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EU-CARICOM FREE TRADE: OPPORTUNITY OR MIRAGE?

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I. INTRODUCTION

Negotiations for the establishment of Economic Partnership Agreements (EPAs) between the European Union (EU) and former colonies in Africa, the Caribbean and the Pacific (ACP) began in September 2002 and are expected to be concluded by December 31, 2007. The EPAs are in effect free trade agreements that will replace the non-reciprocal trade preferences traditionally provided to ACP countries under the Lomé Conventions.

The reform of the EU-ACP trade regime is consistent with the global trend towards trade liberalization and the requirement to conform to WTO rules. The trade provisions of the Lomé Conventions violated the non discrimination principle of the GATT by discriminating against developing countries that are not members of the ACP group. The principle of non-discrimination contained in the most favored nation (MFN) clause of article I of the General Agreement on Tariffs and Trade (GATT) is the foundation of WTO rules. The only exceptions to the non- discrimination rule allowed under the GATT are free trade agreements and the provision of preferences by a developed country to all developing countries. The Lomé conventions therefore failed to qualify for the foregoing exceptions. Given the incompatibility of the Lomé preferences with WTO rules a waiver is required. However, such waivers are subject to challenge from WTO members. The current international environment with its increasing pressures for trade liberalization increases the likelihood that WTO waivers will be challenged. It is therefore in the interest of the EU to replace the Lomé non-reciprocal preferences with a WTO compatible trade regime.

Another important factor underlying the reform of the Lomé trade regime is the EU's objective of integrating ACP states into the global economy. The EU's position is that integration into the world economy is

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necessary to prevent further marginalization of ACP countries in the context of increasing globalization of the world economy. The proposed trade regime is expected to assist this process by promoting compatibility with WTO rules, improving international competitiveness and attracting investment into ACP countries (European Commission 2001).

The poor trade performance of ACP states under the Lomé Conventions provided little economic justification for continuation of non-reciprocal trade preferences. The period between the signing of Lomé I and the termination of Lomé IV witnessed a significant decline in ACP countries share of the EU market from 6.7 percent in 1976 to 2.8 percent in 1998 (European Commission 2001:2). As in the case of other preferential trade arrangements for developing countries, the Lomé preferences were based on the assumption that such arrangements would allow the developing countries to expand and diversify their exports. The failure of ACP states to achieve these objectives suggests that preferences are not sufficient to promote exports and economic growth. Furthermore, trade preferences have become less valuable as the preferential margins enjoyed by ACP states have been eroded by the process of multilateral trade liberalization.

Finally, it can be argued that the establishment of free trade areas with ACP countries will allow the EU to gain increased access to markets. However, realization of this market potential is dependent on the achievement of economic growth and export expansion in the ACP countries. Therefore EU-ACP free trade can yield dividends for the EU to the extent that free trade promotes the export growth necessary to finance increased imports from the EU.

Under the terms of the EU-ACP Partnership Agreement (also referred to as the Cotonou Agreement) signed in June 2000, ACP countries have the option of negotiating EPAs either individually or as groups of countries. However, the EU preference is for regional EPAs. This paper is concerned with the potential costs and benefits of reciprocal free trade with the EU for the small economies of the Caribbean Community (CARICOM).[1]The paper is organized as follows: section 2 provides an overview of the proposed Economic Partnership Agreements. Section 3 reviews the trade performance of the CARICOM countries under the Lomé Conventions. Section 4 considers whether reciprocal free trade with the EU is likely to benefit CARICOM countries. Finally, conclusions are presented in section 5.

II. The Economic Partnership Agreements

The Cotonou agreement provides for far reaching reform of EU-ACP economic cooperation. These reforms embrace all aspects of EU-ACP cooperation including trade, financial aid and technical cooperation. However, the focus of this paper is on the trade aspects of the agreement. The key element of the trade arrangements is provision for negotiation of EPAs based on reciprocal free trade and compatible with the rules of the WTO. The EPAs will cover trade in goods, trade in services and a wide range of trade related issues. In order to allow the ACP countries to adjust to the withdrawal of preferences, the existing non- reciprocal preferential arrangements will remain in place until the end of December 2007. Thereafter, the reciprocal free trade arrangements will be phased in over a transitional period beginning January 1, 2008. The proposed gradual implementation of full trade liberalization takes account of the lower level of development of the ACP countries and is compatible with WTO rules.

The Cotonou Agreement makes special provisions for the least developed countries (LDCs). The LDCs will be allowed to maintain the non- reciprocal preferences they enjoyed under Lomé. In addition, Article 37of the Cotonou Agreement provides that by 2005 essentially all products from all LDCs will be allowed duty free access to the EU market. In the case of those non-LDC countries that decide that they are unable to enter into EPAs consideration is to be given to alternative WTO compatible arrangements.

Regional integration arrangements have been identified as the foundations on which the EPAs will be built.[2] The rationale for the promotion of regional integration is that the individual ACP countries are at a disadvantage in the increasingly competitive global economy. The EU Commission views integration as necessary to expand markets, promote international competitiveness and attract investment thereby facilitating integration into the world economy (Moreau 2000).

III. CARICOM Trade Performance Under Lomé

The Lomé conventions offered very generous trade concessions to the ACP states. With the exception of products covered by the EU's Common Agricultural Policy, ACP states were granted non-reciprocal duty free access to the EU market and were also exempted from non-tariff barriers. Commodity protocols annexed to the Lomé Convention provided preferential access for given quantities of sugar, bananas, rum, beef and veal. A scheme for the stabilization of export earnings (STABEX) provided compensation for shortfalls in export income of ACP countries resulting from fluctuations in the prices of their agricultural exports. Similar assistance for mining exports was provided under the scheme known as SYSMIN.

Provision for the stabilization of export earnings makes the Lomé Convention more generous than other preferential arrangements granted to developing countries by developed countries since it is the only preferential arrangement with this feature. Furthermore, compared to the EU- GSP, the Lomé convention is more liberal with respect to product coverage and rules of origin. The Lomé conventions provide duty free access for 89.6 percent of ACP exports compared to 68 percent under the EU-GSP (see table 1). In addition, the EU-GSP excludes agricultural products which are very important to ACP countries given their low levels of industrialization. With respect to rules of origin, the Lomé convention allows ACP states to use materials from other ACP states to satisfy the rules of origin, however, this is not allowed under the EU-GSP.

Table 1: Treatment of ACP Exports to the EU Under GSP and Lomé Regimes

GSP	%	Lomé	%
Products excluded from EU GSP	16	Protected or un-liberalized Products	0.4
Very sensitive category	9	Protocol products (quota/duty)	10.0
Sensitive category	3.5	Lomé zero duty category	36.0
Non-sensitive category	3.5	MFN zero duty category	53.6
GSP zero duty category	14		
MFN zero duty category	54		
Total	100.0	Total	100.0

Source: CARICOM Secretariat, 2000 pp.129

CARICOM's trade performance under the Lomé trade preferences is disappointing. There has been no significant expansion of exports to the EU market. Over the twenty year period 1980-2000 CARICOM exports to the EU grew by 19%, averaging less than one percent growth per year.[3] CARICOM countries have also failed to diversify their exports to the EU. While the trade preferences granted under Lomé cover both manufactured and primary commodities, CARICOM countries have remained tied to the production of traditional primary products. Table 2 shows that the top 20 CARICOM exports to the EU consist mainly of alumina, agricultural products and petroleum products. Moreover, CARICOM's exports to the EU are highly concentrated with four products (alumina, cane sugar, methanol and bananas) accounting for 73.1 percent of the region's total exports to the EU in 2001. It is important to note that Trinidad and Tobago is the sole CARICOM exporter of methanol, while alumina is exported by Jamaica and Guyana. This means that for the majority of CARICOM countries, exports to the EU are mainly agricultural products. The region's chief agricultural exports to the EU are sugar and bananas which are not dynamic products. A recent UNCTAD study found that high value agricultural products that enjoy good market potential include fresh crustaceans, fish, fresh vegetables and fruit preparations (UNCTAD, 2002b:55). However, these agricultural products account for a very small share of CARICOM's exports. The only fruit preparation among CARICOM's top 20 exports in 2001 was concentrated grapefruit juice which accounted for only 0.8 percent of CARICOM's exports to the EU, while crustaceans, fish and fresh vegetables were not among the top 20 exports to the EU.

Table 2: CARICOM's Top 20 Exports To The EU 2001

Product	Exports(US$ 000)	Percentage of total CARICOM exports to EU
Aluminium oxide (alumina)	231,035	29.8
Cane sugar	140,258	18.1
Methanol (methyl alcohol)	102,110	13.2
Bananas fresh	93,399	12.0
Natural gas	31,703	4.1
Anhydrous ammonia	23,237	3.0
Ferrous products obtained by direct reduction of iron ore	14,062	1.8
Rum and tafia	13,326	1.7
Nutmeg	10,212	1.3
Fuel oils not elsewhere specified	10,194	1.3
Concentrated grapefruit juice	6,058	0.8
Diesel oil	5,250	0.7
Motor spirit	4,369	0.6
Other partly refined petroleum including topped crudes	4,140	0.5
Yachts and other vessels for pleasure	3,429	0.4
Cocoa beans	3,196	0.4
Gasoline	2,632	0.3
Ackee	2,578	0.3
Parts and accessories of automatic and data processing machines etc.	2,374	0.3
Other apparatus	2,336	0.3
Total of top 20 exports	705,900	91.0
Total exports	774,573	100.0

Source: Based on CARICOM Secretariat data.

The failure to diversify exports has been attributed to the complacency generated by the guaranteed markets for traditional products provided by the EU (World Bank 1993). There is some validity to this argument in that preferential access to the EU market has allowed CARICOM producers to continue production of high cost sugar and bananas that are unable to compete without preferential treatment. Available data indicates that the cost of sugar production in the region exceeds the world price, while the average production costs of bananas are twice the average cost of production in Latin America.[4] Nevertheless it is also true that structural constraints within CARICOM countries limited their ability to capitalize on trade preferences.

With the exception of The Bahamas and Barbados which are high income countries, and Haiti which is a low income country, the CARICOM countries are middle income countries that have managed to achieve fairly good levels of human development[5]. According to the United Nations Development Program (UNDP) Human Development Index, five CARICOM countries (Antigua and Barbuda, Bahamas, Barbados, St Kitts-Nevis and Trinidad and Tobago) have achieved high human development while Haiti is the only CARICOM member state with low human development (UNDP, 2002). Notwithstanding these achievements, CARICOM countries are small vulnerable economies that face serious structural constraints.

A major problem is relatively low levels of domestic savings that have resulted in a shortage of the capital required for investment. Gross domestic savings for low and middle income countries averaged 26 percent of GDP in 2000 (World Bank 2002). However, the gross domestic savings of the majority of CARICOM states fell below this level (see table 3). The region is therefore dependent on foreign direct investment (FDI) to fill the savings gap. However, with the exception of Trinidad and Tobago, the region has failed to attract adequate inflows of FDI. Over the period 1995-2000, total FDI inflows into CARICOM countries totaled US$8.2 billion, of which US$3.7 billion (45% of the total) went to Trinidad and Tobago.[6] An important consequence of low levels of FDI inflows is inability to finance the technological upgrading required for improving export competitiveness.

The export capability of CARICOM countries is also impeded by weak private sectors characterized by deficient management and limited experiences in penetrating export markets. Attempts by governments to supplement the underdeveloped private sector by means of state ownership of productive enterprises have not been very successful. In many cases, state ownership had adverse consequences for efficiency and export competitiveness. The lack of dynamism of the region's indigenous private sector reinforces the need for inflows of FDI. In addition, CARICOM governments need to pursue policies designed to foster private sector development. Privatization programs implemented in recent years are a step in the right direction, but much more needs to be done. Competition laws to promote contestable markets, policies to encourage capital market development and an efficient regulatory framework for the protection of property rights, including intellectual property rights are all essential for strengthening the private sector.

Another significant constraint is the inadequate supply of skilled labor. During 1995-97, gross tertiary enrollment in science exceeded 3 percent in only two CARICOM states (Barbados and Trinidad and Tobago), compared to 24 percent in Singapore (UNDP 2001). Moreover, the limited supply of highly skilled labor is being depleted by the brain drain to developed countries. The human resource constraint poses two major problems. First, the ability of CARICOM countries to use technological innovations to improve production efficiency and competitiveness is limited. Second, while rapid technological advances are opening up new export opportunities in knowledge intensive industries, CARICOM countries lack the capacity to fully exploit these opportunities and achieve diversification of exports.

At the regional level, structural problems restricted the ability to take advantage of the opportunity for joint production for export to the EU. The rules of origin governing preferential access of manufactured products under the Lomé Convention allows ACP countries to cumulate value added from other ACP countries in the calculation of originating materials. This provided opportunities for the establishment of regional production networks for export to the EU market using materials from several CARICOM states. However, cooperation in production proved difficult due to high transportation costs, inadequate communication links and underdeveloped industrial sectors.

In addition to the structural problems already mentioned, inappropriate trade policies also contributed to CARICOM's poor export performance under Lomé. In particular, import substitution policies that were intended to promote industrialization emphasized production for the small protected regional market with negative consequences for export growth. Over the last decade, governments of the region have introduced trade liberalization programs intended to increase competition, promote efficiency and stimulate export growth. However, trade liberalization has achieved little success in expanding exports, except in the case of Trinidad and Tobago where technological upgrading and product diversification associated with increase inflows of FDI led to improved international competitiveness. The relative success of Trinidad and Tobago suggests that trade liberalization by itself is not sufficient to promote export growth.

Table 3: CARICOM: Selected Economic Indicators

Country	Population (000) 2001	Per capita income US$, 2001	Adult literacy rate 2000	Balance of Payments current account US$ MN. 2000	Agricultural exports as % merchant-dise exports 2000	Gross domestic savings as % GDP 1998-2000
Antigua and Barbuda	68	9070	86.6	-79.1	..	34.4
Bahamas	307	14960	95.4	-433.8	3.4	..
Barbados	268	9250	98.0	-145.1	25.8	13.5
Belize	247	2910	93.2	-98.2	36.0	15.3
Dominica	73	3060	96.4	-68.9	34.6	18.5
Grenada	99	3720	94.4	-76.9	49.0	20.0
Guyana	766	840	98.5	-109.2	..	28.0
Haiti	8100	480	49.8	..	..	..
Jamaica	2700	2720	86.9	-285.5	20.0	16.0
Montserrat	..	..	..	-9.0	..	13.1
StKitts-Nevis	41	6880	97.8	-58.0	27.8	18.2
St Lucia	158	3970	90.2	-82.4	59.4	15.7
St Vincent	116	2690	88.9	-26.3	71.8	11.7
Suriname	420	1690	94.0	..	..	..
Trinidad and Tobago	1310	5540	93.8	544.3	4.0	29.6

Sources: Based on CDB, UNDP and World Bank

IV. Potential Costs And Benefits For CARICOM

Viner (1950) identified trade creation and trade diversion as the static welfare effects of a free trade agreement (FTA). Trade creation occurs when lower cost imports from a member country displace some higher cost domestic production. The result of trade creation is a reduction in inefficiency within the union that has a positive effect on welfare of the union. Trade diversion which shifts trade from more efficient producers outside the union to less efficient producers within the union has a negative effect on the welfare of the union and leads to inefficiency in the allocation of resources in the world economy. Thus, according to Viner, the net effect of a FTA on the welfare of member countries therefore depends on whether trade creation outweighs trade diversion. In addition to the static welfare effects, a FTA can yield significant dynamic benefits. First, increased competition within the union promotes efficiency, lowers prices and encourages technological advancement. Second, the larger market created by the FTA allows for the realization of economies of scale. Finally, both the larger market and the intensified competition are likely to encourage higher levels of investment.

Recent literature on regionalism suggests that regional trade arrangements involving developed countries and developing countries offer non-traditional benefits to the developing countries that may not be available from integration with other developing countries.[7] Three main benefits have been suggested. First, there is the enhanced credibility of trade reforms undertaken by the developing country. According to this argument, a trade agreement with a developed country reduces the possibility of reversal of policy reforms since the developed country has the power to enforce compliance by imposing sanctions on delinquent partners. The improved credibility of trade reforms is supposed to benefit developing countries by attracting inflows of foreign investment. A second benefit is access to the large market of the developed country. This provides more opportunities for export growth than would be the case with access to the smaller market of a developing country. Third, it is argued there is greater potential for spillover of knowledge and technology from a developed country partner. This can have positive effects on growth in the developing country.

The potential costs and benefits of the proposed EU-CARICOM-FTA will now be examined against the background of the foregoing theoretical arguments. While trade creation is viewed as beneficial in Vinerian analysis, the wide gap in the level of development between the EU and the CARICOM countries suggest that trade creation will entail high adjustment costs for CARICOM. The relative inefficiency of CARICOM production means that in the short run there is likely to be significant increase in inflows of imports from the EU as CARICOM producers will be unable to compete. This trade creation is likely to be associated with increased unemployment and poverty in CARICOM countries, most of which already have high levels of poverty and inadequate social safety nets. With the exception of oil rich Trinidad and Tobago, CARICOM countries generally experience persistent current account deficits. These balance of payments problems are likely to worsen in those CARICOM countries that are unable to increase exports to finance the increased inflow of imports. Furthermore, the reduction in government revenue due to removal of tariffs is likely to aggravate fiscal deficits. This is likely to be most burdensome for the small states of the Eastern Caribbean that rely heavily on taxes on international trade as a source of government revenue.

CARICOM states are likely to experience trade diversion with imports being diverted from more efficient non- EU suppliers to less efficient suppliers within the EU. This is particularly true of those countries whose imports are heavily weighted in favor of non-EU markets. Table 4 shows that with the exception of Antigua and Barbuda and St Vincent and the Grenadines, CARICOM's imports are heavily weighted in favor of non-EU markets. It should be noted however, that the potential for trade diversion will be reduced once CARICOM joins the Free Trade Area of the Americas (FTAA) since CARICOM countries would also have free trade with the North American market.

While in theory, trade diversion has a negative effect on the welfare of the union, CARICOM countries may actually benefit from trade diversion. CARICOM countries are lagging behind in technology, have low levels of industrialization and are heavily dependent on imported capital goods. Consequently, CARICOM countries stand to gain to the extent that the removal of duties on EU imports allows access to cheaper capital equipment. Recent research indicates that imported capital goods facilitate the international spillover of knowledge (Coe, Helpman and Hoffmaister 1997). There is also empirical evidence that imported capital equipment improves export competitiveness by reducing costs and prices in developing countries (Mody and Yilmaz, 2002). This suggests that access to cheaper imports of capital equipment is potentially a significant benefit of reciprocal free trade with the EU given the urgent need for technological upgrading and improved export competitiveness within CARICOM.

The potential impact of the FTA on inflows of FDI into CARICOM is uncertain. The European Commission (1996, 2001) has argued that the free trade agreements would increase the credibility of trade reforms undertaken by the ACP countries thereby making them more attractive to foreign investors.

However, UNCTAD (2001) points out that given rapid technological changes in the world economy and the development of high technology integrated production systems, a skilled workforce, adequate infrastructure and the institutions to support new technologies are now necessary for attracting investment. The dilemma facing CARICOM countries is that while they need increased inflows of FDI to help overcome financial, technological and managerial constraints, they are deficient with respect to the prerequisites for attracting FDI in the context of increasing global competition for foreign investment. It follows that attracting increased inflows of FDI into CARICOM will require more than the enhanced credibility of reforms supposedly offered by the FTA.

CARICOM states have traditionally benefited from preferential access to the EU market under the Lomé Conventions. Consequently, the only advantage of a FTA with the EU in respect of market access is the possibility of more secure market access. The preferential arrangement under Lomé was vulnerable as it required a WTO waiver which is subject to challenge by WTO member countries. A FTA which complies with WTO rules will provide more secure market access. It must be noted however, that greater security of market access is no guarantee of export growth. In order to capitalize on any improvement in the security of market access, CARICOM countries will have to overcome the deficiencies that prevented them from fully exploiting the Lomé trade preferences. The effect of the proposed FTA on CARICOM exports therefore depends on how well CARICOM countries are able to restructure their economies to promote export competitiveness and diversification.

Table 4: CARICOM Countries- Import Structure By Region Of Origin

	EU	USA and Canada	Japan	Developing America	Other	Total Non-EU
Antigua and Barbuda	42.7	20.4	..	8.9	28.0	57.3
Bahamas	20.1	35.8	5.3	3.2	35.6	79.9
Barbados	16.7	45.8	4.2	25.2	8.1	83.3
Belize	12.8	41.3	5.9	31.9	8.1	87.2
Dominica	15.9	13.8	4.3	20.0	46.0	84.1
Grenada	11.4	35.2	3.6	36.6	13.2	88.6
Guyana	13.9	29.5	2.5	46.2	10.9	86.1
Haiti	9.8	58.4	2.0	20.5	9.3	90.2
Jamaica	11.5	46.9	3.9	27.0	10.7	88.5
Montserrat	..	..	..	..	..	..
St Kitts-Nevis	13.6	52.5	2.5	28.0	3.4	86.4
St Lucia	13.0	29.2	2.9	51.0	3.9	87.0
St Vincent	36.6	14.0	2.0	19.3	28.1	63.4
Suriname	25.2	35.0	4.6	26.3	8.9	74.8
Trinidad and Tobago	17.3	38.4	3.4	28.0	12.9	82.7
CARICOM* average	18.6	35.4	3.4	26.6	16.2	81.4

* Excludes Montserrat
Source: Compiled by author based on UNCTAD (2002a)

The proposed EU-CARICOM FTA will extend beyond trade in goods covered under Lomé to include trade in services. The impact of the liberalization of trade in services on CARICOM countries depends on the scope of the agreement reached during the ongoing negotiations. CARICOM countries will benefit from imports of services that have the potential to enhance the efficiency of domestic producers. Examples of such services include professional, technical and infrastructural services. On the other hand, inefficient domestic service providers are likely to be marginalized by the entry of more efficient service providers from the EU. However, under the provisions of the General Agreement on Trade in Services (GATS), mechanisms can be put in place to mitigate this problem.

The GATS recognizes that liberalization of trade in services could have adverse effects on developing countries given the underdevelopment of their service sectors. In order to redress this problem, article IV of the GATS provides that developed country members of the WTO should assist developing countries to build domestic service capacity as well as to improve the efficiency and competitiveness of services sectors. The Cotonou Agreement also includes an undertaking by the EU to assist ACP countries to improve their capacity to supply services. Therefore, the degree to which CARICOM services sectors will be adversely affected by trade liberalization depends on the scope of the liberalization undertaken and the nature of the assistance that will be provided by the EU to strengthen their services capacity.

Export expansion and diversification are critical to the economic transformation of CARICOM economies. In addition to enhancing the competitiveness of existing exports, liberalization of trade in services has the potential to facilitate the diversification of CARICOM exports. Technological advances are increasing the feasibility of cross border trade in services and making it possible for firms to pursue global production strategies for services. This provides opportunities for CARICOM countries to diversify exports by developing new service exports such as information processing. While tourism is the dominant CARICOM service export, some CARICOM countries are exporters of financial services and information processing services. However, successful promotion of new service exports requires the alleviation of supply constraints such as the inadequate supply of skilled labor and deficient regulatory frameworks for services.

The export of labor is an important source of foreign exchange earnings for CARICOM countries. In the case of Jamaica, for example, worker remittances in 2001 amounted to US$ 967.5 MN compared to earnings of US$1279.2 MN from tourism.[8] The cost of these inflows is the brain drain associated with emigration. Liberalization of trade in services under the movement of natural persons mode of supply has the potential to increase earnings from the temporary movement of labor. In addition, opportunities for temporary movement of labor to the EU have the potential to alleviate the brain drain by reducing the incentive for emigration.

However, the experience of the negotiation of the GATS suggests that liberalization of the movement of natural persons is difficult to achieve. Of the four modes of supply of services provided for under the GATS, developed country commitments to liberalization are most limited in the case of the movement of natural persons mode of supply.

The Cotonou Agreement identifies a wide range of trade related issues that are to be considered under the FTA. These include: competition policy, protection of intellectual property rights, standardization and certification, sanitary and phytosanitary measures, consumer policy and protection of consumer health. Given the unequal bargaining power of the two groups of countries, it is reasonable to assume that CARICOM countries will be required to harmonize their laws and economic policies concerning trade related issues to conform with those of the EU. While it can be argued that harmonization of trade related economic policies will facilitate integration into the world economy, the adjustment costs for CARICOM might be substantial. Given the relatively low level of development of the relevant standards and institutions in CARICOM states, the financial costs of implementation are likely to be high. Moreover, adopting EU policies and standards may be detrimental to CARICOM's economic development. For example, adoption of EU competition policies might make it difficult for small CARICOM firms to survive.

V. Conclusions

Despite more than two decades of preferential access to the EU market, CARICOM countries failed to achieve export growth and diversification. This failure was due mainly to structural constraints including a shortage of capital, weak private sectors and underdeveloped human resources. In theory, the proposed shift from non-reciprocal trade preferences to reciprocal free trade with the EU offers the opportunity for export expansion and economic growth in CARICOM countries. While the FTA will entail short term adjustment costs, it is probable that CARICOM countries could benefit from more secure access to the EU market, access to cheaper imports of capital equipment, technological spillovers and increased inflows of investment.

However, the opportunity offered by the FTA could turn out to be a mirage if the structural constraints that limited the capacity of CARICOM countries to take advantage of the Lomé preferences are not overcome. In this context, the extent to which the EU-CARICOM FTA attracts increased inflows of FDI into the region will be a critical determinant of the impact of the FTA on CARICOM economies. The financial assistance and capacity building support promised by the EU in the Cotonou agreement are also essential to enabling CARICOM to create the environment that can attract increased inflows of FDI.

Notes

1. The member states of CARICOM are: Antigua and Barbuda; The Bahamas; Barbados; Belize; Dominica; Grenada; Guyana; Haiti; Jamaica; Montserrat; St Kitts-Nevis; St Lucia; St Vincent and the Grenadines and Trinidad and Tobago. The Dominican Republic is the only Caribbean member state of the ACP group which is not a member of CARICOM. However, the Dominican Republic has opted to negotiate the EPA jointly with CARICOM.
2. See article 35 Cotonou Agreement.
3. Author's calculations based on CARICOM Secretariat data.
4. For further details see Northover and Thomas (1999) and Sandiford (1999).
5. Based on World Bank classification, high income is per capita income of US$9206 or more in 2001 dollars, while low income is per capita income of US$745 or less.
6. Author's calculations based on UNCTAD (2001)
7. See for example, Hoekman and Schiff (2002), Panagariya (1999) and Ethier (1998).
8. Bank of Jamaica, Annual Report (2001).

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