Some Thoughts on Approaches to Export Promotion in CARICOM

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Abstract.

In the post independence period export promotion has played a central role in the development strategies adopted by governments in the CARICOM region. The countries in the region have relied on such measures as fiscal incentives, entering preferential trading arrangements, and the negotiation of preferential access to markets in the major industrial countries of North America and Europe. In spite of these initiatives, the countries in the region have achieved limited success in expanding either traditional exports or in diversifying their exports. In this paper it is argued that these initiatives were based on the notion that that access to markets was the prime determinant for success in expanding exports while paying insufficient attention to the need to establish the foundation for production capability. It is argued that this in large measure is related to the top down approach adopted in policy formulation. We outline a series of initiatives to address this shortcoming in the formulation of policies for export promotion.

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Introduction

The creation of a dynamic export sector has traditionally been viewed as essential to relieving the constraint to economic growth of countries in the region arising from the limited size of domestic markets. At the same time it has always been recognized that limitations in production capabilities and restrictions on access to international markets faced by countries in the region were obstacles which would have to be overcome if a dynamic export sector was to be established. In this paper we will highlight what we consider to have been the principal shortcomings in export promotion strategies pursued by countries in the region. This will be followed by the outline of a series of initiatives to address the identified shortcomings. The first section of the paper will involve a critical review of the export promotion strategies pursued in the pre and immediate post independence period. The second section of the paper will examine the approach adopted in negotiating access to markets in the major industrial countries. In the final section of the paper we will outline the ways in which export promotion strategies ought to be restructured.

Early Export Promotion Strategies

A central development issue faced by countries in the region was that of alleviating the pressing problem of unemployment. The unemployment problem was a reflection of the narrowness of the economic base. Given the limited availability of agricultural land the establishment of a manufacturing sector was seen as being the way to provide gainful employment. The limited size of the domestic market meant that there were few manufacturing activities which could be operated at an efficient scale geared to the domestic market. As a consequence, a viable manufacturing sector could only exist if its production was geared to satisfying both domestic and international markets. At the same time manufacturing capability was constrained by limited domestic savings, as well as capabilities in the production and marketing of manufactured products.

The first outline of the essential features of an export promotion strategy for countries in the region was in the seminal article by Lewis(1950) in which he was concerned with making the case for the need for countries to establish manufacturing sectors. In his view the principal obstacles to the establishment of a manufacturing sector were the small size of the respective island markets, the scarcity of domestic investment capital and limited marketing skills. He stressed that in order to overcome the size constraint; production would have to be geared towards international markets. In addition, since there were very few industries in which the islands together could support more than a single factory able to operate at a reasonably economic scale, a customs union among the islands was an essential requirement to take advantage of the limited opportunities for import substitution (Lewis, 1950. p.30) Lewis, inspired by what he saw as the success of the Puerto Rican "Operation Bootstrap" argued that the way to overcome the obstacles of capital scarcity and marketing skills would be to attract foreign firms to establish plants in the region to produce items for export. Foreign firms could be induced to establish plants in the region if they were provided with an appropriate set of incentives such as temporary monopoly rights, tariff waivers on material inputs and tax holidays.

The governments of Jamaica, Barbados, the Leeward and Windward Islands and Trinidad and Tobago, all enacted legislation providing incentives along the lines suggested by Lewis directed at attracting foreign direct investment. However, in simply providing a package of incentives, the industrialization strategy was heavily biased towards import substitution rather than export promotion. Jamaica did introduce an Export Industry Encouragement Law in 1956, which provided a package of incentives for firms engaged exclusively in export production. The passage of such a law suggests the Jamaican government at that time viewed the promotion of exports as a special feature rather than as an integral part of the industrialization process. The result was that these incentives although leading to a growth in manufacturing activity, particularly in Jamaica and Trinidad and Tobago, did not result in a significant growth in exports of manufactured products. By pursuing what was essentially a national rather than a regional approach in their industrialization strategy, given the small size of national markets, the firms established were relatively high cost inefficient enterprises. This would make it more difficult for the sector to evolve from pure import substitution to export activity.

During the 1960's leading Caribbean economists challenged with increasing vigor the extent to which orthodox economic theory and its associated policy implications were relevant for Caribbean economies. This questioning of orthodoxy was reflected in their approach to development strategy and export promotion. They argued that making foreign direct investment play a central role in industrialization strategies as advocated by Lewis, would work to reinforce the structural weaknesses contributing to the perpetuation of underdevelopment in the region. They saw a need for a more active role for government in the development process. They made a case for an economic development strategy in which regional economic integration would play a central role.

Brewster and Thomas (1967) argued that the structure of production in the region could be deepened and strengthened through the creation of industrial complexes based on a policy of pooling resources and the creation of economic linkages between countries in the region. Export trade was still seen as playing a central role in the development process. However, the emphasis was now placed on the promotion of intra- regional trade through regional import substitution. It was their belief that there existed industrial opportunities which could be exploited while avoiding the difficulties of finding extra- regional markets. This could be achieved while maintaining a high degree of competitiveness with respect to quality and cost of production (Brewster and Thomas, 1967, p.61).

Other studies (Girvan, 1967; Beckford, 1967) highlighted the scope for expansion of intra- regional trade through regional collaboration in bauxite and aluminium products, as well as food products. Beckford indicated that through regional collaboration export substitution, a concept introduced by McIntyre (1965), could allow low cost Windward Island banana producers to be ceded new markets by the higher cost Jamaican producers. He suggested that Jamaica might be convinced to allow this if it could be assured that it could replace the lost banana exports with exports of manufactured products and foodstuff to the Windward Islands.

Governments in the region at that time were not philosophically inclined to assume the major role in the economy implicit in these strategies. However, they were quite willing to accept in principle the notion of the necessity for greater regional collaboration. Initial steps in this direction were taken in 1968 with the establishment of the Caribbean Free Trade Area Association, CARIFTA. This was a standard free trade agreement. It did help stimulate regional export trade and help to sustain interest in a further deepening of the regional integration process culminating in 1973 with the establishment of the Caribbean Community and Common Market, CARICOM.

The agreement embodied most of the requirements necessary to support closer regional collaboration. However, the governments never fulfilled their commitments to consult each other on important matters. There was also a general inability on the part of governments to implement projects identified as being feasible. In summary, the expectation that regional integration would lead to a major expansion in trade between the participating countries and make it possible to establish production on a firm competitive basis for entering extra – regional trade was not realized.

Extra- Regional Trading Arrangements

The emphasis on developing extra – regional markets for exports really started after 1970. There were a number of domestic and external developments which contributed to this greater emphasis on an outward oriented development strategy. The collapse of the economies of Jamaica and Guyana in the seventies forced them to seek financial assistance from the International Monetary Fund. The structural adjustment programmes which were imposed on countries as a condition for providing assistance usually required a commitment to the pursuit of an export oriented development strategy.

The call for a New International Economic Order at the United Nations in 1973 brought to the fore the need for a new economic relationship between developed and developing countries. Emphasis was placed on the need for the developed countries to accept a greater degree of responsibility in the promotion of development. In the area of trade relations it was argued that developed countries had to open their markets to the products of developing countries as a means of reducing the disparity in income between rich and poor countries. There was also a call for developed countries to assist developing countries in raising their production capabilities in order to take advantage of new market opportunities.

One of the first significant developments in the attempt by countries to expand their extra – regional exports occurred with the signing of the Lome Convention in 1975. This treaty provided producers in the region with guaranteed access to markets in the European Community. In the case of primary products, such as sugar and bananas, this was in the form of quantitative and price guarantees. The basic principles of guaranteed market access and preferential prices on designated products remained in place throughout subsequent renewals of the treaty. Although the sugar and banana protocols under the treaty made an important contribution to those export sectors, their role can be seen more in contributing to the survival of those sectors rather than allowing for significant growth in these sectors' exports. On a number of occasions producers were not able to meet their quotas. The access to markets provided by the treaty did not make a significant contribution to the development of new export products. The experience of CARICOM countries is indicative of the fact that a successful outward looking development strategy requires more than access to markets. It also requires a productive sector which is both capable and willing to exploit the market opportunities.

Another major initiative designed to promote exports by countries in the region was the Caribbean Basin Initiative. This initiative announced by President Reagan in 1982, was a trade and aid package. The initiative embodied tax and investment credits designed to encourage firms US firms to establish production facilities in the region. These firms were expected to produce items that would be exported to the United States taking advantage of the duty exemptions embodied in the proposal.

The Caribbean Basin Initiative did not live up to the expectations of either the governments in the Caribbean or that of the United States. At the time of its announcement the US economy was experiencing its worst recession in fifty years. The recession contributed to a dampened investment climate for both domestic and overseas investment. In the subsequent recovery, the Caribbean was simply one among a series of location from which firms could choose. Furthermore, since such firms were attracted to locations which could provide cost savings, in particular savings in labour costs, countries in the Caribbean were at a disadvantage with respects to those in the Pacific region.

With the coming into being of the WTO the move from the non-reciprocal preferential market access arrangement, which the Caribbean and the rest of the ACP group had enjoyed since 1975, was made necessary by the fact that the general WTO membership was no longer willing to approve the waivers under which these arrangements had operated. In order to maintain preferential access to European markets while avoiding the need for a waiver, the principle of non- reciprocity embodied in the previous arrangements had to be abandoned. The recently concluded Economic Partnership Arrangement, EPA, between the European Union and Cariforum, CARICOM plus the Dominican Republic, embodied these changes.

There has been considerable controversy surrounding whether the recently concluded agreement is likely to prove beneficial to countries in the region. We will direct attention to those aspects of the critique which deal with its potential impact on exports from the region to the European Union. As indicated earlier, securing access to markets in Europe and North America has not led to significant increases in exports to those markets. This point was underscored by Thomas (2008) in his assessment of the Economic Partnership Agreement when he pointed to a key economic lesson which could be drawn from past agreements. This was that securing legal access to overseas markets for CARICOM exports (except perhaps for traditional ones) did not seem to influence sales in those markets. This he argued reflected the inability in the region to resolve the intractable problem of weak development capacity. Other critics argued that the development component of the Cariforum/EPA took a back seat to the trade and investment liberalization component (Brewster, Girvan, Lewis, 2008). They argued that in order for a reciprocal trade agreement between partners of highly unequal levels of development to bring the poorer partner closer to the level of the richer, adequate resources must be transferred to them to facilitate a build up of their productive capabilities in infrastructure, human capital and enterprise plant, equipment and technology. They pointed to the fact that resource transfers were not a legally binding obligation under the EPA. They also pointed out the many SMEs in Cariforum needed targeted product specific and firm specific assistance to raise their supply capabilities and competitiveness.

The Role of Exchange Rate Misalignment

It is frequently argued that exchange rate misalignment would work to undermine the ability of a country's producers to take advantage of the opportunities created by improved access to international markets. We will now turn to an assessment of the extent to which exchange rate misalignment may have played a role in the relatively poor performance of the export sector of several countries in the region. An overvalued currency would weaken the external competitiveness of a country. A rise or fall in the real effective exchange rate (REER) is usually adopted as the standard on which to evaluate the degree of over or under valuation of a country's currency.

In a study on exchange rate misalignment in a select group of Caribbean countries covering the period from 1970 – 2001 (Moore et al. 2003), the authors attempted to estimate the degree of over or under valuation by comparing the actual REER in the respective countries to the equilibrium REER value. They found that over the period both Barbados and Jamaica made sizable competitive gains. The improvement in Barbados's competitive position in the latter half of the review period was attributed mainly to a slow down in the annual rate of growth in wages. In Jamaica, they argued that most of the improvement in external competitiveness could be attributed to the large nominal exchange rate devaluations. It was pointed out however, that in the 1990's, the appreciation in the REER, brought about by the high rate of increase in real wages contributed to a stagnation and decline in the country's international competitiveness. In the case of Trinidad and Tobago, they found that the REER was more likely to be overvalued than undervalued during the period.

However, as the authors pointed out, in spite of the decline in competitiveness Trinidad and Tobago still retained a sizable competitive advantage over other countries in the region and retained its position as one of the largest suppliers of goods to other countries in the region.

In another study assessing the competitiveness of the Jamaican economy (Henry, 2001), it was found that over the period from 1986 to 2000, the movements in the REER indicated a decline in the international competitive position of the country. A report by the IMF on the Eastern Caribbean Currency Union (IMF, 2008) stated that there was an appreciation in the REER of member countries during the 1990's resulting in a decline in their international competitive position. There was, however, a real depreciation after 2002. This came about as a result of the fixed link between the EC dollar and the US dollar, given the large nominal and real depreciation of the US dollar against most major currencies in that period.

Monetary Policy and International Competitiveness

If countries in the region are to achieve a greater measure of success in expanding their export sales, special emphasis has to be placed on enhancing production capabilities. This would involve the creation of an environment in which producers in the respective countries would be in a position to increase the volume, as well as, the range of products to be sold on international markets. In other words countries would have to become more internationally competitive. We will begin by indicating with respect to the individual country experiences, how some aspects of monetary policy pursued by the central banks in the nineties might have worked to undermine the competitiveness of exporters.

An ability to mobilize funds at a reasonable cost will clearly have a bearing on the ability of firms to compete internationally. During the nineties lending rates in nominal and real terms were maintained at high levels in all countries in the region. It was shown that even in the case of Barbados, the country which on average had the lowest lending rates in the region during that period, the real lending rate was significantly higher than the prime lending rate in the United States (Bennett, 2006). Lending rates in Jamaica, in particular, were exceptionally high. The high rates were in large part a reflection on the decision taken by the Bank of Jamaica to rely on the interest rate mechanism as the principal exchange rate management tool. It was argued that high interest rates contributed to the stagnation in labour productivity, which could be attributed to inadequate levels of investment in worker training, as well as in improving the quality of equipment used by the work force. The high cost of funds encouraged producers to economize on training and other productivity enhancing investments. The stagnation in labour productivity combined with increases in real wages accounted in large measure for the decline in international competitiveness of Jamaican exporters (Bennett, 2006).

The monetary policies of the Bank of Jamaica during the nineties also contributed to an appreciation in the real exchange rate, undermining the competitiveness of exporters. The bank, particularly in the first half of the decade, did not place emphasis on controlling the rate of growth in the money supply and in the expansion of credit to the private sector. The high interest rates, by dampening aggregate demand, should have worked to stabilize the real exchange rate. However, the impact of the high interest rates on aggregate demand was offset by the increases in the money supply and credit to the private sector. In addition, the steady increase in government consumption expenditure in that period contributed to the real exchange rate appreciation. The Bank of Jamaica changed its approach to monetary management in the latter part of the decade, placing more emphasis on controlling the rate of growth of the money supply and credit to the private sector. This led to a lowering of the rate of inflation and a moderation in the trend towards appreciation in the real exchange rate.

New Directions in Trade Policy

The inability of producers in the region to take advantage of export market opportunities was attributed to their weak international competitive position. These reflected deficiencies in the quality of labour and management, pointing to a need for an enhancement in the stock of human capital. However, over and above the necessary investments in human capital there is a need to create within society an environment more conducive to innovation. There is a critical need for new ideas with respect to types of products to produce, as well as marketing strategies. In order for such developments to occur, countries in the region will have to overcome what Romer (1992, 1993) referred to as an idea gap. He defined an idea gap in the following way.

> The notion of an idea gap includes concepts that some authors have in mind when they speak of a technology gap, but it is intended to suggest something quite broad. The word technology invokes images of manufacturing, but most economic activity takes place outside factories. Ideas include innumerable insights about packaging, marketing, distribution,

> inventory control, payments systems, transactions processing, quality control and worker motivation that are all used in the creation of a modern value economy (Romer,1993, p.544)

In addition, Thomas Homer – Dixon (2000) referred to the importance of ingenuity, as reflected in an ability to bring fresh approaches to traditional methods of operation, will also be a factor of importance.

If this new environment is to emerge, one which facilitates the generation of new ideas and ingenuity, there will have to be changes in the traditional modes of interaction among different groups in society. Barrett (1997) for example, refers to the importance of trust in making it possible for an environment conducive to encouraging innovative activity to emerge. The importance of trust is explained in the following way:

> For individuals to interact willingly, innovatively and continuously, they must possess trust in people and institutions ….. to safeguard them against catastrophe and exploitation, and to provide reliable information(Barrett, 1997, p.554).

This raises the question as to what will be required to bring into effect these necessary societal changes. At the very least it will be necessary to depart from the traditional hierarchical top down relationships on which the society has traditionally functioned. It has been pointed out that the real basis of competitive advantage rests with innovativeness at the level of the firm (Hirst and Thompson, 1999). The degree of innovativeness it is argued is directly linked to such institutional considerations as the constitutional nature of company governance systems, the institutional operation of the labour market and the form of social settlement between social partners and organized interest groups. In a report prepared for the Economic Commission for Latin America and the Caribbean, it was noted that in the Caribbean, the nature of the technical and social aspects of class relations among entrepreneurial, professional and technical workers and their ability to take concerted action to raise productivity was severely undermined by the poor quality of their representative organizations (Watson, 1994).

The traditional top down societal relationships is also reflected in the issues which have received most attention in the international trade negotiations in which the region has been involved over the years. There is little evidence to indicate that those who are engaged in activities in what might be called the tradable sector might have had any meaningful input in the negotiations. This might account for the fact that while the negotiators might have devoted considerable time to such issues as terms of market access and non reciprocity, the matter of means of enhancing productive capacity appears to have attracted far less attention. In the controversies surrounding the potential benefits from the recently concluded Economic Partnership Agreement between Cariforum and the European Community, the regional negotiating body pointed to the fact that it had consulted a wide range of stakeholders. These included state representatives, the private sector and non state actors. It was stated that from these consultations emerged a coherent regional negotiating position. However, as Thomas (2008) pointed out, these negotiations took place in an environment in which there were marked negotiating asymmetries between the regional negotiating body and the various stakeholders. This raises questions as to the extent to which the concerns of these stakeholders were fully reflected.

There is also a need to broaden the approach in the formulation of trade strategy to palace more emphasis on establishing relationships with firms in the industrial countries. This would help create an environment in which countries in the region would be likely considered when such firms are considering new investments.

In summary, if the deficiencies highlighted are to be corrected, then those involved in the tradable sector must be prepared to take on a greater measure of responsibility in the formulation of policy. This will come about only when there is a fundamental change in the society with respect to attitudes concerning the responsibility in the formulation of policy. This will require a fundamental change in society with respect to attitudes concerning the responsibility for the articulation and finding of solutions to the problems faced by society. Essentially, what will be required is a sense of shared community responsibility in the framing and execution of measures geared to a realization of defined objectives. An appropriate step towards the realization of such an outcome would be to work towards establishing strong community based organizations at the centre of the policy development process. Dynamic community based organizations will provide the environment for the generation of ideas and the development of new approaches to the solution of problems. The experience gained in these organization would have spill –over effects which would be reflected in the behaviour of individuals in their work environment, as well as in other areas social interaction.

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