

TRADE POLICY AND
CARIBBEAN DEVELOPMENT:
PROSPECTS AND OPTIONS

A SUMMARY

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1.0 INTRODUCTION

This is a summary of the Technical Report done for the Caribbean Development Bank on **Trade and Caribbean Development**, which was conducted in the first half of 2001. The terms of reference required the researchers to:

- i. Critically assess the ongoing trade initiatives within the context of the production restructuring challenge facing the Region.
- ii. Identify and discuss specific aspects of the new trade policies that have or can circumscribe the supply response of countries in ways that are inconsistent with production and trade diversification and the development of production flexibility.
- iii. Critically assess the constraints to production flexibility and product diversification facing Caribbean economies with a view to recommending policy approaches which are likely to promote a reduction in economic vulnerability and income volatility and provide opportunities for achieving sustained economic growth, increased employment and the elimination of poverty.
- iv. Provide policy advice on the way forward in as much detail as available, to decision-making authorities in Borrowing Member Countries.

2.0 LIMITATIONS AND DELIMITATIONS

Time and resources limited the effort to an examination of three factors relevant to the restructuring of production in the Commonwealth Caribbean:

- Size of population
- Size and structure of capital
- Balance of payments

The research was conducted on five countries and with data collected on a number of sectors. The countries selected were Barbados, Jamaica, St. Kitts and Nevis, St. Lucia, and Trinidad and Tobago. This selection sought to anticipate differences in the effects of different patterns of development in the larger countries vis-à-vis a possible divergent experience in the Windward and Leeward Islands.

A mix of quantitative and qualitative analysis was attempted. The methods ranged from face to face interviews with industry professionals in all of the countries studied, to time series and other quantitative analysis, including the use of descriptive statistics. There were major limitations in conducting the quantitative work as time series analyses could only be executed for three of the

five countries: Barbados, Jamaica, and Trinidad & Tobago. Further limitations were discovered due in part to relatively short data series (not exceeding two decades) for these countries. Also, secondary information, drawn mainly from studies in Industrial Economics and International Trade, was used in the study.

Industry analysis was done on two areas of primary agriculture: sugar in Jamaica and bananas in the Windward Islands. Analysis of the Jamaican bauxite industry as well as oil and gas in Trinidad and Tobago completed the focus on primary production. The apparel, tourism, and information services sectors were also examined against the backdrop of the effort made by these countries to diversify their economies.

3.0 DEFINITIONS

The framework used here seeks to link the process of growth and change in various sectors, with that in the economy as a whole. It is an essential thesis of the study that the traditional categorization of key factors of production, such as capital, misdirects analysis and policy.

Domestic capital is simply defined as the means of production created *within* a society. This encompasses supporting institutions (education, financial, technical) that expand production capabilities of Caribbean society. Domestic capital formation is a sequential and cumulative process that flourishes in an environment of macro-economic and political stability, provided in the structure of governance. Admittedly, the official records invariably fail to measure this variable adequately, but it is critical to the framework employed in this study.

It is noteworthy that in the quantitative work, the definition of domestic capital has sought to differentiate it from **imported equipment and tools**, which are essentially derived from capital created in the rest of the world. Thus, in the quantitative study, domestic investment or domestic capital formation is **net of imported equipment, tools and related services**. There is also labour of different types that is an input into the process of production. For present purposes, **labour** is measured, as traditionally, by the number of hours worked.

Another key concept is **production restructuring** which is used here to mean the reorganization of production in terms of increasing the **share of commodities using domestic capital intensively**. Trade policy has to be judged in terms of its contribution to the accumulation of capital. In the analysis conducted here, **trade policy** is interpreted as comprising government policy, with respect to tariff and non-tariff barriers, export promotion and foreign market creation, to alter the current account balance of payments transactions of the economy. Trade

policy is an aspect of development policy, and, as such, must ultimately facilitate production restructuring.

The concept of trade policy which is used here gives greater weight to **foreign market creation** in support of process development and product diversification, and hence to the movement of domestic capital and its sociology being transported by the movement of Caribbean people. It encapsulates a greater integration of Caribbean people into the world economy, not primarily by altering tariff and non-tariff barriers, but rather by their free movement into all markets in the creation of a new *Enterprise of The Indies*.

THE PROCESS OF CAPITAL ACCUMULATION

Institutions, Firms and Activities Involved in the Quest of Capital Accumulation

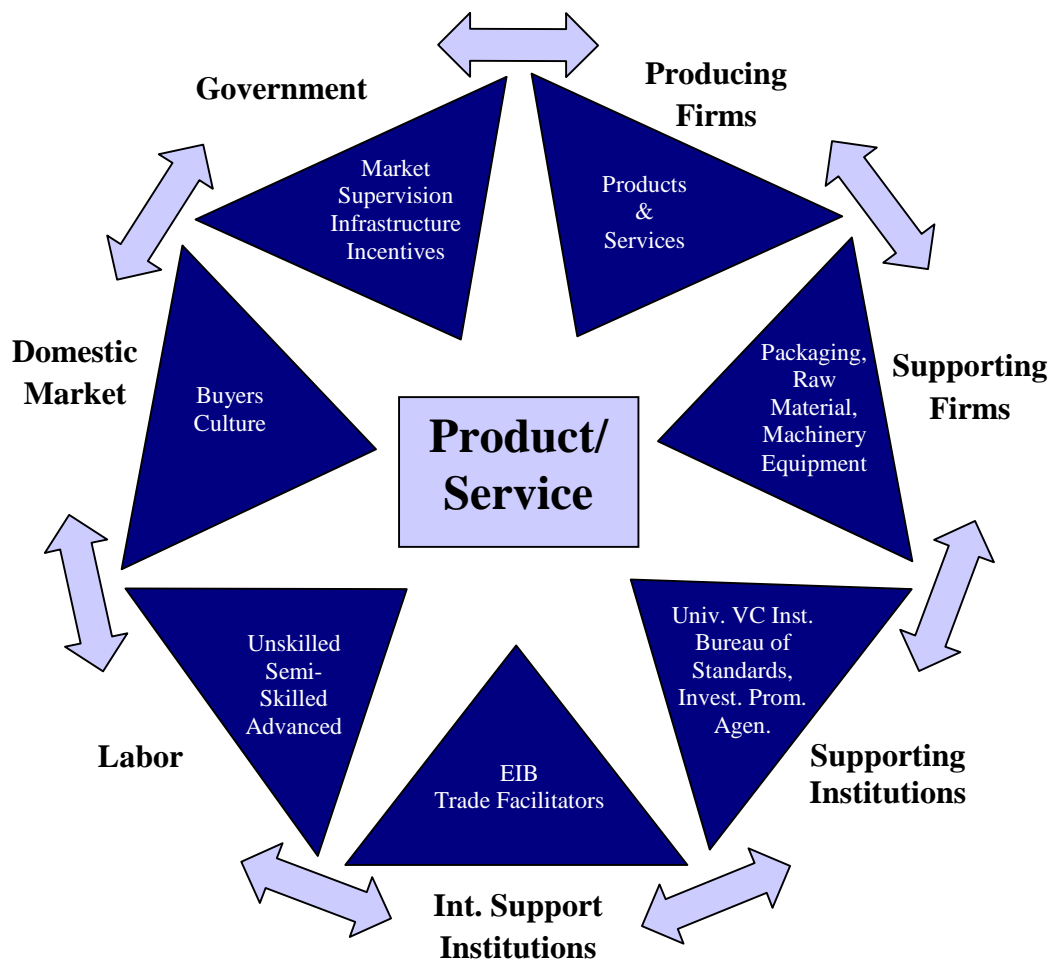


Figure 1

Figure 1 above attempts to bring together some of the elements in the production system. Goods and services are produced by firms, which are influenced by a range of economic and institutional factors. Government provides the legal and political framework but as well, supporting and facilitating institutions. Trade policy is about ensuring that domestic firms develop the capacity to produce goods and services that can be price-making in external markets, but this is a capacity that derives from the nature of the surrounding environment and the extent to which it resources firms through domestic capital.

4.0 HISTORICAL FOUNDATIONS

The impact of the new multilateral initiatives on the Caribbean has to be viewed in a historical context, and in particular, in light of its post-independence experience. This can be divided into:

- The immediate post-independence period up to the early 1970s.
- The period from 1970 to the early 1980s.
- The early 1980s to the present.

In the first years following independence, trade policy in the Caribbean revolved around the attempts by the Governments to modify the inherited arrangements of the colonial period by encouraging international corporations to produce for the domestic market. Tourism was of minor importance in this thrust except in Barbados. The firms that entered the Region, focusing on the domestic market, soon found themselves uncompetitive. The programme of product diversification soon ran its course, and did little to protect these countries from growing domestic debt and inflation crises. The dependence of these economies on the performance of the primary export sector remained almost invariant.

In the second period, the state took a more active role in the formation of capital in some countries, the major examples being Guyana and Jamaica with respect to the bauxite industry, and Trinidad and Tobago with the oil and gas industry. The main thrust was to the diversification of export activity through the downstream processing into alumina in the former case and to energy based industries like steel, urea and methanol, in the latter. Another feature was the thrust by the State to modify taxation regimes to garner more from the mineral export sector specifically (where there was one) or from the corporate sector generally. State participation also took the form of involvement in the utilities.

The establishment and deepening of regional integration was another notable feature of the period, with the shift from CARIFTA to CARICOM. International economic cooperation was also underlined with the Lome agreement, which provided certain preferences to the Caribbean countries in the European market, banana, sugar and rum being some of the more important.

The third and most recent period has been characterized by the adoption of structural adjustment, price stabilization and trade liberalization programmes. This was initiated in response to balance of payments and fiscal crises, which warranted the involvement of the IFIs – World Bank and International Monetary Fund - to assist in some cases. A boost to weak export performance was given by the US Government through the Caribbean Basin Initiative, and by the Canadian Government through CARIBCAN. A major underlying assumption was that the development of exports required increased foreign investment in a highly liberalized economy, and the procedures recommended by the IFIs were designed to bring this about.

The completion of the Uruguay Rounds and the establishment of the WTO have deepened and widened the process of globalisation, and non-trade elements have been included in the institutional framework of the international trading system, e.g. labour, environmental and phyto-sanitary standards. An essential element in current trade is the degree to which the process is WTO compliant. Thus, the revision of the Lome Accord has brought the Cotonou Agreement that essentially signals the end of traditional preferences. In keeping with WTO, the remaining preferences have been converted into tariffs. Moreover, the stimulation of investment flows and the freeing up of trade are to be underpinned by the trio of sets of rules under the rubric of TRIPS, GATS and TRIMS.

5.0 LESSONS OF EXPERIENCE

The countries of the region have all recognized their vulnerability. Persistent balance of payments problems in some, failure to achieve self sustained growth, the limited growth of exports or an underlying weakness of the competitive sector have brought home the fact that in a liberalized environment of the early 21st Century, the Commonwealth Caribbean faces considerable difficulty. One reactive posture has been to seek to deepen the integration through the Caribbean Single Market and Economy (CSME). Another has been to seek the maximum postponement of the end to preferences for key exports. A third is to embrace the FTAA.

A preliminary investigation of the periods suggests that the problems of transformation and of development derive in part from the nature of trade policy implicit in the industrial policy pursued by the region and from flawed premises that have entered some areas of policy-making. Much of the encouragement given to production has been of the import intensive nature, and has served to deepen technological dependence. Indeed, the lessons of 450 years of reliance on exogenous initiatives prove that the Caribbean markets do not work on the principles now fully codified in the WTO's rules. It is unlikely that the problems of technological dependence can be solved by merely relying on transfers from the technologies of the international corporations and foreign direct investment.

On the other hand, there have been signs of substantial process and product diversification, even if the official policy has not been able to interpret their initiatives in these terms and official records on their efforts have not been kept. One manifestation of this adjustment may well have been the general growth of remittances into the Caribbean throughout the 1990s. Jamaica has benefited the most from this process in the past two decades, and gains in other economies of the region have not been trivial. This process amounts to a small but fundamental change in the structure of employment and supply that actively complements the absorption of resources through direct exports: migrants are involved in the use of their labour and capital abroad from which the country derives remittances.

When compared with the fiscal incentives in support of import-intensive activity, the official effort to assist private domestic capital formation initiatives has been dismal. The regional sociology is creative in production, but the societies have not been sufficiently creative in redesigning government to formulate and implement policies supportive of domestic capital formation, and of institutional arrangements for an ongoing program of product and process development. A significant aspect of this failure is continuing excessive and inappropriate aggregation of sectoral and other data collection. Thus, the net gain of the share of domestic capital and capital-intensive output in the domestic economy misleadingly appears to remain small, though not necessarily trivial. Except through the monitoring of remittances in the balance of payments, the contributions of domestic capital are not proactively measured in the official record.

When placed in the context of its efforts to create capital and externalities that attract foreign direct investment and imported factor inputs, support by the governments for private sector innovation and private capital domestic formation in the region continues to be miniscule. Caribbean States have not demanded a full recording of the returns to domestic capital as defined here, with the result that the official record provides limited documentation of this effort.

A major lesson of Caribbean history is that sharing in the international pool requires integration into the world economy on different terms, economically, institutionally and politically, than those offered by foreign investors of various types (Best, 1980). In particular, one must take account of the emergence of indigenous technological initiatives, which respond to demand through supply-side initiatives, with product differentiation and niche creation. This may well require relatively less, not more, integration into the world system through multinational corporations.

6.0 IMPLICATIONS OF CURRENT TRADE POLICY

The failure to anchor transformation and deriving trade initiatives on *endogenous* technological development in Caribbean economies is perhaps the most important deficiency of the analyses, rules and proposals deriving from WTO compliance. The assumptions for trade policy in the positions of the CARICOM Secretariat, the RNM, and many governments in the Region may have been very accepting of WTO principles. This underlying analytical perspective with its thrust to open competition, also misdirects the approach to adjustment and restructuring.

For example, the development policies of most Caribbean countries call for the creation of differentiated commodities and market niches, often with some level of intervention on the part of the State. Yet, such a process is fundamentally at odds with the implicit assumptions of competition policy of WTO. The effect of WTO measures has rather encouraged greater product and process homogeneity by increasing imports of existing technologies, and indirectly, by creating a greater role for international corporations. The Region needs to be clear that all trade policy premised on the move to perfect competition should at best be applied with considerable caution and at a very measured pace.

The long-term problems of vulnerability to price and technological shocks, and of slow endogenous technological change have been created, in part, by over-reliance on imported technologies and failure to develop indigenous technological capability. If international assistance is to be sought, it should be directed not only at the opportunity to enter into industries established by the rest of the world, but also for assistance with the invention of new solutions to demand and supply problems and the opportunity to restructure the economy while exploiting the gains from new intellectual capital.

In the final analysis, Caribbean transformation may be achievable only if the Caribbean moves urgently to establish its *own* capital foundations firmly, based on preoccupation with consumption of its *own* heritage generated by its *own* dynamic practice of creative action and creative thought. This interpretation is consistent with RNM's recommendation that CARICOM countries must urgently develop national and regional strategies based on a long-term vision of development (Caribbean RNM, 2000).

The music industry of the Caribbean has been an important example of the approach to be adopted. It has engaged in market penetration through the Caribbean Diaspora and has created mainstream product, fully differentiated from alternative competing product. Yet, until recently, it hardly figured in the industrial policy of these countries, and received no assistance that could compare with the incentives granted to foreign capital.

This fact must count for something in the understanding of the design of trade policy. The experience of the entertainment sector indicates that Caribbean countries may profit from trade policy that pays adequate attention to the need to win support for these creative efforts internationally through facilitating the market creation and market penetration initiatives of the firms and sectors of the region. The Caribbean Diaspora presence can be the fulcrum of market penetration.

Building competitiveness through endogenous technological progress in the Caribbean thus requires active trade policy in the form of international market creation and market penetration. The very history of capitalism confirms this as the main lesson about the successes of the North Atlantic and Pacific countries and their international corporations. Similar evidence can be found in the successes of India and Jamaica in their reverse settlement of Britain and Europe.

Such taste formation processes require movement of people, with their capital, their firms, and their supporting institutions, not merely for visits, but for settlement. Even the movement of capital as envisaged by the WTO must be modified to reflect this factor. Movement of most forms of Caribbean capital, in the sense of its produced means of production, also requires movement of its people and their entire sociology. Trade policy should promote such movement of population on a non-reciprocal basis.

7.0 SECTORAL ANALYSES

The study reviewed the performance of some key sectors to establish, from secondary data and discussions with industry personnel. The study also sought to identify the extent to which and trade diversification had been advanced, and the headway made by countries in respect of production flexibility and production diversification in the context of their trade policy framework. The selection included two traditional industries in agriculture - sugar and bananas - two in minerals – bauxite and oil and gas – and three others which have been promoted as part of the process of diversification – tourism, apparel manufacture, and information processing.

7.1 Agricultural Commodities

For the purposes of the present exercise, the focus was on sugar in Jamaica and bananas in the Windward Islands.

Sugar, one of the founding institutions of Caribbean society, remains a major economic activity in the Jamaican landscape, employing over 30,000 persons, or just under 3 percent of the workforce, and contributing less than 2.0 percent of GDP.

Post World War II balance of payments crises in Britain created a viable market for Windward Island bananas. The UK needed to conserve foreign exchange in the reconstruction of the economy after the War and the Windward Island colonies were a ready source of the fruit within the sterling area.

In the Windward Islands, bananas proved ideal as a small farmer crop. It could be grown on small acreages, and as a perennial, could supply the needs of households on a continuing basis. Bananas thus emerged as the major employer of labour in the Windward Islands. At its peak production level in the early 1990s, there were over 13,000 registered growers in St. Lucia, the largest producer among the islands.

Because of high labour and import intensity and low land productivity, both sugar and bananas have been characterized by high unit cost of production relative to international standards. Thus, both industries have historically depended on preferential treatment to survive as export industries. At the beginning of the 21st century, these industries remain uncompetitive by international standards, with costs several times those of efficient producers on the world market.

Historically, leading firms in both industries, and Governments have attempted to conduct research aimed at improving methods of production and reducing unit costs. In the absence of capacity for applied mechanical and chemical research, the emphasis has been on agronomy. In recent years there has been an effort to broaden to other areas including chemical research. In sugar, one product has been Xanthum Gum, but it has remained un-commercialised. In bananas, there has been considerable work on the development and introduction of varieties. These gains have been inadequate to compensate for the cost disadvantages (relative to market price) imposed by low land productivity, and high labour and import intensity.

Repeated negative price shocks create crises of profitability at the level of the producers, and trigger balance of payments problems at the level of the country, thereby severely limiting the ability of these sectors to upgrade imported inputs to raise productivity and lower unit costs. These factors explain, in part, the failure of Jamaica to engage in co-generation of electricity, which would have created considerable energy for a country that is energy deficient, and which would raised the productivity of sugar itself.

At the same time, the industries have not developed capital related solutions to restructure and reduce costs. The industries and the societies have neglected to construct local technology and capital that will allow for supply side adjustments to the demand problems faced by sugar and bananas. In other words, there has been failure to ‘capitalise’ sugar and bananas, while the losses continue in both.

Against this background, both industries are now exposed to new tariff rules. Protective quotas and protective tariffs are being abandoned. The lowering of international commodity prices exacerbates the vulnerability of these economies. In the new mode of international reciprocity, the region has locked itself into international agreements to reduce tariffs thereby creating fiscal crises and vitiating the discretionary role of Government to subsidise key sectors at critical points and to promote capital formation.

Special Preferential Sugar will be exposed to full liberalization as early as 2002 unless new concessions are won from the EU. The prospects for such concessions are not good. Since inefficiency is partly related to size in any price-taking activity, it is not likely that Jamaica's sugar industry would survive in the long run without either continued massive budget supports from government or substantial product diversification. Diversification is clearly the more feasible and desirable scenario, and trade policy would need to address such prospects urgently. But the central point is that prospects for successful diversification are mixed and would require the deployment of extraordinary domestic inventiveness and suitably rapid capital formation.

Alternatively, in the medium term, the regional industry could be rationalized, with Jamaica, Guyana and Belize becoming the major centers specializing in sugar production, marketing its output mainly to the region rather than to the EU or the USA. Total regional demand in excess of 200,000 tons already exists to support this adjustment. Alternative capital-intensive activity could be located in St. Kitts, Trinidad and Barbados, which, in any case, have much less potential to compete effectively in sugar production.

In the case of bananas, the very features that have made bananas attractive as a small farmer crop have created a handicap to change and to diversification, which were essential in a price-taking situation. These factors have had their effect on planning as well, with the institutional base, both at the governmental and to some extent, at the non-governmental levels, being slow to respond to obvious signals from the market. Thus, while the Governments have all espoused diversification as a strategy, actions in the past displayed ambivalence at best, and lethargic responsiveness, at worst.

The emphasis has been on fresh fruit supply largely as a result of the monopoly role exercised by Geest over the years. The intra-Caribbean trade has been slow to emerge, although there is a considerable market, especially in the major tourist destinations. Windward Island bananas have not fully exploited this market. There has been relative failure to experiment with processing of bananas even though the level of rejected fruit has been adequate to sustain a considerable processing market for fruit unable to meet fresh market standards.

The special circumstances of the early 1990s have also been responsible for the slothful response in reacting to market conditions. Banana prices were very encouraging in the first years of the decade. With the EC dollar being tied to the US dollar, and with income in the form of pounds, Windward Island banana producers could hardly contemplate the effect of changes imminent with the formation of the EU, in the first instance, and then of WTO subsequently.

The region, having been accustomed to preferences, has not been prepared psychologically for a rapid restructuring of its agricultural sector. While sugar was given more than a century de facto, banana production is being given a decade at best. The psychological preparation for the removal of whatever is available by way of external support and to organize strategic measures in restructuring, has been absent.

The new rules in the international marketplace have put paid to preferential treatment. Competitiveness in commodity production implies control over technology such that one's product price can be lowered by productivity change. In other words, technological superiority on the supply-side is the sine qua non of survival and competitiveness in the production of commodities. This has not been the experience in bananas and sugar and even where, in the latter case, there have been substantial possibilities for downstream and internal diversification, there has been technological and other rigidity. Both industries now show signs of rigor mortis.

7.2 Natural Resources

The study examined the experience with natural resources – bauxite and alumina in Jamaica and oil and gas in Trinidad and Tobago. Jamaica is the world's third largest producer of bauxite and of alumina. These products accounted for more than 50 percent of the country's merchandise trade, and about US\$740 million of foreign exchange earnings in the year 2000. The industry is the second largest earner of foreign exchange for Jamaica, after tourism (World Trade Organization, 1998). Oil and gas and petroleum or petroleum derived products are even more dominant in the case of Trinidad and Tobago, contributing 27 percent of GDP, and 66 percent of merchandise exports. The trade policy of these countries in respect of their natural resources has been closely intertwined with the development path they have followed in the use of natural resources.

7.2.1 Bauxite and Alumina in Jamaica

There are now five major companies operating in the bauxite and alumina sector of Jamaica: they are mainly foreign, with one being a joint venture with the Government. The main products of the industry are bauxite and alumina, with some limited production of other by-products. Since 1974, the industry has undergone some fundamental structural changes. In 1974 to 1981,

crude bauxite production exceeded the production of bauxite processed into alumina downstream. After 1981, this structure changed, as the industry succeeded in expanding its alumina production relative to bauxite. Overall though, the structural change was accompanied by a general decline in production.

The inputs into the industry comprise mainly imported machinery and transport equipment, and associated construction and engineering works. The trend has been towards a decline in employment, by approximately 46 percent since 1975. However, the structure of employment has remained largely unchanged. Since very few of the inputs used have been in the form of domestic capital, the result has been a rising imported input to labor ratio. Bauxite is clearly the quintessential open industry – importing in order to export.

In the absence of a rising role of domestic capital, the evidence seems to be that the country has been stuck with bauxite and alumina, and has not been able to diversify beyond smelting. Industry specialists indicate that the capital requirements for downstream investments in alumina are relatively small by industry standards and the technology is accessible internationally. However, a number of problems constrain such adjustments.

Large international companies with the financial capacity to invest in the industry tend to locate plants in, or close to, the markets they seek to supply. The Jamaican market for downstream products such as aluminum or chemical derivatives or alloys is almost nonexistent. With no significant options for integrating alumina into the local industrial base, it has been difficult to attract such foreign direct investment. Local entrepreneurs are unwilling to initiate investment in downstream activity, including fabrication and chemical production.

Thus, only two major options seem to exist at present for further development in the industry. The first is further investment in alumina production to take advantage of the opportunities for significant value added. The second option is restructuring of the industry for some degree of product diversification, into such areas as the production of caustic soda. Alumina demand is likely to stay buoyant, since aluminum is the second most widely used metal in the world. Currently, new applications are growing in areas such as automobile production and computer production.

The central trade policy issue is that expansion further along the route of alumina production or by way of product diversification seems likely solely through foreign investment. The international corporations which invest also own facilities in other countries that produce bauxite and alumina, often more cheaply than Jamaica. As such, investment can only be attracted if the

country offers appropriate trade-related deals to offset the advantages of expanding plants operated in other bauxite producing countries.

Measures generally available under the Export Industry Encouragement Act and other laws include tax concessions and duty free access for imported inputs, including oil, machinery, equipment and services. No subsidies are currently available, and projections are that these benefits will be eliminated by January 2003 in order to comply with the WTO agreement on Subsidies and Countervailing Measures (World Trade Organization, 1998:68).

There seems to be little chance that attraction of additional foreign investment could be done by further fiscal incentives because of the tight budget and balance of payments constraint of the country. In any event, the current foreign investors in the industry are the major international players. Leverage over them is quite low when related to the size of the investments needed to expand capacity in the industry, and the nature of the incentives that the Government could provide.

So far, local investors have not risen to the challenge with respect to productivity increasing investments in the local economy. Similarly, regional investments have not been attracted into Jamaica to undertake the investments identified. Moreover, in the era of structural adjustment, the state is increasingly unwilling to intervene as entrepreneur, and in any case may not be able to do so, given its budgetary difficulties that are attendant on the currently moderate performance of the leading export sectors.

7.2.2 Oil and Gas in Trinidad and Tobago

Trinidad and Tobago has been an oil producer for more than a century. The sector rose to prominence as a foreign exchange earner in the 1940s, and came to dominate the economy in the immediate post independence period. Not only was it a source of crude, but, in the context of the geo-politics of the international oil industry, it was seen as a safe location for the refining of crude brought from elsewhere in the world. It was also relatively close to some of the major centers of demand on the eastern sea-board of the United States and in Western Europe. As a result Government revenue became heavily dependent on oil.

The Middle Eastern conflict of the early 1970s, the aggressive posture of the Libyan Government towards the oil companies operating in that country, and a decline in stockpiles, sparked a massive increase in prices, and to the creation of real muscle in OPEC. This astronomic rise in the price of oil improved the revenue base, and relaxed the constraint on the financial resources

for industrial development for the Government, which could write industrial policy and also implement it in tackling intractable problems of unemployment creation and diversification.

Although the ten-year boom that the country experienced was to display some of the characteristics of the Dutch Disease phenomenon, the Government secure some achievements: reduction in economic and social inequality, and expansion of education and health services, transportation, roads, ports and other major infrastructure. The Government led the way by itself investing in the economic infrastructure through energy-intensive and other industries. It became the largest entrepreneur with over sixty state enterprises. The focus of this state-led industrial transformation included steel, urea, methanol, and ammonia, which became new components in the exports of the country, in some cases in joint venture with foreign capital. This expansion was characterized by a massive importation of plant and equipment.

The collapse of oil prices in the early 1980s forced the country eventually into the arms of the Washington Institutions and to a reversal of many of its policies. There was a refocus on to the non-oil sector. More importantly, the collapse in oil prices had taken place against the backdrop of declining oil production, and a growing lack of competitiveness of the refinery operations. Some of the enterprises established in the energy intensive sector ran up huge losses and the Government, now strapped with fiscal constraints, was forced to privatize. Foreign private sector interests in steel, fertilizer and other industries took advantage of the infrastructure that had been built up and of world-class plant and equipment that the Government could no longer manage. Moreover, the thrust into energy intensive industries and the discovery of gas in large quantity meant that the country has remained attractive as a base for gas intensive industries.

The economy is now more gas based than oil based and its energy future seems oriented in the direction of the former. The recent signing of an arrangement between British Petroleum and the Government of Trinidad and Tobago, however, has exposed the fundamentals of the relationship between the country and the developed world. The country has witnessed the return or advent of other transnationals in the expanding gas sector.

Gas has replaced oil, but the arrangements are not much different. The fundamental issue on the production side may have less to do with resource-based industrialization per se and more with the understanding of the requirements for productive capability and technological prowess. The experience in respect of diversification and transformation deriving from the trade in its resources of oil and gas has been a mixed bag. This is demonstrated in

- the role of domestic capital formation;
- the degree of strategic thinking and implementation of plans; and
- the role of the country in the international industry.

There has been some amount of domestic capital formation with domestic firms mastering the technology of oil production and becoming involved in farm-out arrangements, creating symbiotic relationships with the foreign transnationals and absorbing technology and being able, on their own, to arrive at technical solutions and configure plant and equipment. There has also been some transfer into other areas with firms capable of providing professional services in process technology and in some aspects of design. This is clearly seen in the methanol and ammonia industries where several of the plants are totally managed by locals.

On the other hand, there has been a retreat of the state from a direct role in industrial transformation. The fiscal constraints and the losses incurred by some of the state enterprises in the mid 1980s forced the country into a shift in policy in respect of state participation in directly productive activity. Economic policy succumbed more directly to the dictates of the Washington Institutions and the reversal of policy in respect of state enterprises. The Government sold en bloc to foreign interests, without attempting to involve the domestic private sector, and the technical cadres through divestment to local interests. This applied even in respect of enterprises that were profitable.

The activities in which the state had participated were all in areas where there is considerable concentration internationally. The requirements of Trinidad and Tobago becoming and remaining a major player with strategic clout would have required a clear-sighted government with the accumulated resources to enter other areas of the market, for example by securing a market and distribution presence in the consuming countries, and/or taking a strategic share in one of the majors. In the absence of such an approach, the country has been limited to traditional relationships for the most part and its 'trade' as well as its production are determined directly by the decisions of the transnationals. Privatization resulted in missed opportunity for going to the next stage.

Trinidad and Tobago, while still a small producer in the international context, has, however, been able to create a niche for itself, largely because of strategic decisions taken by the Government of the day in the 1970s. The bulky investments taken at Point Lisas have put the country on the world energy map. In spite of price fluctuations, presence in the marketplace has worked to good advantage when prices have been attractive. Even though the thrust to downstream investments has not been sustained, the country has benefited from strategic investments made in the 1970s and is not insignificant in spite of its size. However, the inability to maintain fiscal resources to engage in major investments, and more importantly, the failure to maintain a strategic think-tank focusing on the national interest in the international industry have frittered away the opportunity of changing the vertical control exercised from outside.

7.2.3 Lessons of Natural Resource Exploitation

There are certain lessons deriving from the experience with bauxite, alumina, oil and gas. In respect of the trade related issue, oil and gas, like bauxite, are marketed under certain special conditions. These markets are highly oligopolistic with a few large firms – the majors – controlling the distribution and having production agreements in respect of the major producing fields. This feature, rather than new trade rules and policies, determine the nature of participation of Caribbean producer countries in these industries.

There is admittedly, differential opportunity for these countries in respect of flexibility and product diversification in these industries. However, trade policy and development policy with the use of a natural resource base require a good understanding of all areas of the industry, and concerted strategies to promote domestic capital. Strategy must extend as well to expanding a country's presence in the marketing and distribution structure of the international industry and in forming strategic links, such that the benefits that derive at any level are equitably distributed. The theory of oligopoly suggests that the market and therefore trade will not dictate an equitable result on their own.

7.3 The Apparel Industry in Jamaica

As in other parts of the world, the Apparel Industry was one of the first sectors promoted in the initial efforts at industrialization in the Commonwealth Caribbean. Following some early preoccupation with import substitution, most of the countries turned to export markets as the basis for the growth and expansion of the industry. The more recent experience in the industry, however, has been dominated by efforts to exploit the privileges accorded by the United States to the Caribbean Basin countries under the CBI and subsequent versions of the Act since the mid 1980s. This has created a segmentation of the industry into a segment created by trade policy responding to special conditions in the United States and the segment that utilizes domestic capital, and attempts to create indigenous design for the domestic market but with an eye for export possibilities.

7.3.1 Export-processing Operations

In respect of the former, the rationale of the Caribbean as a location for apparel production is derived from a number of factors. The Multi-fibre Agreement provided the US apparel industry with the wherewithal to reconfigure itself. The application of new technology allowed the industry to reorganize some areas of production. However, the final sewing of garments has remained highly resistant to mechanization. Low wage locations in close proximity to, or on the doorsteps of the United States became especially attractive for final stage processing. This

locational advantage together with the application of quick response systems, and the mercurial changes in fashion, explain the emergence of this activity in Jamaica and the Dominican Republic.

To the Governments of the region, faced with high unemployment, apparel-processing operations offered an attractive opportunity for employment creation. By the late 1980s, offshore production of garments in EZPs became the main foreign exchange earner in the manufacturing sector of Jamaica, with a number of new producers, mainly foreign investors operating in the export free zones (EFZs), especially in the Montego Bay Free Zone. Trade policy defined industrial policy for the entire sector, with the result that the fiscal regime was focused almost completely on encouragement to foreign firms seeking access to low wage locations. Incentives for the foreign investors to locate in Jamaica are provided under the umbrella of the Jamaica Export Free Zone Act. Companies operating in the free zones receive incentives including exemptions on income taxes in perpetuity and custom duties on machinery and equipment.

To operate in a free zone (defined as outside the customs territory of Jamaica), a company must export 85 percent of its output outside of CARICOM. At one stage, there were some 180 firms operating in the industry. Since 1996, government extended the scope of the Free Zone Act to cover single entity free zones. As of the year 2000, 3 companies operate under these extended provisions, down from 4 in 1998. By contrast, 163 operators in the “Customs Territory” of Jamaica are mostly fashion houses and dancehall fashion centers.

From the perspective of the national origin of the operators, 19 (10.6%) are foreign corporations and 161 (89.4%) are local. Since the mid 1990s, employment has been on the decline, with 18,000 persons employed in 2000 as compared to 36,000 persons in 1995. The majority (77%) is employed in the fashion houses, dancehall fashion centers and other operators in the Customs Territory of Jamaica.

Jamaica also exports apparel to Canada under CARIBCAN. This program provides for managed access to the Canadian market, which is automatically increased every year by 6 percent, with the exception of specific sensitive products. The CBI and CARIBCAN firms combine Jamaican workers with foreign management and imported equipment in the assembly.

There is an inherent limitation in the contribution of this segment to the development of the country. The imported equipment is typically not of the most recent vintage, as investors seek to take advantage of Jamaica’s relatively low labor costs, a workforce that is very experienced in the assembly of apparel and has some basic local training in sewing skills (from HEART-NTA). Skill development in apparel assembly is limited, and is restricted to a specific aspect of garment

assembly. Thus, fragmentary skills are not fungible to other process or activities. They also provide little scope for self-employment. In addition, Jamaica used a series of recurrent devaluations to achieve labor competitiveness thus reducing the labour force employed in the apparel assembly industry to a commodity.

The export-oriented industry features no internal efforts at product differentiation. Any semblance of differentiation is due to the entry of new foreign investors bringing different apparel to be assembled. The industry also features no general interest in establishing a full-package industry. The tenets of the Caribbean Basin Economic Recovery Act (CBERA), 1983 and 1990, also inhibited the US firms from relocating higher value-added activities such as textile manufacture, garment design, pattern making, cutting, marketing and distribution to CBI beneficiary countries.

The objective of this preferential trading agreement was to reduce the competitive disadvantages of the US garment manufacturers. To this end, their uncompetitive labor-intensive activity was undertaken in low-wage Caribbean countries and the higher value-added activities were done in the US. The Asian firms that dominated the CMT production also failed to transfer higher value-added activities to Jamaica.

There are other problems: security costs due to drug trafficking, depreciation of the nominal exchange rate, that increases the Jamaican dollar costs of imported inputs, and high costs of electricity and rentals, substantially above those of the other assembling countries such as the Dominican Republic or Mexico. Labor costs have also been rising in the Montego Bay Zone, given its location in the country's major center of tourism, and this has not been counteracted by investment in high technology to raise productivity.

Competition from Mexico has led to the exit of foreign investors with a consequent fall in employment, output and exports since 1995. The general liberalization of the global textile industry resulting from the phasing out of the Multifibre Arrangement has also led to the entry into the USA and Canadian markets of producers other than Mexico, and has made Jamaica substantially less cost-competitive in its main export markets. The exit may be accelerating. Discussion with the investment promotion organisation in St. Lucia confirms a similar pattern. The garment firms disappeared from St. Lucia, St. Vincent and St. Kitts with the entry of Mexico into NAFTA, and cheaper usage locations like the Dominican Republic expanded operations.

The central structural problems of the industry are similar to those of bauxite and sugar. Much of apparel production in Jamaica is a price-taking activity that is highly vulnerable to any contradictory movements of price and unit costs. Through the EFZs, Jamaica has participated in

the mature segment of the international apparel industry, primarily with firms and institutional arrangements that give the country little or no control over the supply-side adjustment factors that allow the international industry to deal successfully with demand and price adjustments. The ongoing trade initiatives subsume the elimination of the Multi-fibre Agreement, and the full freeing of trade in apparel, the fall-out effects of which industrial policy in Jamaica and the Eastern Caribbean had not fully anticipated.

7.3.2 Domestic Capital in Apparel Production

The domestic capital intensive firms in Jamaica and elsewhere in the Commonwealth Caribbean run the gamut from seamstress type to operations with just a few machines to larger establishments of one hundred or more workers and machines. Generally speaking, they are “full package” operators, carrying out with varying degrees of competencies, production activities ranging from fabric and garment design, pattern making, cutting, assembly to marketing and distribution.

In Jamaica, they are categorized as fashion houses in the case of the larger operations, and dancehall fashion centers in the case of the smaller home-based operations. Many of these operations are family-owned and run establishments, but the corporate structure also embraces privately incorporated companies. A limited number of these firms have succeeded in penetrating the extra-CARICOM market, serving niche markets in the US and Europe.

The Investment Promotion agencies in the region such as JAMPRO and the Tourism and Industrial Development Corporation of Trinidad and Tobago (TIDCO) typically assist this segment with trade shows with workshops, seminars and missions abroad, while some participants go to international trade shows with their own resources, or with funding from Caribbean Export Development Agency.

In general, however, this segment does not enjoy the types of incentives, positive externalities and general benefits available to operators in the free zones. The segment’s efforts to innovate have been constrained by the absence of training support. There is an absence of suitable training programs in the technology and management of the apparel business. The HEART-NTA of Jamaica focuses on sewing, even though designing is the key to the creativity of the local industry.

The industry also fails to benefit from economies of scale and scope, and lacks access to venture capital. There is little opportunity to enjoy the externalities derived from the clustering of manufacturing and marketing activities as experienced by firms in countries such as Italy. The

deepening of the production process is also stymied by the absence of internationally competitive textile mills. There is thus a heavy reliance on imported fabric.

The firms in this sector are now faced with increased competition from finished apparel imports. Trade liberalization is having a deleterious effect on those operators who are heavily dependent on the domestic market. In Jamaica, the twin effects of liberalization and crime have resulted in a decline in the growth of the dance hall and entertainment fashion segment.

There are a few firms in Jamaica and elsewhere in the Commonwealth Caribbean, which despite the difficulties outlined above, manage to achieve considerable export success in extra-regional markets. They have managed to bring Caribbean uniqueness to apparel products that are in high demand in both the domestic and international markets. Although there are differences among them, there are several common characteristics that contribute to their success. These include:

- International exposure gained through participation in trade shows
- A mastery of production technologies
- Unique marketing and distributing methods
- A breed of “new” managers with experience gained abroad

The domestic apparel industry is not without capacity, but it has not been the focus of an integrated trade and development strategy. In the emerging open trade in garments, the Caribbean can survive only in the area of fashion, if there is suitable domestic capital formation in respect of the use of local design and creativity in exploiting niches.

7.4 The Information Service Industry

This has been the most recent sector for industrial promotion and for foreign exchange earnings in the region. Technological change has allowed for the reconfiguration of information processing in office work. The increasing deregulation of telecommunications and the growing international integration of computers and communications have allowed companies in the industrial world, attempting to gain cost efficiencies, to outsource information processing activities away from their central offices to low-wage developing countries.

The outsourcing of information processing activities has been accelerated by organizational changes occurring within firms in industrial countries. The need to achieve time and cost efficiencies has compelled companies to implement techniques such as just-in-time systems and electronic data interchange. In consequence, large companies are increasingly outsourcing non-strategic activities like data entry and information processing.

A variety of factors influence decision to outsource:

- Comparative wage rates
- The availability of workers and their access to specialized training.
- Government's labor policies with respect to fringe benefits, paid vacation leave, etc.
- The price, quality and reliability of basic infrastructural services (electricity, public transportation, air cargo, courier and airline services, rental rates for facilities).
- Strong and stable economic and political systems, which is essential in avoiding extreme changes in industrial policies (including investment incentives) and maintaining exchange rate stability.
- The cost and quality of living.
- The cost and availability of information processing equipment and services, and the presence of support services.
- Geographic location.
- Proficiency in the English language.

Caribbean countries possess several locational advantages vis-à-vis the North Atlantic, the home base to many large firms. Most of the activity is concentrated in Jamaica, Barbados and Trinidad and Tobago, where a range of services such as key data entry, telemarketing, CAD/CAM and software development are undertaken.

The case of Barbados is of significant interest. Its government made considerable commitment to develop the Information Service Industry. It offers a package of incentives to investors which consists of the following:

- A maximum corporate tax rates of 2.5 percent for the International Business Company (a company which market its products/service outside of the CARICOM market),
- Exemption from import duties on production related inputs;
- Full repatriation of capital, profits and dividends;
- Training grants scheme to subsidize worker training
- Reduced telecommunications rates; and
- Subsidized rental rates of operational space.

The government has also sought to provide a skilled workforce for this industry. In 1998, it announced EduTech 2000, a plan to upgrade schools, retrain teachers and equip classrooms and

laboratories with computers and up-to-date programs. EduTech will link schools to the Internet and develop a curriculum to integrate the program into the schools.

The information service industry grew very rapidly in Barbados. From a single firm employing 61 persons in 1980, this industry peaked at 47 firms employing almost 3000 persons in 1998, in activities ranging from data entry at the lower end of the spectrum to software development at the higher end.

Since 1998, however, the industry has experienced divestment. The competitiveness of activities at the lower-end segment of the industry is presently being challenged by those undertaken in lower cost locations. The country's relatively higher wage structure, is more compatible with that required for higher value-added information service activities.

The Information Service Industry in Barbados, as in some other Commonwealth Caribbean countries, consists of two distinct segments. One segment is dominated by the internationally competitive foreign companies, producing mainly for the extra-CARICOM market. The other segment is occupied by locally-owned firms. The firms in this segment are typically small, producing for the domestic, CARICOM and extra-CARICOM markets. There is little interaction between firms in these two segments.

Despite government commitment to develop this industry in Jamaica and Barbados, the two largest participants, the capital accumulation process among most locally-owned firms has been weak. Indeed, to some extent, the government's emphasis on promoting foreign firms has been to the detriment of their local counterparts. The locally-owned firms in Barbados do not appear to fully capture the potential synergies arising from the presence of several internationally competitive foreign firms operating in their industry. Previous legislation curtailed the early formation of joint activities among foreign and local firms, and the need for secrecy has also been an inhibiting factor.

The development of an indigenous supply capability is hindered by the corporate strategies used by foreign firms operating in this industry. In the cases of St. Kitts and St. Lucia, and to some extent, Barbados, the firms have been fully enclave operations, functioning as subsidiaries of foreign (US) firms, from which all contracts come, or as dedicated local contractors to foreign firms. Also, few foreign firms used the services of local firms for activities such as simple repair and maintenance of equipment or the design of software programs since it seems to be more cost-effective to use the services of parent companies (Barclay, 2001).

The cost of telecommunications services, are the main constraint on the growth of the industry at the lowest level. Countries such as St. Lucia and St. Kitts have been able to enter the market by providing computer literate workers for information processing. At the lower end, wages and communication costs are the primary factors in the decision of foreign firms and in the viability of domestic firms.

At the higher level, there is the issue of the strategic machinery of governments in stimulating demand for a higher quality of workers who could attract firms seeking to write soft-ware and to develop new programmes for their home market and/or for the international market. Much will depend on the willingness of Caribbean countries to invest heavily in creating that level of depth in the work force adequate to the requirements of making Caribbean countries competitive in the higher areas of the sector. The Barbadian experience is noteworthy here. The country actively encouraged several foreign firms to make improvements in its education system. More recently, the software companies have been involved in upgrading the computer curriculum of the local university.

Yet, in spite of the handicaps locally-owned firms have faced – lack of incentives, high cost of communications, small domestic market, lack of venture capital – the information service industry has attracted a new type of entrepreneur, the young professional, who traditionally would not have become involved in entrepreneurship. Several of these “new” entrepreneurs have flourished. They are engaged in a diverse range of activities, including data processing, CAD/CAM services, and the provision of management and technology services. Most export their output to US and CARICOM markets. They share some similarities including an emphasis on training in export-orientation and a focus on achieving competitiveness.

On another level, there is the option of the Region using information technology to increase the competitiveness of the domestic industry in the international economy. There is undoubtedly some of this taking place, but there are very few examples of path-breaking work that has helped Caribbean firms to develop proprietary solutions using information technology, for example, in process technologies used in oil, gas, bauxite, and sugar industries.

The presence of Caribbean countries in this industry has as much to do with their being able to provide skills and knowledge workers at relatively competitive rates as it has to do with their proximity to the major industrial markets. The foreign firms have entered to exploit these advantages, and the fiscal incentives that are provided by way of cheap space and duty free entry of essential equipment. The markets have been fully open and the new trade policies have brought no major changes, except in so far as labour standards may emerge as an area for

sanctions. Generally, though Caribbean countries have observed labour standards in the segment of the industry in which they participate.

Meanwhile, the Caribbean finds itself simply responding to a technological dynamic that resides abroad. Deepening involvement, and diversification into the areas likely to derive greater income and foreign exchange earnings are contingent on an infrastructure of knowledge and skills. This will constitute the foundation of trade policy in the area, but the preoccupation with the establishment of call centers as part of industrial policy does not give much basis for hope.

Issues relating to TRIPS have remained largely an academic consideration since the region has not been seriously engaged in the development and licensing of software or in the fine-tuning of applications. In the absence of concerted strategies to deepen the knowledge base in the sector, and to engage in the more creative areas of the industry, the Caribbean runs the risk of repeating the errors experienced with apparel assembly.

7.5 Tourism in Jamaica

Tourism has been the bright spot in the growth of the economies of the Commonwealth Caribbean. The countries best favoured with sun, sea and sand have been the first to exploit the opportunities offered by the growth of the international industry, which is one of the fastest growing sectors in the world economy. Among the English-speaking Caribbean, Jamaica has attracted the largest number of visitors. The industry is the most important industrial sector, and has become the main foreign exchange earner for the country. The Jamaican experience is significant, in particular, because of the growth of its own firms and their capacity to run tourism plants abroad. In an industry that has been relatively open, and free of restrictions, Jamaica has been able to establish its competitiveness.

Three international chains with headquarters in Jamaica supply about 40 percent of the rooms available and 60 percent of all the all-inclusive hotels. These are Sandals, Super Clubs, and Friends International. This structure evolved over the past 15 years, from an earlier stage in which the dominant hotels were foreign owned.

After a period of considerable growth in accommodation and employment, the industry has displayed slower growth in the more recent past with average occupancy remaining stable at about 58 percent. It is a high cost industry relative to international standards with a typical room being four times the cost in the Dominican Republic and other competing destinations and the prospects for cost containment are not encouraging. A significant proportion of the costs are attributable to systemic, rather than merely industry, inefficiencies. These include costs of plant

construction, architectural services and interior decoration, imported equipment, and land costs. Unit labour costs, including professional services, are also relatively high. One reason for these high unit labour costs is tightness in the tourism labor market. There is not a large supply of tourism sector-trained personnel in the country.

As a result of the high unit labour costs, survival is based mainly on the peculiarity of the product and the development of capital, as distinct from the imports available to the tourism industry. The major strength of the industry is the rich diversity and continuing differentiation of the product based on geography (climatic, sea, sand), music, other local entertainment, cuisine, heritage, and sports.

Tourism is one of the few sectors in Jamaica in which creativity is spread across all segments of the industry, and in which the creativity of the large establishments is paramount. Jamaica has developed its own model of the “all-inclusive” hotel, which provides a high degree of customer satisfaction to the tourists.

Two significant developments in the industry in recent years have been the growth of the all-inclusive and the rapidly rising role of the entertainment subsector, inclusive of the man-made attractions, as a contributor to the value-added of the industry. Music is one of the most valuable inputs into tourism, and is an attraction to all types of tourists from all destinations.

The music-entertainment-tourism interface has, in turn, permitted regular change in the tourism product. Mento, ska and rocksteady have been the forerunner to the dramatic development of reggae and the major festivals of Reggae Sunsplash and Sumfest into worldwide commodities. More recently, there have been the similarly significant developments in dancehall, reggae-soca with the Jamaica carnival, and to a lesser extent the rise of the Jazz and Reggae festivals.

This industrial segment makes intensive use of domestic capital. Tourist accommodation is linked with performance facilities and other entertainment infrastructure to create a dynamic package. Moreover, there is finance to allow the high rate of capital formation. Even if tourism or music makes considerable use of imported inputs, the sector forms and uses domestic capital intensively. More than any other sector, the music-entertainment-tourism dynamic demonstrates the potential for the Caribbean economy to transform process and product if capital formation occurs in support of innovation.

There is also rapid development of community-based tourism with rich possibilities being identified with a number of parish-specific festivals. Another major development is the recent integration of tourism into the education system, especially through the HEART Trust, with the

integrated Hotel Training School and Hotel Facilities, and the strengthening of training in the music – tourism link. Sports are also making a substantial contribution through soccer and golf. These innovations are supported by extensive niche marketing.

Some negative restructuring has been taking place in recent years, in the form of the destruction of many of the small tourism plants – bed and breakfast, etc. Perhaps the single most important change in recent years is the development of a master plan for the industry by its stakeholders through a major program of community consultation. This has laid substantial foundations for a participatory process of development. Evolution to date has occurred without a design, but the proposed plan promises to make a difference.

Initiatives towards product development and diversification are now more carefully coordinated with the underlying motivation to reduce the dependence of the market on tourists from the USA and Britain, and to increase the market share deriving from other sources such as Europe and Japan.

The tourism industry benefits from a wide range of incentive schemes. Under the Hotel Incentives Act, standard hotels get a 10-year relief from income tax and from import duties on building materials, machinery and equipment. Combined convention centers and hotels get relief for 15 years. Under the Resort Cottages Incentives Act, incentives are provided to resort cottages, including through duty-free status for importation of building materials and furniture.

Industry sources have expressed the strong view that since tourism is highly integrated into entertainment, it is also necessary to invest in entertainment promotion. There have been significant efforts in music education in recent years at the University of the West Indies and more importantly, the Edna Manley School of Music and the Creative Arts. This was implemented in an attempt to booster the music component of the music-entertainment-tourism paradigm. Government and the industry have made important moves to set up copyright laws and collective management services to facilitate the flow of incomes from this important source.

Some industry analysts have also urged that government write off tourism marketing expenses and increase efforts at export promotion to underwrite development of the product. The rationale here is that this will assist with product development and marketing by the private sector. The all-inclusives spend very heavily in marketing abroad, in the constant redefinition of their packages and have displayed sophistication in linking back into other areas of the value chain by establishing a presence in main markets. Clearly, the constant redefinition of the product has to be supported by continuing innovation. The country has displayed some ability in this capital creating area before, but this needs official recognition as the basis for competitiveness.

7.6 Summary of Industry Studies

The review of performances of specific industrial sectors on which the countries have depended for their foreign exchange earnings reveals the following:

1. The production of agricultural primary products – sugar and bananas - has survived only as a result of protection in the main markets, and the Region has largely failed to embrace opportunities for diversification within these industries. This failure leaves them still reliant on preferences for employment and foreign exchange earnings.
2. Xanthum Gum and agro-tourism have remained unexploited within the sugar industry in Jamaica; in St. Lucia, banana chips, other forms of processing and the development of the intra-regional fresh fruit market in bananas have been virtually ignored.
3. The attempt to industrialize and diversify through the promotion of export oriented garment assembly, electronic components and even information processing has left the Region at the lower level in the commoditization of manufactures and the supply of services.
4. Structural links through the CBI, CARIBCAN and the Lomé agreements have not allowed for the creation of dynamic manufacturing industry in the Caribbean, and the attempt of governments to encourage foreign investors seeking the advantages provided by these trade agreements have detracted from their promoting domestic firms, some with dynamic potential and capable of genuine domestic capital formation.
5. Resource based industrialization through bauxite and oil and gas has fared better, but has to some extent been thwarted by oligopolistic production of dominant foreign firms, and the strategic moves of other governments. While Trinidad and Tobago has derived considerable benefit from oil and gas, and has made considerable strides in downstream activity, it has not fully exploited fortuitous circumstances, and, in its more recent acceptance of the idea of reduced participation of the state, has dismantled its strategic think tank, that might have identified a more dynamic participation in the international industry including commercial presence abroad.
6. Foreign investors have no inherent interest in diversification strategy of Caribbean countries: they have avoided downstream activity in aluminum production in Jamaica. Downstream activity now exists in oil and gas in Trinidad and Tobago, with participation by foreign firms as a result of strategic moves made by the Government in the late 1970s and 1980s, when its revenue base allowed it to deepen the downstream process on its own, but this strategy was largely abandoned when fiscal crisis ensued.

7. The Jamaican experience with tourism has been a major success in the exploitation of the amenity resources of sun, sea and sand, which with the involvement of domestic capital of creative and dynamic domestic firms has led to the creation of Jamaican all-inclusive hotels and the emergence of complementary entertainment and music that differentiates the Jamaican Tourism product. The firms have sought as well to capture some of the gains in marketing and distribution.
8. While there is some tendency and capacity in the economy to create suitable capital, there has been a failure to glean sufficient technological externalities in production and exchange, with a resulting limitation in successful process and product development, which in turn, keeps the region perpetually on the path of highly vulnerable import intensive industrialization.

8.0 ECONOMETRIC ANALYSIS OF CONSTRAINTS

Econometric and quantitative testing for constraints of process and product diversification was undertaken with the use of macro-economic data for Barbados, Jamaica and Trinidad and Tobago, which were the only countries for which there was suitable series of statistical data. More limited data were available for St Kitts and Nevis and for St Lucia, and less rigorous analysis could be conducted in these countries.

The study differentiates very carefully primary factor imports, which consists of imported equipment and tools, from domestic capital. This is an important feature of the work, and allows for a clearer delineation of the impact of certain policies in the transformation or lack thereof, of Caribbean economies.

The analysis sought to corroborate and generalize indications from the sector studies that there exists a capital constraint on transformational growth, and hence on process and product development, and associated production flexibility and industrial restructuring. In addition, partly because of the degree of openness of the economies, and the high degree of vulnerability to both price and technology shocks, resulting from intensive use of imports in the main sectors, the possibility of a balance of payments constraint was explored. Finally, tests were conducted for the presence of a population size constraint.

8.1 Barbados

Domestic Capital Formation:

The results of the tests on the macro-economic data provide evidence that the pattern of capital accumulation is a fundamental constraint on endogenous productivity growth, and hence on process development and product differentiation. The study found that there was a lack of any substantial combined role of productivity growth and rising wages.

Balance of Payments:

The analysis of the data confirms the existence of a balance of payments constraint on growth and structural change. The capacity of Barbados to meet its international obligations and its ability to benefit from international technological externalities combine to form a substantial constraint on its program of transformational growth.

Income Vulnerability:

The results suggest that the economy is not evolving by increasing international competitiveness across a range of production activities. There is a continuing high degree of income vulnerability in the Barbadian economy.

If Barbados does not concentrate its production system on sectors that are capital intensive in the sense of their reliance on domestic capital formation, it will not be able to raise the standard of living of its households on a sustainable basis vis a vis its dominant trading partners.

8.2 Jamaica

Domestic Capital Formation:

The data revealed a significant role of domestic capital formation in creating externalities for foreign direct investment. However, the productivity of capital and labour is tightly constrained by the type of capital formation that is ongoing in the society. Thus while the sectoral data provides evidence that substantial capital formation is ongoing in sectors such as tourism, music, entertainment, and in the domestic fashion industry, these tendencies are too small relative to the whole economy to dominate the general pattern.

Balance of Payments:

The analysis of the data reveals that growth and structural change in Jamaica are also constrained by the balance of payments. The nature of the findings in Jamaica imply that problems such as persistent debt and difficulties in meeting international obligations, on the one hand, and

establishing assets abroad to expand remittances or in winning externalities from imports as well as undertaking import displacement, on the other, may well be exacting a tighter constraint on the achievement of potential in Jamaica than in Barbados. The economy has not yet set in motion an endogenous process of capital formation that translates into sustainable productivity, growth and rising international competitiveness.

Income Vulnerability:

The absence of any major evidence of productivity growth points to the relative failure to take advantage of opportunities for process development and product diversification and points to a continuing likelihood that incomes will tend to be highly vulnerable until that is accomplished.

8.3 Trinidad and Tobago

Domestic Capital Formation:

The results show that the considerable growth of productivity over the past decades has occurred without any strong association with changes in the incremental domestic capital output ratio. In other words, the attraction of foreign investment and associated primary factor imports and technologies explain most of the improvements in the Trinidad and Tobago economy. On the other hand, as with Jamaica and Barbados, the transformation of its economic structure is tightly constrained by the size and structure of domestic capital formation.

Balance of Payments:

The results reveal a balance of payments constraint that appears to be substantially tighter than that of either Barbados or Jamaica. Thus, despite its considerable wealth from its energy sector, Trinidad and Tobago is a archetypical Caribbean economy with both a capital formation and balance of payments constraint on production structuring. Any difficulty in the supply of foreign exchange earnings from oil and gas would expose the limitations in domestic capital formation.

Income Vulnerability:

Income vulnerability is not as severe as in the cases of Barbados and Jamaica, and is linked to the susceptibility of income to exogenous shocks engendered by the lack of industrial diversification, reliance on primary inputs and exogenous technologies. Persistent vulnerability to external shock betrays the lack of endogenous process and product development. Trinidad and Tobago is not fundamentally different from other Caribbean economies. It is just that it has been richer than others in the more recent past.

With respect to the matter of size, no evidence was found in any country that the dynamic form of the population size constraint, in particular, the rate of growth of the labor force participation rate, is binding. This does not mean that population size is not important in the Caribbean: simply that it is not independently so.

Generally then, although old sectors have stagnated and have been replaced by a new focus, the fundamental structure of the economy has remained the same. The case of Trinidad and Tobago seems to reflect more exogenously generated riches and greater externalities created by rapid change in the quality of imported inputs, not by a fundamentally different structure to that of Jamaica and Barbados.

Discussions with firms in the respective countries generally have supported the quantitative analysis. Table 1 seeks to present in tabular form a rating of some of the industries in the context of the domestic environment in which firms have functioned. This is a partial list of factors that intervene in competitiveness, and is adequate for present purposes. While there resides a high element of subjectivity in the way this table is derived, at the very least, in counterfactual terms, the table addresses the concerns of policymakers and personnel in investment promotion agencies.

Table: 1 Rating of Industries *

Sector/ Country	Domestic Capital Formation	Import Intensity in Plant & Equipment	Rate of Technical Change Internationally	Labour Availability		Institutional Facilitation			Industrial Relations Climate	International Market Place	
				Educational Level	Depth in Specific Skills	Industrial Promotion	Finance for Domestic Firms	Information Sensitivity		Demand	Level of Concentration in Supply Internationally of Producer Firms
Bauxite, Jamaica	1	5	3	2	3	1	1	2	3	3	5
Petrochemicals, Trinidad	2	5	3	3	4	3	2	3	3	4	4
Tourism, Jamaica	4	4	3	2	2	4	2	4	3	4	3
Apparel (Domestic Firms), Jamaica	2	4	4	2	2	4	1	3	3	3	3
Apparel (Domestic Firms), Trinidad	3	4	4	2	3	3	1	2	3	3	3
Information Processing, St Kitts	1	5	5	2	2	4	2	2	4	3	3
Information Processing, Barbados	2	4	5	4	2	4	2	4	4	3	3

**1 - 5 in ascending order of importance*

9.0 CONCLUSION AND RECOMMENDATIONS

The Commonwealth Caribbean has been integrated into the international trading system ever since its modern history, as an appendage of a colonising Europe. The early 21st Century finds the region attempting to adjust as independent countries to the new systems of governance in international trade. The defining characteristic of the new ethos is epitomized in the notion of globalisation, and underpinned by the establishment of WTO. Bilateral and multilateral economic agreements, regional groupings and other forms of inter-state economic collaboration are expected to observe rules in compliance with WTO stipulations.

The over-arching concern of this study has been the examination of the extent to which the Caribbean could participate successfully and reap sustained benefits in its international economic relations. The study also examined whether the Caribbean could wean itself off its taste for preferences. Review of the trade policies of the region has revealed a failure to formulate and implement a sufficiently comprehensive trade policy for the transformational growth of the economy.

The main deficiency has been in the failure to give adequate priority and resources to foreign market creation and population resettlement in service of capital production, use, and export. In general, despite a long history of failure to transform the fundamental structure of import-intensive production, post independence trade policy has given inadequate attention to the needs of diversification through intensive use of domestic capital.

Meanwhile the industries that have operated under special bilateral trading arrangements – sugar, bananas, and apparel assembly – have locked the region into a low level trap. Whether in bananas or in apparel assembly, there have been restricted processing and market growth, reliance on outdated imported technology and limited skill development. Even where there were opportunities for domestic capital to emerge and to engage in product differentiation, these have remained unexploited. While there have been important initiatives in the mineral sector, the requirements for ensuring its contribution to transformation and development have not been addressed on the fundamentals. Yet tourism in Jamaica with its links to entertainment and music, and the domestic fashion industry illustrate how domestic capital contributes to transformation. However, it has not been the tradition of Caribbean Governments to pin their hopes on domestic capital.

Examination of the new policies reveals some movement in the right direction with respect to the CSME, and especially its protocol to allow movement of capital, but the problem of population movement is inadequately addressed. Further, at the level of bilateral and multilateral relations

outside of the CARICOM, there is excessive haste in implementing the programs to remove local tariffs and non-tariff barriers. Such trade policy would further limit the transformational growth of the region's economies and runs the risk of again subordinating development policy to trade policy benefits that will prove specious.

The results generated in the quantitative analysis and the information derived in the qualitative work suggest that Caribbean economies have a considerable task ahead if they are to increase process innovation and product differentiation, and hence increase international competitiveness primarily through productivity growth. Since investment generally, and domestic capital formation in particular, are the long term factors that permit for productivity growth, product differentiation and process development rather than wage or import price suppression, the central challenge is to create capital for such purposes.

Space in the international market place is partly dictated by the negotiation process: trade diplomacy has its role to play. However, industrial policy interpreted against the domestic sociology and the institutional base can determine the capacity for innovation and domestic capital formation. It is a moot point how well trade negotiators and the facilitation agencies have taken these realities on board. The elimination of the capital and balance of payments constraints requires systemic changes. The specific recommendations that follow attempt to provide the framework for change.

Lay the Foundations through Knowledge

Perhaps the most important first step in policy formulation is to anchor capital formation on the dynamic growth of domestic knowledge and technology. Education, research and development are a part of capital, though not yet systematically counted in the estimates of capital formation for the national record. Careful attention is needed to deal with this foundation aspect of capital formation. The litmus test of education is in the application and in the generation of new knowledge: it is not about certification. It is reflected in capital formation and productivity growth.

Undertake Relevant R&D to Create New Industries

National programs of support also seem to be vital to the success of the innovative efforts of firms and industries that succeed in competitive capital formation and related product differentiation. The experiences of the music and carnival industry, especially in Trinidad & Tobago, again are instructive. The experiences of industrial development with respect to electronics, communications, laser and infrared technologies, and more recently the ceramics technologies, in the USA are also instructive.

One form of public support evident in countries such as the USA for example, is usually an associated tacit but comprehensive program of protection of innovations from foreign competition through “standards” of various sorts, production regulations, and regulations relating to the participation of foreigners in industries that matter for the national security.

The process of capital formation for the achievement of process and product innovation is also helped if the initial capital investment is recognized as intellectual work from the start, and if it is also small enough to be undertaken without the help of the state by those entrepreneurs who are curious enough.

Break Institutional Formalism

The phenomenon of Xanthum Gum or “banana chips” is widespread – from formalistic approaches to research in the University system, to the development of new ideas and products that, even when profitable cannot activate an energetic supporting institutional base on the scale to turn them into successful and dynamic competitors in the international market. The institutional structure may, in formalistic terms, seem to display all the requirements to support innovation and capital formation. Unfortunately, their activities are conducted more by rote than with any clear understanding of the roles they are expected to fulfill.

There is clearly an urgent need to address issues such as the dearth of venture capital, the paucity of institutions that provide technological and management support in specialised fields, such as apparel manufacture and information services to the local investor. The region needs to foster those firms which are capital-intensive in the use of domestic capital inputs. It is these firms that will become the global players in the international arena.

Improve Worker Training and Upgrading

The system of education needs to be strengthened since it relates to worker training and upgrading. If the available statistics on performance in the CXC are any guide, a large proportion of secondary school graduates have been “mis-educated.” In addition to the mis-educated, there is a large cohort who have missed out on the opportunity of a basic secondary education but who are expected to be in the labour force for another 25 years, creating the phenomenon of the ‘double-miss’ (Henry, 2000). As a rule of thumb, to correct for deficiencies in all of the countries, a target of 10 percent of the work-force should be engaged in some form of education and training upgrading at any one time for at least a decade.

Competitiveness is partly determined by the mindset of the work force. As the industry studies clearly suggest, Caribbean economies find themselves at a relative disadvantage. Moreover,

productive flexibility and the ability to diversify have to be built on the capability of the workforce to transfer from one activity to another in response to market demand.

Support the Innovators

There are many examples in the studies of continual process and product development, leading to even more technological dynamism and suitable capital formation – tourism, the fashion industries as distinct from the assembly of apparel. Here, the story is one of repeated breakthroughs against all odds.

The wisdom of international experience is that the society should adopt the path that promises more technological dynamism based on the dynamics under its control. Governments have to embark on funding for a massive and comprehensive program to identify and support research and development of all current economic activities in the domestic sociology, with the aim to bring as many potentially feasible ideas as possible to commercial success in the long run.

Develop Supporting Institutions and Make Factor Markets More Contestable

Additional support should take the form of mutually supportive agreements in order to achieve a sufficiently comprehensive freeing up of the local factor markets, development of supporting institutions including governance, and by facilitating the creation of overseas assets for marketing and capital development. The innovating firms and communities could most likely profit from increasing the contestability of all domestic and international markets for resources.

Government should therefore promote the common objectives of making factor markets more contestable, including land and credit markets, developing the localized capital markets with special reference to localized knowledge and supportive institutions, and the development of the institutions of participatory democracy. The purpose is to make the targeted industries continuously more adaptable and more competitive.

Reform Trade Policy

What the Lomé Convention, the CBI, and similar deals provided to Caribbean states was not “competitive” advantage but rather mechanisms by which to avoid confronting the crises of competitive disadvantages. For the most part, the protected and privileged industries have proven to be so unprofitable that they have left most countries with major balance of payments crises and public sector debt crises, since their real costs ultimately show up in the balance of payments and the government budgets. The result has been, that, for the most part, they have been widely abandoned across the region, as the search for better options continue.

The central focus of country trade policy should be based on the fullest possible integration of **all Caribbean economies**, wherever they may exist, partly for kinship reasons and the associated maximization of the stimulus to innovate, and partly because in its early stages of development, trade tends to be driven by the dynamics of favorable population movement more than by any other variable. Close links with the Caribbean Diaspora must be part of trade policy.

Trade liberalization should be complemented by the creation of a more liberalized domestic environment with enhanced factor mobility; by a long-term vision and strategy for development of competitive or potentially competitive sectors; and by a policy to engender supply-side capacity.

In that regard, the Region should consciously seek to wean itself away from the taste for preferences and should explore initiatives in trade negotiations and trade diplomacy with a focus towards taking a definitive shift to improve its commercial presence and to keep itself abreast of knowledge on marketing, distribution and technology. These can be placed under the rubric of **TRICKS** – Trade Related Initiatives for the Development of Commerce and Knowledge Systems.

The basic trade policy recommendations are therefore the following:

1. Broaden export promotion in existing trade policy to one of **foreign market creation**.
2. Slow the pace of elimination of the tariff and non-tariff barriers in the light of the finding that the terms of trade are not central constraints on domestic transformation.
3. Determine the tariff and non-tariff structure primarily in terms of the need to develop and use domestic capital in the sectors of the economy.
4. Link the pace of elimination of tariff and non-tariff barriers to the rate of competitive transformational growth.
5. Increase relative support for market creation/penetration and export promotion activities in current trade policy through:
 - Active support for the movement of the people and their supporting sociology (settlement) into foreign markets: the growth of the Caribbean Diaspora is an important fulcrum for foreign market penetration.
 - Faster tracking of the CSME, especially with regard to freedom of movement.
 - Reform of the export promotion system to focus on the development of domestic capital.

6. In relationship with (4), increase substantially the relative attention given to TRIPS, TRIMS and GATS in the continuing negotiations, with regional interest guiding approaches.
7. Introduce in the CSME a Definite Agenda to Create a Caribbean Common Information Area.
8. Concentrate efforts on helping firms in the region increase their competitiveness by introducing new processes and activities that, as far as possible, can *displace* imports and expand exports in the market place.

The capacity of Caribbean economies to earn their keep in the international economy of the 21st Century can no longer be premised on the search for preferences and special concessions, important though these may be for survival in the short term. The research has demonstrated that competitiveness is based on productive human resources capable of innovation and product innovation. It is also about capital formation driven by domestic agents seeking to utilize their skills and knowledge creatively.

The study has not engaged in the identification of industries that will be competitive in the early 21st Century. Banana farmers in Micoud in St. Lucia, sugar workers in St. Thomas in Jamaica or in the Free Zone in Kingston, and the call center in St. Kitts, face a similar problem and so does their Governments. How to manage the transition as these workers withdraw from sectors in decline and how to retool – be educated and retrained – for new possibilities such that their human capital constitutes the base of domestic capital formation on which the transformation of these economies depends?

The study has established clearly why certain activities have been uncompetitive and what must be done to create competitiveness in future. In seeking to point to the answer, the study has proposed the policy framework necessary for competitiveness, and therefore the fundament of trade policy consistent with industrial policy and development policy.

The main task of the Caribbean Development Bank will be to assist member countries with the resources to engage in industrial policy formulation based on the specifics of their situation and in a participatory process, in-country. In addition to commitment to the exercise by key agents, this will require considerable data, including an inventory of areas of domestic capital formation, which have generally been ignored in the official data.

While foreign capital can contribute to employment and foreign exchange earnings, it cannot be the answer by itself as experience has demonstrated. Likewise foreign capital-intensive activities

will always contribute less to development and to earnings, even in the best of circumstances than would activities intensive in the use of domestic capital and founded on local knowledge and innovation. In the anxiety to secure foreign investment, the Caribbean has been attempting to walk on one leg. By devoting more energy to domestic capital formation, and to human resource development, the Region will ensure that it becomes than fully ambulatory and can run on two legs. That is essentially about what is in the heads of Caribbean people and how they apply it.

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