

Shaping a Trade Agenda to Promote Regional Integration and Competitiveness for CARICOM: The EPA and Other Negotiating Challenges

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Objective – Facilitate and stimulate a broad political debate on the ways in which trade arrangements can promote regional integration and competitiveness. Request – to share my insights and experience with participants on the issues: Engaging the EU and the US: The Role of Free Trade Areas (FTAs).

Definition of an FTA

An FTA comprises an economic grouping of states that agree to eliminate tariffs and other barriers to trade among themselves. By specializing in the production of goods and services in which each member of the FTA has comparative advantage, competitiveness is enhanced and economic welfare is maximized. In the context of the World Trade Organization (WTO) members of an FTA are required to eliminate tariffs and other barriers to trade on *substantially all the trade* between them. Specifically, in the definition and language of the GATT, the WTO requires that:

“A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.”²

In relation to tariff negotiations Article XXVIII bis of the GATT provides that:

“[N]egotiations on a reciprocal and mutually advantageous basis, directed to the substantial reduction of the general level of tariffs and other charges on imports and exports and in particular to the reduction of such high tariffs as discourage the importation even of minimum quantities, and conducted with due regard to the objectives of this Agreement and the varying needs of individual contracting parties, are of great importance to the expansion of international trade”.

How do FTAs fit into the development agenda?

The mainstream economic view is that growth can lead to poverty alleviation provided that the relevant actors or stakeholders can participate in the growth process. Small

¹ Seminar organized by the Organization of American States (OAS) and the World Bank, with the support of the Commonwealth Parliamentary Association (CPA). The views expressed are the presenter's and do not necessarily reflect the views of the CRNM.

² See GATT Article XXIV, paragraph 8 (b).

economies face significant constraints in realizing economies of scale and scope. The thinness of markets can lead to inefficiency and loss-making businesses. Conceptually, as countries enter into FTAs they broaden their individual domestic economic spaces and hence provide enhanced opportunities for economic growth. Trade then becomes the engine of economic growth, especially for small open economies with limited domestic markets, skill base and natural resources.

It would seem though, that in a Caribbean context the service-oriented industries potentially hold the greatest prospects for economic growth and development through FTAs. The difficulties of developing economically and environmentally sustainable manufacturing industries are well known. But for some service-oriented industries the size of the firm can be an asset. The small firm, optimally structured to maximize profits can export its services to recipients in the larger economy and can keep doing so till capacity limit is reached. The large firm in the bigger economy faces a small market of finite size.

The major challenge though remains the establishment, development and growth of the small firm. Classic FTAs are agreements on market access – they do not make provision for institution building for economic development. However, with the increasing understanding of the need for some sort of special and differential treatment for developing countries in the WTO developing countries are now demanding more of their developed counterparts when negotiating FTAs. Perhaps the biggest of these for the Caribbean will be the Economic Partnership Agreement that is currently being negotiated with the European Union. Let us examine the process and status of negotiations of the CARIFORUM-EU EPA in greater detail.

Examining the CARIFORUM-EU EPA

CARIFORUM-EU EPA negotiations are meant to result in a modern, state-of-the-art FTA between the countries of CARIFORUM and the EU, with a development dimension.

It will ultimately replace the Cotonou Agreement currently in force between countries of the ACP and the EU. The EPA must be compatible with WTO law, in particular it must satisfy the requirement that tariffs are eliminated on *substantially all the trade* between the Parties in accordance with Article XXIV of the GATT.³ *Substantially all the trade* is yet to be defined, however there are benchmarks based on existing FTAs, in which countries have eliminated barriers on at least ninety percent (90%) of the trade between them. In many instances countries that have recently negotiated FTAs have liberalized trade on a significantly higher percent.

In addition to liberalization of trade in goods, the EPA will contain a chapter on trade in services consistent with the provisions of Article V of the GATS on economic integration. These provisions include: substantial sectoral coverage (paragraph 1(a)) and elimination of substantially all discrimination (paragraph 1(c)). CARIFORUM is presently aggressively seeking enhanced market access in the EU for certain non-

Comment [CP1]: Falkenberg emphasized: completion of the FTA on time; DFQF; no plan B; region to define its positions in the EPA; we need private capital flows;

³ Article XXIV of the GATT is captioned: Territorial Application, Frontier Traffic, Customs Unions and Free Trade Areas. In particular, Paragraph 8 (a) (i) and (b).

traditional areas of service-delivery notably under Mode 4 (Article 1, paragraph 2(d)) of the GATS. The Services chapter will also include some elements of investment aimed at making it easier for investment flows from an EU member state to enter the CARIFORUM area.

The EPA will also cover a number of trade-related areas including: intellectual property, competition, government procurement, the environment, social aspects, personal data protection, and cooperation and dialogue on taxation and finance.

Negotiations in the CARIFORUM-EU EPA are at a very advanced stage. There is a total of four phases in the process of negotiations: The first phase (April – September 2004) was aimed at establishing an understanding of the *fundamental concerns and interests* of EPA negotiations for both CARIFORUM and the EC. In addition an indicative schedule of negotiating meetings in subsequent phases, subject to change in accordance with progress in the actual negotiating sessions was agreed upon.

In Phase II or the Regional Integration Phase (September 2004 – September 2005) the two Parties sought convergence on the priorities for regional integration and exchanged information in the areas of services, investment, trade related issues and regional market access. Phase II also identified eleven priority needs of the regional integration processes within CARIFORUM which were identified by the Regional Preparatory Task Force (RPTF).

Phase III or the Consolidation Phase (September 2005 – December 2006) was meant to define the structure and scope of the EPA and determine an approach to trade liberalization that sought to promote sustainable development within the CARIFORUM region. Detailed negotiations were conducted during that phase and were organized into four Negotiating Groups: Market Access for Agricultural and Non-Agricultural Goods; Services and Investment; Trade Related Issues; and Legal and Institutional Issues.

Phase IV or the Finalization Phase (January 2007 – December 2007) is meant to concentrate on completion of the EPA negotiations by the end of 2007. CARIFORUM and the EC are to consolidate the results of the negotiations by addressing items of disagreement stemming from previous rounds of the talks. In order to complete the negotiations within schedule, both parties will aim to sign an agreement in the second half of 2007 and take the measures necessary for the application of the agreement as of January 1, 2008.

Modality of negotiations

On the CARIFORUM side the negotiations process is organized as follows. The Caribbean Regional Negotiating Machinery (CRNM) is responsible for the overall coordination and execution of the negotiations and receives its mandate from the Council of Ministers of Trade of CARIFORUM countries.

Negotiating positions of CARIFORUM are formulated through a process of consultation as follows. Stakeholders, experts and other affected groups communicate their concerns and positions on various issues in the EPA negotiations to the CRNM.

The CRNM also arranges various consultation processes in member states at which input can be made into the process. Information received from all these sources is then used to compile various draft positions on how to approach the negotiations in the different subject areas.

CRNM then circulates the proposed positions to officials at technical level in CARIFORUM member states and convenes meetings of either Technical Working Group (TWG) or Expert Group, at which positions are discussed in detail and regional positions are adopted.

Regional positions on the various subjects are then presented and discussed at Special Meetings of the Council of Trade Ministers, at which stage a negotiating mandate is secured. The negotiating mandate is then executed by a College of Negotiators comprising the Director General of the CRNM at the level of Principal Negotiator and several lead and alternate negotiators for each of the negotiating groups.

Negotiators are drawn from individual CARIFORUM member states, as well as from the CRNM. Further, CRNM technical staff provides direct technical assistance to negotiators whenever negotiating sessions are convened with the EC.

Progress in the EPA

EPA negotiations have proceeded according to schedule. However, treatment of several issues of interest to CARIFORUM has been less than satisfactory. First, both CARIFORUM and the EU broadly share a similar vision of the EPA. Both sides believe that an EPA has to be more than a classic FTA built purely on market access commitments and obligations and should extend to contain a significant development dimension with respect to the CARIFORUM side.

However, when it comes to the specifics of the negotiations there is considerable divergence in some key positions of the two sides. In particular they do not agree over the following issues: how the development dimension should be crafted so that it infuses all aspects of the EPA; financial resources for CARIFORUM's implementation of commitments under an EPA; approach to tariff elimination; variability in the economic structure and progress of CARIFORUM states; treatment of investment taking into account bi-lateral investment treaties; and commitments in the areas of sustainable development and good governance.

The EU's stance on a single starting line (SSL) as the basis for liberalization of trade in CARIFORUM, if adopted, could result in the smallest economies undertaking to cut their tariffs to the same extent as significantly larger economies. Consequently, this would place considerable pressure on the already weak fiscal systems.

Outstanding issues

Negotiations are presently at an impasse in the market access pillar. CARIFORUM is finding great difficulty in agreeing a single list of products to be excluded from the EPA tariff cuts. As a consequence the scope of coverage runs the risk of not satisfying the substantially all the trade criteria that must be met if the EPA is to be WTO compatible.

CARIFORUM should embark upon maximization of the flexibility in implementation of the EPA, opting for long phase-out periods for sensitive products while diversifying its export production base.

In order to help build the regional integration processes, a major challenge that remains is the transportation of goods from one member to another. The EU should provide technical and financial assistance to the Region for establishment of a shipping line. This is seen as a major priority for success of the Region's own integration and market building and ultimately, the success of the EPA between CARIFORUM and the EU.

There has been some slippage in the talks but the region continues to work in good faith towards completion of the negotiations on time and implementation of the EPA on schedule.

If the EPA is not implemented on schedule there would be profound implications for the region. All its existing preferential arrangements with the EU would be lost and legally, it would qualify merely for GSP.

What can politicians do help the negotiations?

Politicians can help the process by sending stronger messages to the Commission and members of parliament in EU capitals about the issues that are of concern to us. These include: the development dimension – specifics on funding for EPA adjustment; technical assistance for EPA implementation; tariff-cutting modalities to be adopted; and the fact that EU members will enjoy significantly enhanced market access to the region when the EPA comes into effect.

In addition, our politicians can help by articulating our negotiating positions through informal channels. These include newspapers, radio and television programs. The EU for instance has engaged in a media campaign of telling the world it will grant DFQF to all countries negotiating the EPA. Yet, as one minister has said DFQF is not always in our best interest.

[Gaza made a point about the seemingly incompatible objectives of the EU and CARIFORUM in negotiating the EPA. I don't think it is necessarily the objectives that are different. I think what differs fundamentally is how do we get there and how quickly. The EU wants to see a single space created either de jure or de facto. We in CARICOM all profess the same vision, we want a single market. But I cannot help having heard the

same mentioned by several representatives here. The frustration of not realizing the fruits of integration is impacting our economies and our people. Yet, when the region is caused to meet a challenge by exogenous factors we rise to the challenge]

Examining the possibility of a CARICOM-US FTA

CARICOM has been considering the possibilities for engaging the US in future trading arrangements for some time since the collapse of FTAA negotiations. The US is the single most important market for most member states of CARICOM accounting for more than half the exports (approximately 56.4% in 2004) and one third the imports (35.4% in 2004) of goods, with significantly larger numbers for services of many of its members, especially the smaller members.

Trade between CARICOM and the US has been governed by two agreements loosely referred to as the Caribbean Basin Initiative (CBI). The specific agreements are the Caribbean Basin Economic Recovery Act (CBERA) and the Caribbean Basin Trade Promotion Act (CBTPA).

CBERA provides unilateral duty free market access in the US for most goods from twenty-four (24) beneficiaries of Central America and the Caribbean. CBERA's objective includes the diversification of its members' economies from raw material and resource-based commodities like aluminum, bananas, coffee, petroleum and sugar. Member countries are: Antigua and Barbuda; The Bahamas; Barbados; Belize; Costa Rica; Dominica; Dominican Republic; El Salvador; Grenada; Guyana; Guatemala; Haiti; Honduras; Jamaica; Montserrat; Netherlands; Netherlands Antilles; Nicaragua; Panama; St. Kitts and Nevis; Saint Lucia; Saint Vincent and the Grenadines; Trinidad and Tobago; British Virgin Islands.

CBTPA enacted in May 2000 amends CBERA by providing for preferential tariff treatment for additional products that originate in a country, which the US President has designated as eligible to receive CBTPA benefits. All CBTPA countries must meet all the CBERA intellectual property rights criteria, as well as satisfying CBTPA's criteria, i.e., to either meet or exceed WTO TRIPS.

Unfortunately neither of these agreements is secure as they are unilateral preferential trading agreements. In fact, the US is currently seeking to renew its WTO Waiver for these agreements but has so far been unsuccessful, given the objections that have been raised by a few WTO members, notably Paraguay.

Options open to CARICOM

In the absence of the FTAA, CARICOM has basically two options for engaging the US: reverting to GSP or completion of an FTA. Reverting to GSP would imply less than present preferential treatment under the CBI, since there exist many commodities that currently enter the US duty free under the CBI but not under the GSP. [66.9% of Exports enter duty free under MFN, 33.1% enter duty free under CBI – if GSP is available as an

alternative it covers only 21%] Moreover, some CARICOM members (Antigua and Barbuda and Barbados) have been recently graduated from eligibility to qualify for GSP and as such this is not an option for them.

Therefore, in practical terms the only real option open to CARICOM is some type of FTA – an agreement that can meet the WTO standard of liberalization of *substantially all the trade* as mandated by Article XXIV of the GATT.

Yet, completion of an FTA with the United States would not be an easy task given its very high ambition level in all FTAs completed so far. First, the US takes the *substantially all the trade* standard very strictly and this has been demonstrated recently in its completion of the CAFTA-DR agreement. [Title XXI, Section 2102 of the United States Trade Promotion Authority Act (TPA) of 2002 provides the template that guides the US approach to the negotiation of bilateral FTAs.] Second, negotiations are very intense. The US typically seeks to conclude an agreement very quickly leaving little room for intensive internal consultations during the process. Third, negotiations are costly.

At the same time, CARICOM should not lose sight of the advantages of being latecomers to bilateral negotiations with the US, which could allow the Region to draw from, and build on, the precedents in prior bilateral agreements, as well as to negotiate special concessions that would carve out space for Member States in the hemisphere. There is an added advantage of being a latecomer in the hemispheric bilateral schedule as it gives the Region sufficient time to ensure coherence between its engagements in the hemisphere and those in the context of EPA negotiations.

CARICOM would therefore ideally be seeking an EPA type of trade agreement with the US – the agreement would have to include provision for a development dimension through which the economies of the region could be structurally transformed and reoriented for greater efficiency. But the US has not yet negotiated such an agreement before and therefore it would be the first of its kind.

Dynamics of FTAs in the Hemisphere

Since the collapse of FTAA negotiations the US has shifted to bi-lateral FTAs with its other partners in the Western Hemisphere. These include Chile, Peru and Colombia.

In particular, the US has recently completed an FTA with the countries of Central America and the Dominican Republic (CAFTA-DR). These countries were previously beneficiaries of the CBI and as such they now qualify for enhanced, secure access to the US market relative to CARICOM countries.

With enhanced, secure market access for goods into the US the CAFTA-DR countries are now positioned to improve upon their developmental aspirations and to lock-in on opportunities not yet open to CARICOM.

An important additional consideration in relation to the dynamics of FTAs in the Hemisphere is that all these agreements contain chapters on a range of additional areas not included in the CBI agreements. These include services as well as several of the trade related areas: intellectual property, environment, government procurement, etc. Thus the beneficiaries of these agreements enjoy the possibility of deeper integration with the US relative to CARICOM.

Uncertainty about the WTO DDA

In the absence of an FTA with the US the only other route for access to the market by the region is via the WTO. But the WTO poses limitations. First, the types of concessions made at the WTO are not as ambitious as those found in FTAs. Countries commit to undertake *some liberalization* of tariffs but not their elimination on substantially all the trade as in an FTA.

Additionally, it remains unclear whether the WTO DDA negotiations are likely to complete on schedule. There continues to be intense differences among key players of the G6 and the talks have yet to be fully multi-lateralized since the breakdown in negotiations in July 2006.

Challenges to a CARICOM-US FTA

CRNM has undertaken some analytical work on the merits of completion of an FTA with the US and this work is being studied by member states. The major challenge is of a fiscal nature – members are likely to have to concede significant tariff revenues if they are to complete an FTA with the US. This implies the need for fiscal reform as a pre-condition for entering such an arrangement with the US. Perhaps CARICOM may wish to start the process through cooperation with the US for fiscal reform as the first stage in preparation for FTA negotiations.

But there is the additional challenge of the way in which the region perceives itself. The region is too often seen as retreating and engaging in a self deprecating exercise. FTAs present threats, but they also potentially present opportunities and it is important to concentrate on the opportunities if we are to move forward.

The New Thinking for a Caribbean Firm and its Policy Implications

What about availability of financial capital, is that a challenge? I argue it is not necessarily a challenge. The problem most often is that our business people fail to innovate - they fail to sit and visualize what it is they want to accomplish. The power of all innovation originates in human minds, i.e., our thought processes are creative. So if we are failing to innovate it is because we are failing to think constructively. Yet, no one country has a monopoly on ideas for business. Business ideas originate from individual minds, so the success of business is directly related to the quality of thought that has gone into its creation. Thought is the only creative power and is possible to be found in all of us if we so desire to make the appropriate application.

Caribbean business now needs to think differently. In harnessing the benefits of an FTA the region must embrace the concept of business integration. Business integration should therefore infuse a concept of production sharing – coordination of all activities of the “commodity or service chain” not only nationally but also across the single economic space. Rather than being restricted to being a national entity, the Caribbean firm must operate as a regionally integrated entity, where decisions on output volumes are made jointly by all parts of the regional firm. This would provide the “launching pad” for the firm to operate internationally.

Of course labor movement within a regional integration context implies that employers can seek the most skilled labor within the region to accomplish the tasks of the firm. In so doing we have an increased sum game - labor gets the best possible wage, while the firm gets the best possible product or service for its market.

In order to take advantage of the challenges and opportunities under regional integration the Caribbean firm needs to see itself not merely as a national entity servicing a domestic market, but as a regionally-integrated entity facing a market several times its domestic size.

Success in the conduct of business nationally will be influenced by how the firm positions itself as a regional or international player. Caribbean firms must, therefore, first use the regional integration process to increase their efficiencies and productivities regionally. Simultaneously, they need to keep their eyes on the international market. Every Caribbean firm should consider establishing a presence in each others’ markets and in extra-regional markets – United States and the European Union. Establishment of businesses in those markets is predicated upon the fact that there already exists a significant Diaspora and the fact that tourists who have visited the Region should have acquired a demand for its products and services.

Caribbean firms should also seriously consider their role in innovation, protection of their ideas through patents, then implementation of the businesses that derive from them either regionally or internationally.

In conclusion, it must never be forgotten that *the heart of any business is the power of the thought processes behind it and thought is found in each and every one of us*. It is time that the Region views itself differently and starts engaging in right thinking. Rather than concentrating on the weaknesses of small size, businesses should concentrate on integrating regionally to build efficiency. Policy makers then should orient policy in a direction that complements that new orientation for business. The CSME will provide an optimal opportunity to pursue this regionally and the FTAs being negotiated will provide the opportunities to do this multi-laterally. And, once they have done so, as in Richard Branson’s advice, they should immediately seek to establish a presence abroad, as no firm is too small to do so.