (Antigua and Barbuda received virtually nothing in those years. See Table 3.2.)

In **Guyana**, net flows of grants and loans to the government have remained positive despite external debt stock and accrued debt service ratios that are the highest in the region and among the highest in the world. Rescheduling of old obligations that were on commercial terms and new concessional lending and grants have made this possible. Debt forgiveness counted as grants amounted to US$114 million in 1991 but was not significant again until 1996.[13] In the 1990s, Guyana has received more net official assistance than any other country in the region except Haiti; on a per capita basis Guyana received an annual average of US$77 in 1993–95—more than Haiti but less than the OECS countries.

Haiti has recently received the most in net official flows, mostly in the form of grants, although Haiti's large population has meant that in the 1990s the grants have averaged only US$70 per capita in 1993–95. Official credit flows were zero in the early 1990s, because the country was not creditworthy and did not repay principal on old loans, but now lending on concessional terms is growing rapidly, along with grants. Private transfers and other private flows were US$80 million in 1994 and presumably increased in 1995 and 1996. In **Suriname** positive flows of official grants and private transfers continued through the early 1990s, but there was virtually no lending until recently. Creditworthiness was an issue, given the lack of an appropriate macroeconomic framework. In Suriname, net foreign direct investment was actually negative in the early 1990s.

Larger economies. The larger economies have had low or negative flows to their public sectors in the 1990s, but large positive flows to their private sectors. (See Figure 3.4.) Not surprisingly, the experience of the larger economies dominates the aggregate figures in Table 3.1.

The **Dominican Republic** has had little change in net flows over the past few years. Flows to the government declined from 1992 to 1994, as the net lending flow became about US$100 million more negative and grants stayed about constant at just under US$100 million. Increased flows to the private sector were almost as much as the official decline, as transfers

Table 3.2
Overview of Net Resource Flows to CGCED Countries (1993–95)
(US$ million)

	Antigua & Barbuda	*Barbados*	*Belize*	*Dominica*	*Dominican Republic*	*Grenada*	*Guyana*
To Public Sector	–18	–6	31	18	41	12	56
Loans	–23	–16	5	1	–57	1	4
Multilateral	–5	–6	3	–1	30	1	22
Bilateral	0	–3	1	2	–43	2	–11
Commercial	–18	–7	1	0	–44	–1	–7
Grants[1]	4	10	25	17	98	11	52
of which debt forgiveness	0.0	0.0	0.0	0.0	0.0	0.2	6.0
To Private Sector	21	10	13	16	182	21	2
Loans (private non guaranteed)	–1	...	–2	...	–16	...	...
Foreign Direct Investment (net)	22	10	15	16	198	21	2
Total Net Resource Flows	3	4	44	33	223	33	58
memo items: official aid	–0.3	1	30	18	85	13	63
official aid per capita ($)	–5	5	140	239	11	145	75

Table 3.2 (continued)
(US$ million)

	Haiti	*Jamaica*	*St. Kitts & Nevis*	*St. Lucia*	*St. Vincent & Grenadines*	*Suriname*	*Trinidad & Tobago*	*Total CGCED*
To Public Sector	492	72	7	28	24	72	–22	807
Loans	24	–105	3	3	4	4	–36	–187
Multilateral	24	–12	2	3	1	-5	93	151
Bilateral	–0.1	-69	–0.3	0.1	2	1	–51	–169
Commercial	0	–25	1	0	2	8	–78	–169
Grants[1]	468	177	5	25	29	67	14	994
of which debt forgiveness	10.3	40.3	0.0	0.0	0.0	0.0	0.0	57
To Private Sector	4	154	16	32	38	–21	366	855
Loans (private non guaranteed)	...	33	...	...	...	...	–32	–17
Foreign Direct Investment (net)	4	121	16	32	38	–21	398	872
Total Net Resource Flows	496	226	24	60	62	51	344	1662
memo items: official aid	492	97	7	28	23	63	56	976
official aid per capita ($)	69	38	167	169	204	154	43	46

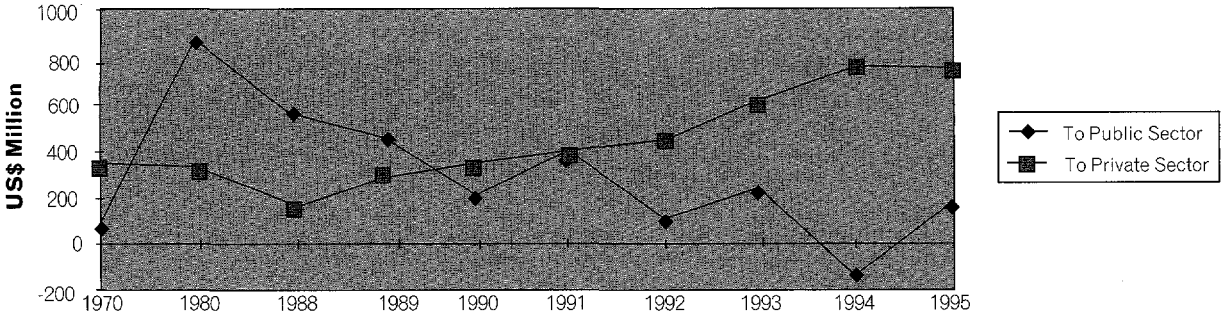
[1]Includes technical coop. grants

Source: 1997 World Bank's Global Development Finance publication, formerly World Debt Tables.

increased about US$60 million and FDI continued its gradual rise, reaching US$271 million by 1995 and probably more now.

For **Jamaica** net flows declined in 1992–94. Lending flows to the public sector became more negative, and grants other than debt forgiveness stayed in the range of US$90 million to US$180 million. Debt forgiveness was high in 1991 and 1993, US$231 million and US$105 million, respectively, but less than US$10 million in each of the other years in the 1990s.[14] The Paris Club rescheduling, the Extended Fund Facility, and adjustment lending from the World Bank finished around the end of 1995, so official flows have become more negative. Foreign direct investment has grown strongly in the 1990s, up to well over US$100 million in 1994 and 1995. Private transfers were also large and at times created problems for short-term macroeconomic management.

Figure 3.4 Net Flows to Larger Caribbean Countries



Trinidad and Tobago has had small net flows of official loans and grants in the 1990s. The flows to the private sector have boomed, however, led by foreign direct investment, which rose from an averaged of US$134 million in 1988–92 to US$398 million in 1993–94. This was mainly to the oil and gas sector.

Barbados completed most of its structural adjustment from the early 1990s and now has the debt profile of a successful graduate—robust inward flows for the private sector and negligible net flows for the public sector—because it is repaying past public borrowing and receiving little in grant assistance.

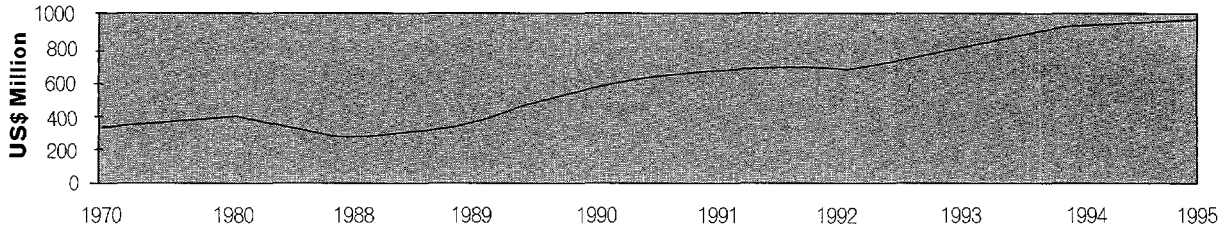
For the larger Caribbean countries the challenge for the medium term is to raise public saving enough to sustain public-sector investment while repaying the principal on debt. The inflows to the private sector that help the economy to balance payments internationally are not directly available to the public sector to help pay its obligations. To raise resources to service its debt, with negative net flows, the public sector must run an overall surplus. In other words, to avoid domestic borrowing, which is costly, the recurrent public-sector surplus (public saving after grants) must be enough to cover public investment (other than what is externally financed) *and* net repayment of principal. Most of the gross external lending is now for projects, so improved implementation is necessary to help balance the flows to the public sector. A good public-sector investment program is also needed to obtain the mix of investments that will best serve the economy and that will be sustainable, considering the maintenance and other recurrent expenditures needed to make use of the investments.

FUNDING SOURCES

Bilateral loans need to be part of the discussion here along with grants, for they both come mostly out of the same development assistance budgets. Even grants from multilateral sources like the EU, the United Nations Development Programme, and the Multilateral Investment Fund at the Inter-American Development Bank (IDB) come ultimately from the foreign aid budgets of individual countries. The total of grants and net bilateral credit flows to the Caribbean has grown some in recent years—from annual averages of US$679 million in 1988–92 to US$830 million in 1993–95. As Table 3.1 shows, almost 15 percent of grants have consisted of debt forgiveness in the 1990s. For the Caribbean governments the reversal of credit financing flows from multilateral and commercial sources accounts for most of the aggregate decline of their external financing.

The multilateral lending flows reflect a combination of two phenomena: balance of payments and project lending. Balance of payment lending, from the International Monetary Fund (IMF), the World Bank and the IDB, were intended to be short- and medium-term assistance that the countries would repay promptly. Guyana, Jamaica, and the Dominican Republic (IMF only) partook heavily in the 1980s, and Guyana continues to do so, but on concessional terms. The repayment of loans that were on commercial terms puts great strain on fiscal resources and the balance of payments, especially when the initial lending was excessive relative to

Figure 3.5 Net Foreign Direct Investment in the Caribbean



the actual subsequent growth. The standard expectation for countries receiving adjustment lending has been that, as it tapered off, the economies would be ready, along with donor support, to increase investment under a more efficient incentive regime. The resulting growth of exports and inflows of investment capital would allow the countries to improve the balance of payments and repay the adjustment loans. This has rarely happened smoothly. With a few exceptions—Barbados, St. Lucia, and Trinidad and Tobago—governments are sorely lacking the capacity to implement investment projects. The problem is especially severe in Haiti, Guyana, Jamaica and Suriname, where repeated rounds of unplanned fiscal adjustment through inflationary erosion of real wages have left a shortage of trained and motivated personnel in the public sector.[15]

Foreign commercial lending to the public sector has largely ceased, leaving negative net flows for governments that borrowed in the past and zero for the others.

As noted earlier, foreign direct investment has been the main source of increased financing for the private sectors and for the aggregate economies. The country-by-country review shows that this is happening in almost all countries, the biggest exceptions being Haiti, where investor confidence is lacking. Guyana, for instance, has had modest but sustained FDI flows since 1991, which indicates some interest from foreign investors and thus a potential for more FDI when policies improve. The largest recipients of FDI in 1993–94 were Trinidad and Tobago, with an average of US$392 million per year; Jamaica, with US$306 million; and the Dominican Republic with US$187 million.

Private transfers averaged US$940 million per year for the subregion. Mostly these were remittances from workers abroad, and they financed private consumption or domestic investment. The Dominican Republic and Jamaica had the largest flows, averaging US$392 million and US$307 million, respectively, per year. For Trinidad net private transfers have been negative since at least the early 1980s, probably reflecting remittances by foreigners who came to work in Trinidad.

Shifts in the composition of external flows, from public sources and recipients to private-sector ones, are qualitatively appropriate and consistent with Caribbean countries' medium-term economic strategies of making the private sector the engine of economic growth. As most countries, especially Barbados, the Dominican Republic, and Trinidad and Tobago, improve the environment for the private sector, the international development community needs to renew its commitment to support them with technical assistance, project funding, and, as appropriate, the reduction of debt service on old credits.

4 AGENDA FOR ACTION

GROWTH AND DEVELOPMENT in the Caribbean will not be easy. Some doors are narrowing for the region—specifically, official aid and traditional trade preferences from Europe and the United States. This seems unavoidable as budget constraints and other foreign concerns displace old colonial ties and Cold War alliances. But other doors are opening, as the private sector abroad sees opportunities for business—trade and investment—with the Caribbean private sector. The new doors must open faster than the old ones close if the region is to avoid a spiral of stagnation and social instability and to grow fast enough to reduce poverty.

Caribbean economies have been moving gradually toward more reliance on private-sector exports of services and away from dependence on preferential access for traditional exports to Europe and the United States. Similarly, their external financing has been shifting from flows to governments, from both commercial and official sources, toward flows to the private sector from both commercial sources and remittances. These shifts have gone furthest in the larger and higher-income countries of the region but are also happening in most of the smaller and lower-income countries.

These developments have put Caribbean growth onto a more sustainable foundation for the longer term. Continuing these trends will require that the new export and financing channels expand faster than the old ones contract. Whether that can happen in the short term is uncertain, however, because the value of the preferential treatment for exports of bananas, sugar, and textiles has declined in the past few years faster than expected, as have official aid flows to many Caribbean governments. External commercial lending to governments dried up in the 1980s, and the rebounds in the 1990s, often undesirable, have not been large in the aggregate. Making faster growth possible and making it happen will require actions by the industrial

nations and international financial institutions and by the Caribbean countries themselves.

The decline of official trade preferences and aid from the industrial countries to the Caribbean seems unavoidable and in the long-run desirable, but it could derail the development process unless the decline is predictable and moderate enough in pace so that the economies have time to adjust. For the poorest countries, aid flows need to be sustained, and for the middle-income countries they need to be phased out smoothly. At the same time, the growth of non-preferential, private-sector exports will need to expand at a faster pace to take up the slack. Bringing the Caribbean economies into a free-trade area for as much of the Americas as possible seems to be the best way to open up these export opportunities without creating another regime of special trade preferences. The European Union should also consider bringing the Caribbean into a broad trade relationship as an eventual replacement for the trade preferences for bananas and sugar, and for the various aid programs. The governments of the region receiving bilateral aid and lending from international financial institutions need to implement the programs and projects in a timely manner so that the grants and loans can disburse as planned.

Most of the international financing is coming from and going to the private sector, so the main challenge is to create institutional and regulatory environments in which the financial resources from both domestic and international sources will go into efficient production, particularly for export.[16] The reason for the export emphasis in this context is to match the acquisition of external liabilities—foreign financing—with the increased capacity of the economy to generate foreign exchange to service those liabilities.

PUBLIC SECTOR REFORM

Improving the environment for private sector investment, employment, and growth requires reform of the public sector at the macroeconomic and the micro-institutional levels.[17] Governments need to focus the mandate of the public sector. This is not an ideological recommendation, for the public sector in most high-income capitalist countries is larger relative to national income than in the Caribbean. Rather, it is a practical consideration, as recommended by Sir Arthur Lewis, so that the scope of public-sector activities matches the availability of resources, not only for the sake of macroeconomic stability—a prerequisite for efficient private investment—but also for improving the performance of the public sector.

The problem with the public sector in most of the Caribbean now is not its aggregate size but its ineffectiveness in performing the myriad tasks theoretically in its mandate. The most common complaint about governments is that existing programs fail to deliver adequate service, often because resources are stretched too thin. Improving service delivery requires not only focusing on the high-priority functions but also allocating spending efficiently among wages, capital, maintenance, and materials, and designing programs to complement what the private sector is doing. Most Caribbean countries have extensive infrastructure, but it suffers from low maintenance, from obsolescence due to technological progress, and from demand that expands faster than supply. They also have extensive education and health-care systems, but they lack adequate resources for complementary non-wage expenditures, and salaries are often too low to retain qualified personnel. Usually the expenditure programs necessary for the Caribbean to compete in the hemispheric market for private investment exceed what the public sector can afford with the resources that the electorate and tax payers will provide.

In choosing where to focus its activities, the government should consider what the private sector needs for growth, and what the private sector can and cannot do for itself and for society. Efficient and impartial regulation, enforcement of private contracts, maintenance of price stability, and assurance of public safety are emerging in the Caribbean as increasingly important services for the government to provide in order toin order to promote private-sec-

tor growth and social welfare. The growth of the middle class and the diversification of the private sector and NGOs over recent decades mean that the government can now reduce its role in many areas where it once seemed essential. In traditionally public-sector areas like health care, communication, and electric power generation, the private sector has expanded greatly in recent years.

The choice of the role of the public sector should recognize the options for partnerships with the private sector and NGOs. Management, financing, and ownership are separable functions that can be allocated as appropriate to the situation. Usually this means working together in roads, water, and social sectors, through mechanisms such as cost recovery for publicly provided services, management contracts for entities that remain in public ownership, and subsidies for the poor to utilize private providers. For activities that produce marketable goods and services, full privatization is more often the solution, in order to reduce the strain on the public-sector budget and managerial resources and, perhaps most important, to make a level playing field for competition by the private sector.

Reducing the costs of doing business—to attract new entrepreneurs from abroad and from the ranks of the domestic informal sector—will require streamlining bureaucratic procedures and, more important, changing the attitudes and incentives of the officials. Some countries have preserved the colonial tradition of cumbersome controls to prevent abuses, but in the fast-moving global business world today, this often prevents decisions that are prompt enough to facilitate economic development. These governments need a more balanced approach, with incentives for achieving results and serving the client. Other countries face severe problems of corruption and incompetence. The old culture of control, permission, and favors should give way to a new attitude of providing service to facilitate internationally competitive production.

Changing incentives for government officials requires evaluating individuals and agencies and holding them accountable for actual performance. Some efforts in this direction are already underway or planned in the Caribbean, drawing on models from Britain and New Zealand. Some countries of the region are moving toward executive agencies and program budgeting, with "value for money" audits of performance, as ways to increase the incentives for more effective and efficient delivery of service.

To implement these reform programs, it is necessary to have a government-wide vision of where the whole program is going. Personnel and financial information systems need to be implemented throughout the government to assure that the reform efforts in one agency do not merely shift redundant staff or spending from one part of the system to another less visible one. Other types of institutional reform, however, have had more success when implemented on a pilot basis, for instance with the customs and tax administration reforms in Jamaica, with the postal system and registry offices in Trinidad and Tobago, and with the various pilots in the Eastern Caribbean Economic Management Program. Starting with pilots allows learning and reduces the fiscal burden of the up-front costs of investing in reforms, even ones that lead to longer-term savings. In choosing pilots it has proved wise to pick areas with a high probability of success and high visibility, so that the success will engender political support for pressing ahead in the next phase.

Regulation, Taxes, and Trade Policy

While reduction of regulation and taxes is necessary in some cases, this has already happened in many places. Some regulation and taxation needs to be retained or even strengthened in order to preserve the fairness of competitive markets and to provide the state with the necessary fiscal resources. Reducing the uncertainty and the special efforts needed to obtain the most favorable treatment will be important to attract new investors, although this will not be easy. Many politicians and local business firms find comfort, and sometimes corruption, in the traditional non-transparent ways of granting licenses and favorable tax treatment. Often the existing

private sector sees little need for change and perhaps prefers not to face the wider competition that a more transparent regime would bring. But that is exactly what is needed to bring more capital, more jobs, better wages, and more growth to the economy as a whole.

For many people, especially the traditional business community in the Caribbean, improving the environment for the private sector means giving special incentives. It is no wonder that people already in business want such policies and do not mind too much having to go through various hurdles to get special access to the tax breaks and other advantages. These strengthen their profits and their privileged position. But fresh, new business is usually more interested in transparent rules, quick responses, and a stable macroeconomic environment, which any substantial programs of fiscal incentives would undermine.

Private investment needs complementary infrastructure, such as roads, ports, and especially telecommunications. The latter is probably the most important now, and clearly the best practice is to have regulations that increase the diversity and competition by the private sector in electronic communications services. For roads, the public sector needs to strengthen its program of maintenance and upgrading. For ports—sea and air—the opportunities for the private sector are growing, usually in partnership with the public sector.

Although some external financing goes directly into investment, much of the external financing and domestic saving goes through the financial sector. This sector has expanded rapidly in recent years, but regulations and supervision have failed to keep pace. Many countries have had financial crises, of which Mexico is only one of the more spectacular. During financial crises and the subsequent cleanup, vast amounts of resources get misallocated. The advantages of prevention are a clear lesson for the Caribbean countries, but not an easy one, given limited administrative resources. Regional standards for regulations, external technical assistance, and cooperation among supervising agencies would be useful.

LABOR AND HUMAN RESOURCE DEVELOPMENT

For development to reduce poverty and be sustainable, it needs to use labor relatively intensely and build on the skills and energies of the people. Reducing payroll taxes and other taxes on labor input in the formal sector would help encourage appropriately labor-intensive investments. Foreign investors in the service sectors, which hold the most promise for most Caribbean countries, need a well trained and flexible labor force. Education levels have been a traditional advantage of the English-speaking Caribbean, and Cuba has made major advances in this area, which remain offset by other factors. Other non-anglophone areas need to give more attention and resources to education. Throughout the Caribbean, the content of education and training has not kept up with the times and needs serious revamping. Part of the solution will include curricula with more on technology, computers, hotel and restaurant management, and health-sector management. The more fundamental reorientation will require close cooperation with employers and stronger incentives for students, parents, and workers of all ages to pay attention to the job market in deciding what to study and how.

Flexibility is more difficult in a small economy, and an important way to increase flexibility of labor utilization for the Caribbean will be to increase mobility of labor within the region. Implementing the agreement of the CARICOM countries to allow unrestricted movement of university graduates would take a step in the right direction. Trained people are often leaving because they cannot get into a situation with a mix of other workers to maximize their efficiency and earning power. The solution is not to try to keep out competing labor, but rather to allow the right mix of labor to occur in the Caribbean. This will require eliminating most national barriers to the markets for factors—capital and labor—as well as goods, so that region-wide firms can form on a scale necessary to compete in the hemispheric and world markets.

ANNEX I: SUMMARY INDICATORS

Table A1.1
Caribbean Countries: Summary of Economic Indicators (US$ mill.)
(1995, unless indicated otherwise)

	Antigua & Barbuda	*Bahamas*	*Barbados*	*Belize*	*Dominica*	*Dominican Republic*	*Grenada*	*Guyana*
Population	69	279	261	216	74	7813	91	842
GNP/capita[1]	6820	12140	6710	2630	2990	1460	2980	590
Real GDP m.p. (1987 US$ MIL)	380	2790	1526	456	156	6554	191	452
GDP % Change								
1995	–1	0	0	2	0	3	3	6
1994	4	0	5	5	1	4	2	9
1993	4	2	0	3	2	3	–1	8
CPI % Change	2	2	2	3	1	13	3	8
Pop. in poverty (%) [2]	12	5	8	35	33	...	20	43
Unempl. rate (%) [2]	7	15	16	11	10	30	16	11
Exports, GNFS	431	1826	891	295	104	2677	163	444
GNFS % of GDP	113	65	58	65	67	41	85	98
Sugar Exports	...	...	32	48	...	87	...	127
Banana Exports	...	...	...	22	16	...	1	...
Bauxite, minerals	...	...	...	...	...	273	...	178
Other Exports [3]	39	...	137	95	26	383	22	175
Tourism	319	1143	503	78	36	1638	...	...
Nonfinancial PS balance	–42	29	20	–31	–5	–18	3	–154
Nonfinancial PS % of GDP	–11	1	1	–7	–3	0	2	–34
Current account balance	–21	–149	17	–30	–36	–125	–22	–135
Current account % of GDP	–4	–4	1	–5	–16	–1	–9	–23
Tot EDT	275	...	597	261	93	4259	113	2105
EDT % of GDP	72	...	39	57	60	65	59	466
EDT % of XGNFS	64	...	67	88	89	159	69	474

Table A1.1 (continued)
Caribbean Countries: Summary of Economic Indicators (US$ mill.)
(1995, unless indicated otherwise)

	Haiti	*Jamaica*	*St. Kitts & Nevis*	*St. Lucia*	*St. Vincent & Grenadines*	*Suriname*	*Trinidad & Tobago*	*All Countries*
Population	7155	2525	41	166	111	410	1305	21358
GNP/capita[1]	250	1510	5170	3200	2280	880	3780	3559
Real GDP m.p. (1987 US$)	1653	3980	153	441	201	861	4966	24760
GDP % Change								
1995	5	1	5	5	4	4	3	
1994	–11	1	3	2	0	–2	4	
1993	–3	1	5	2	1	–6	–2	
CPI % Change	25	20	2	3	2	236	5	
Pop. in poverty (%)[2]	...	34	15	19	17	39	21	
Unempl. rate (%)[2]	...	16	12	16	20	16	16	
Exports, GNFS	128	2946	141	357	124	388	2097	13012
GNFS % of GDP	8	74	92	81	62	45	42	12254
Sugar Exports	...	95	...	...	...	...	38	441
Banana Exports	...	48	...	66	22	...	...	175
Bauxite, minerals	...	723	...	...	...	334	910	2418
Other Exports[3]	86	516	23	53	38	99	1189	...
Tourism	...	999	...	...	47	...	...	...
Nonfinancial PS balance	–176	126	1	–9	1	31	152	
Nonfinancial PS % of GDP	–11	3	1	–2	0	4	3	
Current account balance	–67	–245	–20	–51	–35	92	294	
Current account % of GDP	–3	–6	–9	–9	–14	27	6	
Tot EDT	807	4270	56	128	206	95	2556	...
EDT % of GDP	49	107	37	29	102	11	51	
EDT % of XGNFS	630	145	40	36	166	24	122	

Sources: IMF reports, World Bank's Economic & Social Database; World Bank Staff Estimates

... not available (N/A)

[1]GNP per capita calculated by Atlas Met [3]Includes re-exports

[2]Latest available data since 1989

EDT - Total Debt Stock (Long-term debt + Short-term debt)

PS - Public Sector

XNGFS - Exports of Goods and Non Factor Services

CPI - Consumer Price Index

ANNEX II: U.S. TRADE PROGRAMS WITH THE CARIBBEAN

EXCLUDING MERCHANDISE produced in free-trade zones, 71 percent of the Caribbean countries' total exports flowed to the NAFTA region in 1983. By 1994 this total had declined to 46 percent. This reflects the large shift in composition of exports from traditional goods to non-traditional goods (which include apparel and textile products almost exclusively produced in free-trade zones) and a shift in the direction of trade away from the NAFTA region.

In 1983, 92 percent of the Caribbean countries' exports to NAFTA countries went to the United States. By 1994, this concentration had diminished slightly, but the overall picture had changed very little, with 86 percent going to the United States, 13 percent to Canada, and the remaining 1 percent to Mexico.[18] Given the overwhelming share of the region's exports going to the United States, it is safe to conclude that any policy affecting the trade relationship between the Caribbean region and the United States will affect the trade relationship between the Caribbean region and NAFTA. The following section describes the various trade programs that the Caribbean has used to enter the U.S. market, and their consequential effect on overall trade between the regions.

Generalized System of Preference

The Generalized System of Preference (GSP) became effective January 1, 1976, with the intent of promoting economic development through trade diversification. Under this program approximately 4,300 products enter the United States duty-free from developing countries throughout the world. Eligibility for duty-free status through GSP is dependent on direct exportation from the developing country to the United States, as well as a requirement that at least 35 percent value-added occur in the country. Under the GSP program, products eligible for duty-free access can change over time, and the United States will "graduate" countries from duty-free

eligibility, both for specific products and for the entire program, if the developing country achieves a specified national income or level of penetration of the U.S. market. In the past, Hong Kong, Singapore, South Korea, and Taiwan have graduated.

THE CARIBBEAN BASIN INITIATIVE

The Caribbean Basin Economic Recovery Act, or the Caribbean Basin Initiative (CBI) as it is more commonly known, was initiated by the Reagan administration in 1983, and then permanently extended in 1990 to encourage economic diversification in the Caribbean region. Twenty-eight Caribbean and Central American countries are eligible for CBI status, including British and Dutch colonies, but excluding Cuba. Almost all of them have requested to be beneficiaries and have been so designated.

Unlike GSP, the CBI does not have a graduation process and consequently provides beneficiary countries with greater security for duty-free access to the U.S. market. Its scope is also larger, covering 6,000 products, compared with the GSP's 4,300 products. Although the CBI requires that merchandise be imported directly from the eligible country to the United States, the program offers greater flexibility than GSP in terms of the 35 percent value-added requirement. Countries of the Caribbean Community Secretariat (CARICOM) may satisfy this rule with materials derived from any one, or all, of the CBI countries, and, for goods containing at least 15 percent U.S. content, the value-added requirement is reduced to 20 percent. In addition to the above eligibility requirements, the CBI allows tariff-free access to the U.S. market for articles assembled or produced in whole from U.S. components or ingredients imported directly from the United States. The CBI excludes items such as petroleum and petroleum products, luggage, handbags and flat leather goods, certain gloves, canned tuna, ethanol, sugar, watches with parts from communist countries, most footwear, and most textiles and apparel. CBI thus excludes some of the most important manufactures exports from the Caribbean. Only 8.4 percent of total exports from CBI-eligible countries (including the nine Central American countries not covered in this report) entered the United States exclusively through the CBI program in 1994.[19]

THE PROGRAM FOR PRODUCTION-SHARING AGREEMENTS (807)

To facilitate the global competitiveness of U.S. firms, the U.S. government has instituted a program that provides for sharing production with developing countries. Provision 9802.00.80 of the Harmonized Tariff Schedule of the United States establishes preferential tariff treatment for products covered under this program. This provision (commonly known as 807, from its number in the previous tariff schedule) allows U.S. firms to compete with labor-intensive articles manufactured by foreign producers, especially in Asia.

This program has been the main vehicle of access to the U.S. textile market for Caribbean countries. Established well before the Caribbean Basin Initiative, it permits the duty-free entrance of goods assembled abroad from U.S.-made components and re-exported back to the United States. The plan, which attempts to stimulate trade with the Caribbean countries, is ideal for textile and electronics assembly production, and as such it has been a major influence affecting trends in the apparel trade of the Caribbean region. Garments assembled under this program's provisions are subject to the same quota, documentation and customs laws as other apparel, but importers pay duty only on the difference between the final value of the product and the value of the U.S. inputs. (Foreign inputs are permitted in the assembly process but are subject to tariffs.) Under the production-sharing program, components must be exported directly from the United States in assembly-ready condition, and finished articles must not "lose their identity" during the assembly process. In 1994, 80 percent of the Caribbean countries' apparel products entered the United States under this program and its extension.[20]

The production-sharing program may have been the catalyst for much of the growth in U.S. textile trade between the Caribbean countries and the United States, but quota limitations impeded further growth for some countries. Accordingly, in 1986 the Reagan administration, under the umbrella of the CBI, expanded the production-sharing program to improve the Caribbean's access to the U.S. market.

THE SPECIAL ACCESS PROGRAM (807A)

The Special Access Program for Caribbean exporters, also known as 807A, and the Special Regime Program, an identical initiative for Mexico, permit CBI countries and Mexico to negotiate guaranteed access levels (GALs) to the U.S. market for apparel products. Under these programs, GALs may be increased at the request of the exporting country, once that country has demonstrated that it possesses the production capacity to satisfy the requested GAL increase. With the exception of quota restrictions, the production-sharing and special access programs are identical and must adhere to the same content and customs laws. Accordingly, countries export under the special access program only after they have reached their specified quota levels under the production-sharing program. All CBI countries are eligible for the GALs. However, to date the only Caribbean countries to participate are Dominican Republic, Haiti, Jamaica, and Trinidad and Tobago.[21] One year after the GALs were implemented, the Caribbean countries' textile exports to the United States increased to 23 percent of total exports—from 12 percent in 1985—and have continued to grow since then (see Table A2.2).

Table A2.1
Imports of Textiles/Apparel and Footwear under the 807 Production-Sharing Program (1990 and 1993)
(current US$ millions)

	Countries of origin									
	Mexico		*Dominican Republic*		*Jamaica*		*Other CBI*		*U.S. total imports*	
	1990	*1993*	*1990*	*1993*	*1990*	*1993*	*1990*	*1993*	*1990*	*1993*
Apparel and textiles	759	1,461	584	1,218	160	315	739	1,627	2,618	5,288
Footwear	71	91	15	115	0	1	1	0	908	1,133

Note: According to the American Apparel Manufacturers Association, U.S. textile imports under 807 were misclassified until recently. This may explain the statistical discrepancies between Tables A3.1 and A3.3.
Source: "Production Sharing: Use of U.S. Components and Materials in Foreign Assembly Operations, 1990–93," SITC Publication 2886 (May 1995), Tables 1–7, B-16, B-31.

Table A2.2
Composition of Caribbean Countries' Exports to the United States, 1983–95
(current US$ millions, unless otherwise noted)

	1983	*1985*	*1987*	*1990*	*1992*	*1994*	*1994 (Jan.-Sept.)*	*1995 (Jan.-Sept.)*
Total exports	4,825	3,965	3,463	4,436	4,835	5,512	4,059	4,399
Traditional[a]	3,692	2,420	1,624	1,656	1,466	1,489	1,144	1,039
Percentage	77	61	47	37	30	27	28	24
Non-traditional[b]	1,133	1,545	1,839	2,780	3,369	4,023	2,915	3,360
Percentage	23	39	53	63	70	73	72	76
Of which:								
Apparel from textiles[c]	282	464	778	1,183	1,659	2,145	1,557	1,799
Leather products and footwear[d]	60	64	83	142	195	292	219	186

a. Includes crustaceans & mollusks (036), sugar & honey (061), cocoa (072), tobacco manufactured (122), aluminum ores & concentrates (285), ores & concentrates of base (287), crude oil from petroleum or bitumen (333), petroleum products refined (334), alcohol, phenols, etc. (512), inorganic chemical elements (522), gold, non-monetary (971) of the Standard International Trade Classification (SITC).
b. Includes all SITC codes not listed above.
c. Includes men's or boy's coats, jackets, etc. (841), men's & boys outer garments (842), women's & girls outer garments (843), women's & girls coats, capes, etc. (844), articles of apparel of textile fabric (845), undergarments knitted or crocheted (846), clothing accessories (847) and apparel & clothing accessories except textiles (848) of the SITC.
d. Includes manufacturers of leather (612) and footwear (851) of the SITC.
Note: The values of the traditional exports are derived only from the SITC numbers listed in footnotes b and c as long as these SITCs were among the top twenty export items of the region that year. Total textile exports to the United States vary 2–4 percent by source. This has been explained by differences in how the U.S. Department of Commerce and the American Apparel Manufacturers Association define textiles.
Source: U.S. Department of Commerce.

Table A2.3
U.S. Imports of Textiles from Caribbean Countries and Mexico, 1989–95
(current US$ millions)

Country	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*
World total	21,047	21,937	22,595	26,722	28,216	31,386	31,649	36,390
Percentage growth	—	4.2	3.0	18.3	5.6	11.2	10.4	5.1
Mexico	500	508	673	901	1,127	1,597	2,566	3,560
Percentage growth	—	1.6	32.6	33.8	25.1	41.4	61.0	38.7
Caribbean	1,090	1,140	1,363	1,619	1,955	2,111	2,388	2,400
Percentage growth	—	4.6	19.6	18.8	20.8	8.0	13.2	0.5
Of which:								
Jamaica	226	235	252	293	389	454	531	505
Percentage growth	—	4.2	6.7	16.4	32.8	16.8	17.0	–4.9
Haiti	166	160	146	61	92	29	72	98
Percentage growth	—	–3.7	–8.8	–57.9	49.2	–68.6	148.3	36.1
Dominican Republic	642	694	910	1,203	1,410	1,572	1,731	1,753
Percentage growth	—	8.1	31.1	32.1	17.2	11.5	10.1	1.27

—Not available.

Source: American Apparel Manufacturers Association.

Note: Total textile exports to the United States vary 2–4 percent by source. This has been explained by the different definitions for textiles used by the U.S. Department of Commerce and the American Apparel Manufacturers Association. As well, according to the American Apparel Manufacturers Association, U.S. textile imports under 807 were misclassified until recently. This may explain the statistical discrepancies between Tables A3.1 and A3.3.

NOTES

[1] Unless otherwise noted, the term Caribbean in this report refers to the member countries of the Caribbean Group for Cooperation in Economic Development: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

[2] The export growth figures in Table 1.2 do not include free-trade zones, which are more important in the Caribbean on average than in the other regions. Including free-trade zones would raise the average annual growth rate of Caribbean exports by almost 2 percentage points.

[3] Jeffrey D. Sachs and Andrew Warner, "Economic Reform and the Process of Global Integration," *Brookings Papers on Economic Activity* (Washington, D.C., 1995, Issue 1): 1–96. These results are consistent with the findings of Dollar (1992) for 1976–85. David Dollar, "Outward-Oriented Developing Economies Really Do Grow More Rapidly: Evidence from 95 LDCs, 1976–1985," *Economic Development and Cultural Change* 40(3): 523–44.

[4] Michael Michaely, Demetris Papageorgiou, and Armene Choksi, *Liberalizing Foreign Trade: Lessons of Experience in the Developing World*, in Demetris Papageorgiou, Michael Michaely and Armene Choksi, eds., *Liberalizing Foreign Trade*, Vol. 7 (Oxford: Basil Blackwell, 1991).

[5] Almost 60 percent of U.S. textile imports under 807 come from Mexico, the Dominican Republic, and Jamaica, with most of the rest coming from other CBI countries. See Table A3.1.

[6] IMF, *Direction of Trade Statistics.*

[7] Estimates from the American Apparel Manufacturers Association.

[8] By contrast, in the same period Haiti's exports of these products to the United States fell to one-third of their 1989 value.

[9] Estimates compiled by the World Bank with figures from the Jamaica Manufacturers Association and the Jamaica Promotions Corporation.

[10] Net flows subtracts repayments of principal on loans and direct investment abroad from the gross inflows of loans, official grants, private transfers, debt forgiveness, and direct investments. When the repayments are large, as for Jamaica, net flows can be negative. Flows do not include interest on debt or repatriation of profits, which are part of the current account. Interest payments are combined with net flows for the measure of net transfers, which are often negative for developing countries.

[11] The analysis in the Country Economic Memorandum on *Jamaica: A Strategy for Growth and Poverty Reduction*, World Bank 1994, p. 92, found that the effect of investment on growth was strongest with about a two-year lag.

[12] Of course, all of these countries are small by conventional standards. The smallest "larger" economy—Barbados, with a 1994 gross national product, GNP, of US$1.78 billion—is not much larger than the largest "smaller" economy—Haiti, with a GNP of US$1.54 billion—but they each belong to their group in terms of the pattern of capital flows. The extremes are far apart—Dominican Republic with a GNP of US$10.5 billion and St. Kitts/Nevis with US$185 million. See Table A1.1.

[13] From the same Organization for Economic Cooperation and Development (OECD) sources as the data on grants.

[14] From the same OECD sources as the data on grants. It is possible that some additional debt forgiveness occurred but is not counted in grants.

[15] World Bank, *Public Sector Modernization in the Caribbean* (Washington, D.C., 1996), pp. 18–20.

[16] The relevant regionwide reports of the Bank include *Caribbean Countries Policies for Private Sector Development* (1994) and *Prospects for Service Exports from the English-Speaking Caribbean* (1996).

[17] See *Public Sector Modernization in the Caribbean* (1996).

[18] IMF, *Direction of Trade Statistics.*

[19] See "Caribbean Economic Recovery Act: Impact on U.S. Industries and Consumers, Tenth Report 1994, Investigation No. 332–227," Table 3-1, p. 28.

[20] American Apparel Manufacturers Association.

[21] Costa Rica (a CBI member but not a subject of this study) also participates in the 807A program. "A Special Report from the International Committee of the American Apparel Manufacturers Association, 807 Apparel Assembly," Vol. 1, No. 1 (December 1989).

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