



The Impact of EPA on
Caribbean Economies
A Structural Analysis



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Caribbean Policy Research Institute



The Impact of the EPA on Caribbean Economies

A Structural Analysis of Four
Caribbean Countries

This document was produced with the kind support of our funders:



Canadian International
Development Agency

Agence canadienne de
développement international

10 November 2009

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EXECUTIVE BRIEF

Trade between the Caribbean and Europe had been conducted for three decades under the institutional umbrella of a series of preferential arrangements starting with the first Lomé Convention in 1976. It and subsequent iterations of that framework allowed the collection of ACP (African, Caribbean, and Pacific) countries to enjoy preferential access to the European market. The Economic Partnership Agreement (EPA) recently concluded by the European Union and CARIFORUM (the countries of CARICOM plus the Dominican Republic) replaces the Lomé arrangements and will govern trade between the two regions going forward.

The CARIFORUM-EU Economic Partnership Agreement establishes a free trade area encompassing the European Union and the Caribbean. The feature of the EPA that sets it apart from the preceding arrangements is its WTO-compatibility, in that it eliminates non-reciprocal market access between trading Partners.

As the successor to the earlier conventions, market access is the main component of the EPA. But the agreement goes beyond the scope of goods to include services, intellectual property, innovation, public procurement, competition, protection of personal data, the environment and social issues. The EU's liberalisation of 98 percent of trade in goods is not a significant departure from the status quo ante as some 95 percent of CARICOM product entering the EU already did so duty-free, quota-free (DFQF). CARIFORUM countries, meanwhile, will liberalize 92 percent of trade in goods over a 25 year period and between 65 percent and 75 percent of trade in services.

METHODOLOGY

This exercise traces the economic impact of the tariff reductions on European Union imports into the Caribbean and consequently on the economies in the region. Lower tariffs will shift expenditure towards the now relatively cheaper EU imports for those goods for which a significant tariff existed. As expenditure shifts away from domestic production in the now relative uncompetitive commodities, incomes fall in those industries and resources are released that will eventually be redirected to other economic activities. At the same time, the savings from purchasing cheaper goods will be spent in other ways. The combination of relative supply and demand shifts results in an economy with a changed structure of production. Further, both the reduction of tariffs on European imports and the consequent structural shift in production will have an effect on the government's revenues.

The changes in expenditure and production is simulated using a computable general equilibrium (CGE) model of the economy. CGE models ensure consistency across all their results by ensuring that all participants in the economy – consumers, firms and the government – spend only what they earn or can finance; and that demand and supply match in all markets, even when outside factors, such as cheaper imports, force adjustment.

RESULTS

The broad result obtained is that any disruptive effect of competitive importation on the four economies studied – Jamaica, St. Lucia, Trinidad & Tobago, and Guyana – will be limited and small. This conclusion derives from three structural characteristics. First, trading patterns are derived from a large number of influences, of which price is just one. The tariff reductions of the order 5 to 7 percent on average are not sufficient – even with demand for EU goods being highly responsive to price changes – to overcome history, language, culture, proximity, and endowments. Second, Caribbean economies import mostly what they cannot reasonably and competitively produce already, so a cheaper European source largely serves to divert trade from another imported source. Third, the particular commodities to which tariff reductions apply represent only a small fraction of the productive activities of the region. Some of the liberalization applies to products that the Caribbean will never import, such as fur coats, while others have been deliberately excluded. But most of the economic activity in the Caribbean is devoted to the production of services or mineral extraction, so goods production is only a small part of GDP and employment.

The average 6 percentage-point tariff reduction across all imported commodities into the four countries generates an increase in imports from the EU of 42 percent, reflecting a high price sensitivity. That half-again growth of EU imports, because of both the small share of EU imports and because of trade diversion, has little impact on the shores of the Caribbean. The eventual increase in total merchandise imports in the four economies is only 1.5 percent. By the time account is taken of the share of imports in total domestic commodity supply (average, 40 percent) and the small commodity share in GDP (average, 28 percent), the contraction of domestic economic activity is less than a tenth of the import increase.

A measure of the amount of economic dislocation is the weighted average of the percentage contractions using only the sectors that contract, and ignoring the expanding sectors (that may very well be re-employing workers displaced from the contracting sectors). The calculation reveals that in three of the four economies studied, the contraction of production and employment amounts to only a tenth of a percent. In St. Lucia, however, as much as one percent of GDP and the labour force will be affected. Recalling that the liberalization schedule occurs over 25 years, the tenth of a percent contraction will unfold over a quarter century.

The loss of tax revenue presents a somewhat bigger challenge for some of these economies, but, spread the over the 25 years of the liberalization schedule, it is manageable. The impacts vary widely across the four cases. Indirect tax revenue contracts by as little as one percent in Jamaica but by nearly 13 percent in St. Lucia. The loss is barely noticeable in Jamaica and Trinidad & Tobago, but at one percent of GDP in Guyana and almost 3 percent in St. Lucia, it will take some management to replace.

In the presence of negligible effects, it is difficult to discern finely disaggregated sectoral impacts. If one is to be discerned, the production of machinery and

equipment in both Jamaica and Trinidad & Tobago suffer a one percent contraction. Small though that impact might seem, it may still make the difference between life and closure for some firms.

IMPLICATIONS

In the small economies of the Caribbean, the downside to the EPA was seen largely to be the fear of dramatic dislocation even in the presence of long term benefits. However, that dislocation turns out to be negligible. If there is to be an upside from the EPA, the hope lies in the service sectors and the use to which the development assistance is put. That is where much effort should – and, it is expected, will – go, and that is where the gains from this trade agreement are likely to be concentrated.

While all generalizations must be done with some caution, we may generalize from the four cases studied here to the rest of the Caribbean with some confidence. The four cases were chosen because they represent the variety of economic structures in the Caribbean – agrarian Guyana, industrialized Trinidad & Tobago, large Jamaica, and small, service-oriented St. Lucia. Revenue loss will be a challenge for the smaller economies in the region, but apart from that, policy-makers in the Caribbean need to turn their attention to exploiting the service access opportunities opened up by the Economic Partnership Agreement.



INTRODUCTION

Throughout most of the post-war period in the Caribbean, the goal of trade policy was the pursuit and preservation of preferential access to North American and European markets while protecting domestic markets to any extent allowed and practicable. The spread of a liberal trade doctrine, and in particular the formation of the World Trade Organisation (WTO), represented a fundamental shift in the world economic order. The successful challenge mounted by Central American banana-producing countries against the EU-ACP banana regime was a particularly consequential example of this shift, forcing as it did the English-speaking Caribbean to fully engage the new rules of world trade.¹

The Economic Partnership Agreement (EPA) between the European Union and CARIFORUM (comprising the membership of CARICOM plus the Dominican Republic), signed into effect in January 2008, is an institutional manifestation of this shift. The agreement is an attempt at a framework to usher the small, vulnerable economies of the Caribbean into the new rules of trade – away from preferences, away from primary commodities, and away from sheltered industries. In form and spirit, it establishes a free trade area encompassing the Caribbean and the European Union.

At least at the level of theory, such arrangements ought to usher in a period of rationalization of production between the two areas. In moving from the status quo structure of production to the structure that best exploits comparative advantages, industries and activities will expand and contract. As they do so, productive resources will become unemployed, let off from the contracting activities, and reemployed, allowing the growth of the expanding activities.

In small economies, such trade- or technology-induced structural adjustment has the potential to be both large and lasting. The collapse of any industry in a small economy is a proportionally larger event. Further, with relatively fewer opportunities than would exist in a larger economy, the unemployment that ensues, even if temporary, can persist for a long time, with devastating consequences for vulnerable households.

Regardless of any eventual recovery and growth that may derive from the trade opportunities, the extent and duration of the dislocation of economic adjustment is of consequence. Governments in the region may need to institute compensatory policies to ameliorate the human consequences and facilitate the transition. Those same governments, however, will be called upon to manage the structural transition with a loss of tax revenue as tariffs are reduced on imports from the EU.

¹ Another important rationale for many Caribbean governments was the fact that many of their exports, especially in sugar, was subsidised heavily to keep them surviving. Trinidad & Tobago and St. Kitts and Nevis were two that closed their industries as a result.

The purpose of the present study is to estimate the size of the productive contraction that may follow in the wake of competitive imports from the EU, identify the sectors where it is most likely to occur, and calculate the amount of the loss of tariff revenue. From these results, governments can better prepare themselves for the economic changes to come and the expected revenue loss.

The estimations will be done by simulating the outcomes using a Computable General Equilibrium (CGE) model applied to a sample of four Caribbean economies – Jamaica, St. Lucia, Trinidad & Tobago, and Guyana. These four were chosen because they represent a variety of sizes, levels of industrialization, economic structures, trading patterns, and income levels. From those case studies, cautious conclusions can be drawn about the entire region.

In each of the cases chosen for analysis, we set out to test the two hypotheses in order to ascertain how, and how profoundly, the EPA was going to affect both Caribbean economies and Caribbean governments. In so doing, we hope to better prepare the governments in the region to deal with any adverse consequences of adjustments that may occur in their economies.

BACKGROUND TO THE EPA

International trade necessarily plays a significant role in small economies such as those in the Caribbean. The region's exposure to trade winds has been partially mitigated by the share of its trade that was governed by preferential market access, primarily to the OECD countries through a succession of trade agreements. This vulnerability has become exposed by the current global economic crisis and shifts in the patterns of world trade, and will now be increased by the obligation to shun traditional preferential trade arrangement with the European Union; these have been deemed to be incompatible with the rules that govern world trade under the auspices of the WTO (World Trade Organisation).

The overarching objective of signing a Free Trade Agreement between the European Union (EU) and CARIFORUM countries is to maintain the longstanding preferential market access arrangement that existed under the Lomé Agreement. The WTO panel on the European Union's banana import regime determined that the arrangement that existed under the Lomé Convention was incompatible with WTO rules because it violated its most fundamental principles, those of non-discrimination and reciprocity.

The Cotonou Agreement,² signed in 2000, addressed these by requesting that the Parties conclude WTO compatible trading agreements, involving the progressive removal of barriers to trade between them and enhancing cooperation in all areas relevant to trade. For administrative purposes, the EU negotiated these WTO compatible arrangements by breaking up the ACP group into six regional groupings

² The Cotonou Agreement was signed in Benin in July 2000.

or free-trade areas of which CARICOM³ plus the Dominican Republic was one such group (“CARIFORUM”).

The critical demand of a new agreement was that the non-reciprocal element of the traditional preferential agreements had to be jettisoned in the new agreement to achieve WTO compliance. Whatever benefits that were enjoyed by CARIFORUM countries in the EU market must now be enjoyed by EU members in CARIFORUM. The Economic Partnership Agreement was signed between most CARIFORUM countries and the European Union (EU) on October 15th, 2008. The EPA is a comprehensive cooperative framework which encompasses a holistic approach to development by focusing on the objectives and principles set out in the Cotonou Agreement.

CARICOM’S TRADE COMMITMENTS

CARICOM has signed bilateral preferential trade agreements with developing and developed countries. The CARICOM-Venezuela Agreement is a trade and investment agreements based on one-way preferential market access and investment flows. Tariffs were eliminated on 22% of products and reduced on 67%. The result is that Venezuela’s applied MFN tariff on CARICOM’s exports is, on average, a third less than Venezuela’s MFN tariff. The CARICOM-Colombia agreement made provisions for trade liberalisation and facilitation (which included the exchange of preferences). Initially, it offered one-way tariff reductions on selected CARICOM product entering Colombia, which was revised in 1999 to make the reductions reciprocal. The CARICOM-Dominican Republic agreement made provisions for the asymmetrical application of reciprocity, with mutual granting of concessions by the MDC’s of CARICOM and the Dominican Republic. The LDC’s were required to undertake such commitments until 2005. The Cuba-CARICOM agreement deals with tariff reductions, taxation, trade promotion and facilitation, among other elements. The Costa Rica-CARICOM agreement is a free trade agreement which offers non-reciprocal preferences to CARICOM LDC’s and reciprocal preferences to CARICOM MDC’s.

Preferential trade agreements granting non-reciprocal market access to the major developed country markets take the form of broad arrangements: the CARIBCAN agreement signed with Canada, the Caribbean Basin Initiative (CBI) signed with the USA, the Revised Cotonou Agreement signed between the ACP and the EU. The General System of Preferences (GSP) schemes also grants preferential market access to the markets of Australia, Japan, New Zealand and Switzerland, with the range of exports depending on the individual country’s scheme.

³ This acronym refers to the Caribbean Community which consists of Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago and Suriname.

THE ECONOMIC PARTNERSHIP AGREEMENT

The CARIFORUM-EU Economic Partnership Agreement is a Regional Trade Agreement signed by the EU and CARIFORUM countries which establishes, amongst other areas of cooperation, a free trade area for goods and services. The most distinctive feature of the EPA that sets it apart from previous trade agreements is that it is WTO-compatible, satisfying the requirements of GATT Article XXIV⁴ on Free Trade Areas that eliminates non-reciprocal market access between trading Partners .

To fully comply with GATT article XXIV, there was the requirement that duties and other restrictive regulations of commerce be eliminated on ‘substantially all trade’⁵ between the parties in products originating in such territories. In the EU Commission Guidelines⁶ for Preferential Trading Arrangements (PTA), it was decided that WTO compatibility required 90% liberalisation of trade between the partners through the elimination of tariff barriers.

The EPA in its application and scope is more comprehensive than previous agreements. It expands the former market access commitments from trade in goods only to cover a range of additional subject areas such as government procurement, investment, trade facilitation, competition policy, and intellectual property rights. Importantly, the agreement also includes a services agreement which is compatible with GATS (General Agreement on Trade in Services) article V. Goods falling under chapter 93 of the Harmonised System (HS) have been excluded from the liberalization process. Except for rice, sugar and bananas, as of January 1, 2008 all products from CARIFORUM States will enjoy Duty Free Quota Free Access (DFQF) to the EU market.

HISTORICAL ANTECEDENTS

The modern history of cooperation between the Caribbean and the EU started in 1975 in the framework of the ACP-EU relationship. This relationship came to be codified in a series of “Lomé” conventions (there were eventually four of them) named after the Togo capital where the first was signed. The Lomé conventions were built on the stated principle but practical violation of equal partnership between the parties through economic and commercial cooperation and development assistance.

⁴ Article XXIV, provides exceptions to MFN treatment for customs unions (CUs) and free-trade areas. In particular it requires that, in free trade areas and customs unions, trade preferences are permitted only when duties and other restrictive regulations are eliminated on “substantially all the trade” between the constituent territories. Thus preferences in an FTA have to be reciprocal.

⁵ The quantitative requirement would be that a high coverage must be achieved by the free trade area of around 90 per cent of current trade and of 90 per cent of the tariff lines; the qualitative test would be that no major sector of trade should be excluded.

⁶ This document was presented to the Council of the European Parliament in October 1997.

A system of one-way trade preferences was used to implement the economic cooperation aspect of conventions. These preferences allowed all manufactured goods and some agricultural products to enter the EU with the protection of customs duties or quantitative restrictions.⁷ One of the most important benefits of that relationship was non-reciprocal market access, the only requirement being that ACP countries applied the MFN (Most Favoured Nation) clause within the EU and not discriminate amongst the countries of the Union. To ensure that products such as agricultural goods were not in direct competition the EU's common agricultural policy, a number of protocols were signed covering rum, bananas, sugar, beef and veal.⁸

The establishment of the WTO in 1995 and the changes in the global economy in general, required the EU to re-appraise the framework of its economic and development cooperation with ACP countries. The legal framework of the WTO did not make allowances for non-reciprocal discriminatory preferential arrangements as such agreements violated GATT Article XXIV. When Lomé IV expired in 2000, it was replaced by the Cotonou Agreement – a pact broader in its objectives and scope as it included poverty reduction, sustainable development and the integration of ACP countries into the global economy. These objectives were to be achieved through the negotiation and enactment of new trade relations that incorporated a WTO-compatible, reciprocal agreement.

THE MOTIVATION FOR THE EPA

The Most Favoured Nation (MFN) principle has been the bedrock of multi-lateral trade negotiations since the initial GATT in 1947. The principle stipulates that any concessions granted by a member country to any other member must be unconditionally granted to all WTO members. This provision rules out preferential trading arrangements. Article XXIV of GATT, however, provides for a legitimate exception to the MFN principle in its territorial application by allowing discrimination through the formation of Free Trade Areas. That provision creates the opportunity for the EU to continue a preferential arrangement with the Caribbean (and other ACP groups in turn), but obligates the arrangement to be structured as a free trade area (FTA) encompassing the European Union and the CARIFORUM countries. The EPA is therefore designed to occupy the intersection of the objectives of the Cotonou Agreement and the obligations under the WTO.

⁷ Tropical products which do not compete with European products enter the EU market duty free. Temperate products face an exemption or reduction of customs duties, while fruits and vegetables are subject to seasonal restrictions. Other agricultural products face quantitative restrictions or are excluded from preferential treatment.

⁸ Under the sugar protocol, several ACP countries have the right to deliver fixed quantities of sugar to the EU market at the guaranteed EU price. The banana protocol of the Cotonou Agreement includes no specific commitments on preferential market access for ACP banana exports, because the EU banana import regime had to be changed following a long-standing dispute in the WTO.

In the absence of a trade and development treaty with the EU, all Caribbean trade with the EU would otherwise be governed by the General System of Preferences (GSP), a non-reciprocal, non-discriminatory preference scheme available to all developing countries, while the smaller economies in the region would further qualify for the special provisions of the GSP's "Everything But Arms" (EBA) initiative. Under the EBA initiative, Caribbean exports may enter the EU without reciprocity in terms. No such privilege would be available to the larger economies, however. Further, there would be no institutional framework for development and technical assistance as provided for in the EPA. Finally, some Caribbean exports would continue to attract tariffs upon entering the EU, including commodities such as alumina, rice, cane sugar, rum, methanol, textiles, banana and crustaceans. Thus the EPA appears to confer some advantages on participating Caribbean economies, but only in the presence of the reciprocity demanded by an FTA.

Under the GSP, the pressure of increasing global competitiveness would continue to challenge Caribbean economies. Not only would the Caribbean have to cope with the loss of preferential access with the expiration of the Lomé conventions, but global trends would continue to erode traditional trading relationships. The era of trade liberalisation has led to lower tariffs and the removal of non-tariff barriers worldwide, resulting in increased competition in the global marketplace and thereby enabling rich-country consumers to access a wider array of sources for imported product. This process is ongoing. So Caribbean economies would face mounting pressure to adjust their economies away from traditional patterns of trade. This is the context in which the EPA arrives and provides a framework for CARIFORUM countries to continue to have some preferential access to the European Union market, along with development assistance to facilitate structural change.

The recognition that the on-going evolution of the global economy will continue to pose the challenge of structural change in the Caribbean underlies the equal focus in the EPA on capacity-building. The negotiating parties believed that the benefits available to the weaker Caribbean states under the EPA would not be sufficient to assist them in capacity-building to the levels required for global competition. The EBA initiative makes provision for increased market access opportunities for LDCs to export to the EU but does not provide development assistance that can resolve some of the supply-side constraints faced under the previous trade arrangements with the EU. The comprehensive integrated framework of the EPA makes provisions for development aid and assistance which have the potential to produce significant gains for LDCs.

THE KEY PROVISIONS

Trade Measures

Market access is the main area of focus under the EPA. Unlike its predecessors, this new arrangement goes beyond the scope of goods to include services and other aspects of trade-related areas such as intellectual property, innovation, public procurement, competition, protection of personal data, the environment and social

issues. Wider market access is expected to expand investment into non-traditional sectors, through diversification of exports and the development of an industrial base, resulting in higher added-value exports for the region.

To qualify as a free trade area requires, according to Article 24, that member states within the area “substantially all trade” among themselves, with the conventional benchmark being 90 percent. Under the EPA, the EU has liberalised, duty-free and quota-free, or DFQF, 98 percent of trade in goods and 94 percent of trade in services immediately, as at January 1, 2008. The offer provides Duty Free Quota Free (DFQF) access for agricultural products that had previously attracted tariffs such as beef, dairy, cereals, fruits and vegetables. Custom duties have been removed from sugar and rice, while the quota aspect will be eliminated on a phased basis, ending in 2009 and 2010. Bananas will also enjoy immediate DFQF access to the EU market in a manner which negates some of the objections in the WTO Dispute Settlement Panel on the Banana Protocol.

The EU liberalisation of 98% of trade in goods under the EPA is not a significant departure from the status quo ante. Under the predecessor Cotonou Agreement, approximately 95 percent of CARICOM product entering the EU did so DFQF. The difference of 3 percent covers the afore-mentioned sugar, rice and bananas that had faced quota restrictions.

CARIFORUM countries, meanwhile, will liberalize 92 percent of trade in goods over a 25 year period and for trade in services, 75 percent and 65 percent respectively for the more developed and less developed CARIFORUM countries.

Rules of Origin specify the criteria for a product to be considered as locally-produced and hence qualify for preferential treatment. The new guidelines on rules of origin that have been included in the EPA create new opportunities for CARIFORUM countries to extract more value added through further processing within the region before the final product is exported to the EU. At a basic level, the rules specify that only goods produced in a country, using only materials from that country, or products that have been handled under special conditions by regulation in that country, can be deemed to qualify as originating products.

Given the fact that these are all small states with limited endowments and productive capacity, it is likely that a large share of the inputs required for the production process would originate beyond their boundaries. As a result, the EPA offers improved Rules of Origin benefits over those that existed under previous agreements. These changes would have impacted on the value-added conditions, the discontinuance of the certification of origin and the verification procedures.

A number of aspects of rules of origin have been changed under the EPA. One aspect allows for changes in the treatment of some sectors affected by particular conditions governing production and manufacture; this will mainly affect textiles, clothing, fish and some agricultural products. The changes also allow for some ‘permanent derogation’ from the primary rules through an exception called

‘cumulation’, which allows for the broadening of the concept of originating status of materials and sufficient working or processing. Under the EPA, materials originating in some of CARIFORUM’s neighbouring developing countries will be considered as originating in a CARIFORUM state. Finally, the concept of wholly-owned was broadened beyond products extracted or grown locally to include sea fishing or other products taken from the sea by local vessels and local fishermen.

The service provisions are of particular importance as the Caribbean is the only member region of the ACP grouping that is a net supplier of services. The benefits negotiated under the EPA include agreements which cover investment, trade in services and electronic commerce. The commitments under the EPA cover a range of sectors in which CARIFORUM firms have shown distinct comparative advantage such as tourism, investment and entertainment services. The commitments in services are different from trade, in that the services agreement makes provision for different modes of supply to access or deliver these services.

The market access commitments allow for a generous asymmetry in the level of service liberalisation. The EU has undertaken to liberalise 94 percent of the W120 list of service sectors while CARIFORUM Countries will liberalize only some 65 to 75 percent of their services.⁹ The service sectors will include business, financial, and recreational services and tourism. Further, a number of specific issues have been addressed, such as barriers for CARIFORUM investment in the EU, the cross border supply of goods and services, limitations on number of suppliers and volume of transactions, and access for Caribbean professionals.

To ensure a higher level of transparency and equity in the treatment of EU suppliers, the EU ensures that there is a substantial procurement chapter in all bilateral agreements negotiated. The commitments negotiated on public procurement in the EPA place emphasis on encouraging transparency and the creation and strengthening of regional procurement markets. One of the benefits to the Caribbean of the negotiated procurement rules is that it will provide member governments with a tool to reduce corruption and ensure the proper utilisation of resources through proper verification and administrative controls. This will involve the exchange of information and experience about best practices and regulatory frameworks, the establishment of the appropriate systems and mechanisms to facilitate compliance with the agreement, the creation of an online facility at the regional level for information-gathering and sharing about tendering opportunities.

ACP countries have found it difficult in the past to take advantage of preferential market access opportunities in the EU because of technical requirements and sanitary and phyto-sanitary standards. Generally, the EU has strict rules on health and safety standards that have gone beyond the requirements within the

⁹ The W120 list was used as the basis for negotiations under the GATS in the WTO. These range from business services, communications, construction, distribution, environmental, financial, transport, tourism and recreation services.

WTO. The EPA provides CARIFORUM countries with the cooperation and assistance necessary to meet the standards set by the EU import regime.

Finally, there are provisions in the EPA for customs and trade facilitation. The EPA mandates cooperation to ensure that relevant legislation and procedures, and the administrative capacities of the relevant administrations, are used for the effective facilitation of trade. Easy access to information and transparency of procedures creates an enabling environment to do business, guaranteeing unhindered movement of goods across borders. Businesses suffer significant losses due to delays at borders, complicated and unnecessary documentation requirements, and inadequate use of technology to carry out government procedures. These costs can sometimes be greater than the total of all tariffs combined.

Scale Constraints

The EPA seeks to improve market access opportunities for CARIFORUM members for trade in both goods and services separately. It was recognised that CARIFORUM countries have not been able to take advantage of the market access opportunities in the European market under the previous trade agreements, even in the absence of prohibitive tariffs, because there were obstacles within the Caribbean which seem to have prevented the economies in the region from expanding more aggressively into non-traditional exports. To address these concerns, the trade-in-goods component of the EPA focuses on capacity building. Since the Caribbean has had some success in nurturing successful services businesses, the agreement recognizes that provided a platform from which CARIFORUM firms may expand into the EU market.

Many of the obstacles to regional trade simultaneously inhibit exports further afield, so a strong regional framework is a necessary platform for more expansive export ambitions that would encompass Europe. Deeper regional integration was therefore seen as a necessary condition and appropriate platform for development assistance and a critical element for the success of the EPA.

Size is an obvious challenge to the exploitation of trade opportunities. The local firms in the small Caribbean territories suffer from diseconomies of scale due to the limited market sizes. In addition, the cost of implementing trade agreements has been significant relative to their government budgets, resulting in the region being unable to take advantage of opportunities under various trade arrangements. The EPA will provide resources that will assist CARIFORUM countries to overcome these challenges. Within the context of a fully functioning Single Market and Economy, these resources will be channelled to areas such as trade facilitation, standards setting, customs facilitation, infrastructure building and the development of technological and regulatory capabilities. The planned outcome will be the establishment of certification agencies, testing laboratories, physical infrastructure (roads, ports, telecommunication, electricity and water) and institutions (customs, market research, trade finance, tax reform) along with the capacity for TBT (packaging and labelling) and SPS (processing methods) that has prevented CARIFORUM goods from entering the EU market.

Services

While there are opportunities to be exploited from trade in goods, the region has experienced greater success from trade in services. The EPA now provides an opportunity for the region to leverage its experience in services in the more lucrative economic arena of the European Union. The services sectors in most CARIFORUM countries account for more than 50 percent of GDP and for the OECS sub-regional grouping, many are more than 60 percent.

Under the EPA, the EU has liberalized the importation of 94 percent of its services sectors, including from business services, financial services, tourism and recreational services. These commitments made by the EU go beyond the commitments made at the level of the GATS Agreement. They are broad enough to include the removal of identified investment barriers such as limits on foreign share holding. There are no limitations on the number of service suppliers or the volume of transactions. The agreement allows for the temporary movement of service suppliers -- such as contract professionals if they are in possession of a contract -- in as many as 29 sectors. In the cases where they are independent contractors and self employed persons, they have been granted access in 11 sectors.

The CARIFORUM countries, for their part, have been allowed to undertake different levels of liberalisation in trade in services based on the sizes of the economies. The more developed countries (MDC's) will liberalize 75% of sectors; while the less developed countries (LDC's) will liberalize 65% of sectors. There were no commitments to liberalize public services. The services sectors that have been liberalized by CARIFORUM countries are in sectors where Foreign Direct Investment (FDI) has always been encouraged in the past: tourism, business services, environmental services and maritime services. It is generally accepted that these sectors hold the greatest potential for increasing investment and economic growth in the region.

With different programmes, then, for both goods and services, the craftsmen of the agreement hope to promote Caribbean development. In the goods sector, by facilitating the strengthening regional integration and the institutional capacity in areas and services critical to small business development, the agreement hopes to promote the development and expansion of firms whose products can find a marketplace in Europe. In the service sector, where enterprises and markets in the Caribbean are well established, increases access is deemed to be sufficient to promote Caribbean success in the EU.

CARIBBEAN INTEGRATION IN THE CONTEXT OF THE EPA

Given the importance of the regional integration efforts already undertaken by the region, the negotiators of the EPA sought to build and enhance the provisions related to the CSME. This position was reinforced in Article 1 Para. (d) which speaks of "promoting regional integration, economic cooperation and good governance thus establishing and implementing an effective, predictable and

transparent regulatory framework for trade and investment between the Parties and in the CARIFORUM region” and Article 4, Para(4) which states that: “without prejudice to the commitments undertaken in this Agreement, the pace and content of regional integration is a matter to be determined exclusively by the CARIFORUM States in the exercise of their sovereignty and given their current and future political ambitions”.

The promotion of regional policies within the EPA framework as a means to facilitate the implementation of the EPA clearly implies that the CSME is integral to the EPA process. Operating within a free trade area means policies will be implemented at the regional level, therefore, it is through the CSME process that the necessary framework and institutions will be put in place for both parties to effect the new agreement. The EPA presents an opportunity for a deeper and smoother integration through the CSME than what has been accomplished so far through CARICOM. While it has been mooted that being locked into an EPA development path diminishes the scope for regional integration with detrimental effects on the region,¹⁰ the EPA is constructed with a view to the mutual facilitation of both the EPA and CSME.

Problems have bedevilled the exploitation of CARICOM’s attempts at integration from its inception in 1965 right up to CSME (Caribbean Single Market and Economy) in 2005. The obstacles that have obstructed deeper regional integration will therefore very likely be visited upon the free trade area that includes the EU. As a result, the successful implementation of the EPA demands attention to the removal of these obstructions.

One of the issues that has obstructed the full exploitation of the letter and spirit of Caribbean regional integration is continued restriction on the full and free movement of goods. This is due to the insistence of countries on applying forms of restriction on intra-regional trade by means of unauthorized import duties, export duties, discriminatory internal taxes, fiscal charges, import licences, and quantitative restrictions. Other issues in regional integration include the right of establishment, the free movement of capital, services, and labour, inconsistency in the application of the Common External Tariff, and the absence of policy coordination and convergence.

The EPA is attempting to address these issues by providing funding for the creation of an institutional framework for regional integration, technical assistance, capacity building (including support for trade facilitation), and investment in trade related infrastructure. The EPA makes provisions for technical assistance and development cooperation which should ensure that when trade measures are implemented, they are done within the right framework so that they can lead to sustainable growth.

¹⁰ See C.Y. Thomas (2008) *Trinidad Express*, June 11.

A part of such a framework for sustainable development is technical and administrative capacity. Thus, the EPA provides for capacity building. Technical assistance will benefit CARIFORUM governments in the areas of policy harmonization, legislative reform, and tax reform while the private sector will benefit in the areas of competitiveness and research and development.

IMPACT ASSESSMENT METHODOLOGY

BASIC IDEA AND RATIONALE

The present exercise traces the economic impact of the tariff reduction on European Union imports into the Caribbean. Lower tariffs will initially shift expenditure towards the now relatively cheaper EU imports for those goods for which a significant tariff existed. Expenditure may be drawn away from domestic production (trade creation) or from imports from other parts of the world (trade diversion). Since there is a significant amount of intra-regional trade, such trade diversion may very well be from Caribbean trading partners.

Trade diversion will have little additional impact on the local economy, but trade creation necessitates structural adjustment. As expenditure shifts out of domestic production for the affected commodities, incomes fall in those industries and resources are released. In the long run, those resources shift into their next most lucrative employment, expanding production in the other sectors of the economy. At the same time, the income saved by buying now relatively cheaper European Union imports will itself be redirected to other commodities, increasing demand in the rest of the economy. The combination of relative supply and demand shifts results in an economy with a changed structure of production.

There is a fiscal impact of the EPA, as well. As tariffs are eliminated, the government's tariff revenues decline. But the decline is not commensurate. To the extent that the shift of productive resources and expenditure to other sectors increases alternative economic activities, additional tax obligations will be incurred and the net effect on total revenue will be ameliorated. But there will be, nonetheless, a net revenue loss.

In order to estimate the degree to which consumption expenditure and fiscal budgets will shift to new activities following the reduction of tariffs on EU imports, a computable general equilibrium (CGE) model of the economy is employed. CGE models ensure all subsequent repercussions are reflected in the final solution. A CGE model disaggregates the economy into "accounts" – each account representing a productive sector (such as "bauxite mining"), a factor of production (such as "semi-skilled, female labour"), or economic institution (such as "urban households" or "central government"). The modelling framework maps all income flows amongst accounts. That is, it captures all the income coming into an account by source and allocates it amongst its uses by destination account. Thus, a productive sector's income is derived from the sectors and households that provide the market

for its product and is allocated amongst the sectors from which it obtains productive inputs, providers of labour and owners of capital, and the government which collects taxes levied on the activity. Household accounts, for their part, which collect income from employment, owning capital, and being the final repository of enterprise profits, will allocate that income amongst the productive sectors from which they purchase final consumption goods, the financial account to which they deposit and from which they withdraw savings, and the government to whom they pay direct taxes. The matrix of flows is completed by accounts for the government and the rest-of-the-world.

Transactions between the rest of the world and each of our modelled economies are captured in various ways. For commodities, imports are combined with domestic production to create a composite commodity for domestic consumption, the proportions of which vary with the relative prices of the commodity from each source. This specification reflects the reality that most aggregated commodity groups are made up of a mix of domestic and imported commodities and that price changes will only change the mix. It is through this relative price-change that the effect of the EPA will have its initial impact in the model. As tariffs fall, the relative prices of EU imports fall commensurately relative to both imports from the rest of the world and to domestic production, simulating the partial switch of expenditure from the now relatively more expensive sources to the cheaper one. In a comparable manner, domestic production is divided between the domestic and export markets according to the relative prices that can be obtained in each.

Remittances are accounted for as income transfers from the rest-of-the-world account to households, from which they are spent in the same manner as any other income would be. These flows will be large and important in Jamaica and Guyana, less so in St. Lucia and Trinidad and Tobago. Foreign direct investment is accommodated as a flow from the rest-of-the-world to the savings-investment account, from which it will demand investment goods (such as construction) in the same was any other source of investment.

In addition to enforcing the balancing of the budgets of all the accounts in the model by ensuring that earnings equal outflows, the model ensures that all commodity markets clear insofar as product-quantity supplied must be equal to product-quantity demanded. This may be accomplished by automatically allowing prices to respond appropriately where they are flexible, and sufficient time for adjustment is allowed. Market equilibrium may also be achieved by forcing a quantitative adjustment where it is determined that prices are sticky over the relevant time-frame of the analysis.

The response of factor markets is critical in assessing the effects of any stimulus such as the EPA tariff reductions. In general, factor markets respond in stages. In the first, factor prices are sticky and production expands or contracts its use of factors in response to changes in quantity demanded in the presence of unchanged factor prices. Later, factor prices such as wages have time to adjust, a period that may take up the three years, so that markets eventually clear. After that, in the

very long run, the structure of the economy shifts to reflect the competitive opportunities opened up by the dynamic efficiency gains and the adoption of better production technology that follows from the new trading opportunities.

In the present exercise, we are interested in both short term and long term impacts – namely, the short- term change in employment as well as the long-term effect after labour has had a chance to redeploy. For the short run, quantitative adjustment will be used in labour markets which will be demand-determined with the option for changes in unemployment in the presence of sticky wages. A reduction in demand for unskilled, male labour, for example, will result in open unemployment in the short run. For the long run results, we presume that markets, including the labour market, have had ample time to adjust and allow wages to adjust to take up all but the structurally unemployed. The effect on labour markets over that time-frame, then, will be manifest as lower wages. Whereas labour is assumed to be mobile across sectors, capital is assumed to be fixed and immobile once installed, and is always fully employed.

We use a “Leontief” production function amongst commodity inputs and between commodity inputs and total value added in which the quantities of inputs are determined by fixed coefficients. Within value added, the choice between skilled and unskilled labour and capital is determined by a constant elasticity of substitution production-function which can allow some substitutability as the relative prices of each type of factor shifts.

Since the modelling framework is static, it does not have the capacity for endogenous growth effects. Neither the labour force nor the capital stock can grow over time. This does not prevent the simulations from having something to say about the growth effects of the EPA, however. The models will be able to compare the growth potential of the two states (EPA and no EPA) and estimate the likely effect of the EPA on growth in the long run.

THE MODEL

Assumptions and Closures

With a 25-year time horizon for eliminating tariffs on EU imports into the region, there will be ample time for labour to shift amongst affected industries in a gradual way such that the consequences for unemployment during a short-term adjustment period will be negligible. Therefore, we take the long- run view and assume wages adjust to ensure the continuation of the existing levels of employment. As is the case with most CGE models, we assume that once installed, capital is immobile.

For simplicity, we collapse the liberalization schedule for each country and implement the entire slate of expected tariff reductions all at once. This simplification, if anything, should exaggerate the impact on the economy by concentrating the effects all at once. The results presented below can therefore be interpreted as a worst-case scenario in terms of economic adjustment.

The simulations ignore technological change and capital accumulation during the period in which the EPA is implemented. Both of those considerations account for the growth of an economy over time. The present exercise is not interested in absolute levels of growth, however. Our interest is in the relative effect of the EPA tariff reductions over and above (or under and below, as the case may be) what would have occurred in the absence of the EPA. The positive effect of increased trade on total factor productivity will be calculated using the Baldwin multiplier.

Closure rules – the selection of the balancing variables – are assumed for each of the model’s macroeconomic balances – the savings-investment balance, the external balance, and the fiscal account. Investment is determined by the level of savings. The level of investment is assumed to be exogenous, with household savings rates adjusted automatically to achieve the desired level of savings. The level is therefore the difference between endogenously-determined income and the level of savings required to fund the fixed level of investment.

To maintain external balance, the current account is held at whatever level of surplus or deficit existed in the base year, with the real exchange-rate adjusting automatically to maintain that level. This is consistent with the recognition that our interest in the present exercise is in the adjustment of the economy over the long run. Finally, alternative fiscal-balance closures are investigated and presented in the results below.

Data

Data for these simulations are provided entirely by official sources and the exercise uses mostly unpublished data. The basic database for a CGE model is the flow of goods and services between industries. This data matrix has to be specially-generated by the national accounts divisions of each country’s public statistics agency. That exercise also yields the size of payments to labour and capital owners for each sector of the economy.

A household survey provides information on the accumulation of income by households and on the distribution of the household’s expenditure over the commodity groups produced by the various productive sectors. Ministries of Finance are the source of information on indirect tax payments by each sector, both at the border and on domestic production.

Demands and supplies respond endogenously, with varying degrees of elasticity, to the changes in relative prices amongst the commodities and between domestic and foreign supply. The elasticities chosen reflect experience gained across a range of developing economies with the use of similar models, as well as the specific structural characteristics of the particular sector. In the short run, for example, there is considerable inelasticity in the demand for bauxite, given that the decision to exploit veins has to be made far in advance of the actual mining activity. In contrast, tourists rarely plan tropical vacations more than six months ahead and will respond to the relative cost of competing destinations. The elasticities chosen reflect these structural characteristics.

BASELINE AND SIMULATIONS

The model and simulations are designed to estimate alternatives to the expected baseline outcome. The model itself does not embody a forecast of what growth and trade is likely to be over the next 25 years. Rather, it computes the expected deviation, due to the tariff reductions, of macroeconomic variables and sectoral outcomes from whatever path is going to unfold.

Several alternative scenarios are investigated. Two scenarios stimulate the economy with the tariff reductions programmed into the EPA liberalization schedule, differing only in their treatment of the effect on the fiscal accounts. One assumes that the government does not levy compensatory taxation and instead allows the fiscal deficit to rise. The other assumes that the deficit is unaffected as the government increases indirect tax rates to the level necessary to replace the foregone tariff revenue.

For the purpose of comparison, two other results are simulated. The first is the complete elimination of tariffs on EU imports, including the exempted, “sensitive” commodities. The second alternative is a hypothetical scenario of a unilateral 50 percent cut in import tariffs for worldwide imports.

GENERAL OUTCOMES

There is a great deal of variety in the economic structure, resource endowment, and trading relationships of the four economies studied. Whereas Guyana is heavily concentrated in agriculture and Trinidad in oil and natural gas, Jamaica and St. Lucia have larger service sectors. The European Union’s share of St. Lucian imports is more than four times Jamaica’s. At the same time that Trinidad & Tobago imports a negligible amount from the rest of CARICOM, nearly a third of Guyana’s imports originate in the region.

Notwithstanding that great variety of economic characteristics, however, the underlying structure of these economies means that the reciprocal trade opening component of the EPA will provoke little economic realignment in these countries. There are three reasons underlying this expectation.

Trade patterns are determined by a wide range of factors. Geographical proximity has traditionally been a powerful influence, a legacy of a time when the technology of globalization was less sophisticated and the cost of shipping was higher. A common language and cultural similarity also play a strong role. And a significant part of a country’s trade is always due to resource and factor endowments. All of those considerations are part of the explanation for the small share of Caribbean imports that originate in the European Union. St. Lucia, with the largest share, imports only a quarter of its total merchandise trade from the EU. For Guyana, the share is 10 percent, Trinidad & Tobago, 9, and Jamaica 6.

Europe's increased access to Caribbean markets may displace either local production or imports that previously originated elsewhere. To the extent that it displaces domestic production, such trade creation may confer an advantage to consumers and other producers, but it imposes a disruptive cost on the owner of factors that previously contributed to the local industry. If on the other hand, now cheaper imports from the EU only replace imports from some other source, this trade diversion imposes no cost whatsoever on the importing economy, while conferring a saving.

Production capabilities and comparative advantages in the EU are more similar to those in other industrial countries with which the Caribbean already conducts most of its trade, and quite dissimilar from those in the Caribbean. The U.S, for example, is already the largest trading partner for most Caribbean countries. In consideration of this, it is likely that any new trade with the EU will be diverted from other sources. The models results suggest that at least three-quarters of the new imports from the EU will be diverted from elsewhere, which is the estimate for Jamaica and St. Lucia. For Guyana, trade diversion will account for 92 percent of new imports and for Trinidad & Tobago, a staggering 96 percent.

The third factor that dampens the impact that increased EU access will have in the Caribbean is the structure of production in these economies. Tariff liberalization under the EPA applies only to commodities, and not even to all of them given the extensive list of exclusions. But the economies of the Caribbean are largely service economies. Guyana, with a dispersed population and widespread agricultural activity, has the smallest share of services, and even then it accounts for half of GDP. T&T, notwithstanding its massive oil and natural gas based industries, has a total service sector that is 60 percent of the economy. In Jamaica and St. Lucia, the service share is larger still at 82 and 88 percent respectively. Therefore, even if significant drops in goods-production were to occur in the wake of EPA, most of these economies would not feel any direct impact.

With the EU accounting for only a small share of merchandise imports, with most of any increase in that share being diverted from other sources, and with the merchandise portion of these economies a minority of total output, there is no path for EU access to have a significant disruptive effect on these economies. The model's results prove this reasoning. The price elasticities on EU imports are generous enough to produce significant increases in quantities of imports. The average 6 percentage point tariff reduction across all imported commodities into the four countries generates an increase in imports from the EU of 42 percent, reflecting a high price sensitivity.

That half-again growth of EU imports, because of both the small share of EU imports and because of trade diversion, has little impact on the Caribbean. The eventual increase in total merchandise imports in the four economies is only 1.5 percent. By the time account is taken of the share of imports in total domestic commodity supply (average, 40 percent) and the small commodity share in GDP

(average, 28 percent), the contraction of domestic economic activity is less than a tenth of the import increase.

A measure of the amount of economic dislocation can be gleaned by taking a weighted average of the percentage contraction only in the sectors that contract, weighting each sector by its share of GDP. This formula, designed to capture only the adjustment cost, deliberately ignores the sectors that may expand under EPA and thereby provide employment opportunities for the resources and labour discarded by the contracting sectors. The calculation reveals that in three of the four economies studied, both the contraction and the employment of labour amounts to only a tenth of a percent. In St. Lucia, however, as much as one percent of both GDP and the labour force will be affected.

The above results represent a worst-case scenario in two respects. By collapsing the liberalization schedule and conducting the simulation as if all the tariff reductions occurred at once, the analysis allows factors to become unemployed at once. If the process does indeed unfold over 25 years, then some unemployed labour may find new employment before other sectors experience their adjustment. In that event, there will no time when all one-tenth of a percent are unemployed at the same time.

The second way in which the analysis is a worst-case scenario is with respect to productivity growth. The above analysis presumes that neither the trade-induced, structural reconfiguration of the economy, nor the development assistance funds, generate productivity growth in these economies – an extremely pessimistic assumption. If there were a modest amount of productivity growth in key service sectors, even that negligible amount of dislocation would be mitigated and more than compensated by expansion in some sectors. Such an increase in productivity not only raises income directly, but more importantly, raises savings to finance additional investment. From the ensuing capacity expansion, further increases in income occur. This possibility would produce increases in steady state GDP in the range of 1.6 to 6.7 percent across these economies.

While the dislocation of domestic production may be negligible overall, there are two other reasons that policy-makers may be concerned about the impact of the EPA. By international standards, these are all small and therefore necessarily relatively open economies. Their share of trade in domestic activity is high. Consequently, they depend on border taxes more than larger economies would. Weak administrative capacity in tax-collection only increases that reliance as border taxes are easier to identify and collect. Governments are therefore rightly sensitive to the fiscal ramifications of new trade agreements, which tend to undermine an important revenue stream.

The estimated fiscal outcomes vary considerably across the region and expectedly correlate inversely with size of the economy. The loss of revenue is minimal in the larger economies of Jamaica and Trinidad & Tobago and equivalent to less than 0.2 percent of GDP in each case. For Guyana, the revenue foregone is a percent of

GDP while for St Lucia it is a massive 2.8 percent of GDP. While these are manageable levels for the three bigger countries, recovering from and compensating for this revenue loss will be a challenge for the government of St Lucia as it unfolds.

Note that the data presented represents not the direct loss of import tariffs from the EPA liberalization schedule, but rather incorporates changes in the quantities of imports across the spectrum, the changes in domestic activity and the level of taxation derived from those changes. Thus, we report on how total indirect revenue would change, and on the final impact upon the budget.

While it is comforting to conclude that the displacement of domestic production will be negligible in all of these economies from a macroeconomic perspective, that conclusion, however valid, does not rule out sectoral impacts that may be severe in their geographical locales. In order to answer that question, we now turn to analysis of each case.

JAMAICA

Jamaica's trade outcomes have been determined less by a vision of the role of trade in development and more as a by-product of domestic policy and, as everywhere, by history and geography. The pattern of trade reflects somewhat the legacy of historical economic ties to Great Britain – and through there to Europe. Largely, however, the trade pattern is governed by the proximity and purchasing power of the United States and Canada along with both the historical links and the proximity to the rest of the Caribbean.

TRADE CHARACTERISTICS

Trade Profile and Structure

Like all small economies, Jamaica is highly dependent on trade, which represents half of domestic economic activity. Reflecting its increasing integration with the world economy, the share of the country's imports consisting of consumer goods has doubled to around one-third over the last 25 years. Intermediate goods are about half of the total.

As is the case with many of the countries in the English-speaking Caribbean, economic geography dictates that the United States is the largest trading partner for Jamaica, providing 37 percent of imports and absorbing 27 percent of exports in 2006. With tourism providing a large share of overseas earnings, that 27 percent does not fully reflect the importance of the United States on the earnings side of the current account balance. CARICOM is a significant source of imports, at 15 percent of the total, but a negligible destination for exports at 2 percent.

The European Union, too, is important on only one side of ledger. While the EU's share of exports is significant at 16 percent, the EU provides only around 6 percent

of imports. The export share shows marginal growth over the long term. In the early 1980s, the EU import share averaged 13 percent, while over the last five years, the average has been 19 percent. By contrast, the import share, which had swollen a decade ago to twice what it is today, seems to be on a downward trajectory.

The relatively high European Union export share is explained entirely by bauxite/alumina, which constitutes almost 70 percent of the EU-bound traffic. Bauxite, like many extractive industries, exists in only a handful of countries in the world. European demand therefore, would account for a significant share of Jamaican exports.

From the European Union, Jamaica imports mostly vehicles, machinery and equipment, and pharmaceuticals, all of which account for half of the commodity flow south. The significance of this list is that none of those commodities are produced in Jamaica in significant quantities if at all. They are, however, produced in almost every OECD economy, which suggests that relative prices may be significant in determining the source of imports, but not whether they are imported or not. Tariff reductions by Jamaica in respect of EU products under the EPA are therefore likely to lead to diversion from some sources of imports to others instead of replacing local production. For all other commodities, the EU share is only marginal.

The scope for either export or import growth with respect to the European Union seems therefore to be limited. Outside of bauxite, the export of which was not constrained by tariffs before the advent of the EPA, there are few exports to the EU. On the import side, the relatively low level of existing tariffs and the absence of domestic production in the largest import categories suggest that not much domestic production will be displaced by a cheaper import price.

Trade Commitments

Jamaica's institutionalized trading relationships are many and varied. On its own and through its CARICOM membership, Jamaica has participated in a number of multilateral trade fora such as the World Trade Organisation (WTO), the Free Trade Areas of the Americas (FTAA), the Caribbean Single Market and Economy (CSME), and the African Caribbean Pacific/European Union (ACP-EU), among others. At the same time, Jamaica has signed a number of bilateral trade deals.

Jamaica is an original member of the WTO and has honoured its WTO obligations. During the Uruguay Round in 1994 that founded the WTO, Jamaica bounded its entire tariff structure for goods. Since then, it has dutifully applied Most Favoured Nation (MFN) treatment to all its trading partners. Under the General Agreement on Trade in Services (GATS), commitments were made in the areas of tourism, business, educational services, health, recreational, transport, and financial services. Though the country has not ratified the Fifth Protocol of the GATS on financial services, Jamaica has participated in the extended negotiations on basic telecommunications and financial services.

Jamaica is one of the most active developing-country members of the WTO, recognised for its high levels of participation in multilateral negotiations. In the WTO, Jamaica has strongly advocated for special and differential treatment for developing countries, which it sees as fundamental to its negotiating interest at the multilateral level. The agricultural sector is the single largest employer and the third largest earner of foreign exchange, so Jamaica has taken strong positions on agricultural issues. In conjunction with its other CARICOM Partners, Jamaica has made proposals relating to tariff reductions, such as exemptions from the reduction of tariffs on a percentage of commodities from small developing countries and also the maintenance and expansion of preferences.

Jamaica is active in a number of regional trade agreements¹¹ allowed under Article XXIV of the GATT. Jamaica is one of the founding and leading members of CARICOM and a member of the Caribbean Single Market and Economy (CSME). Much of Jamaica's trade policy is formulated and implemented within the context of CARICOM, being that the country is one of its most active members. Within this framework, preferential trade agreements have been concluded with a number of states. Bilateral agreements have been signed with Venezuela, the Dominican Republic, Colombia, Cuba, Costa Rica, Canada, the USA and the EU.

From the number of bilateral agreements and the size of the markets to which Jamaica has preferential market access, it may be concluded that market access is not a binding constraint on Jamaica's development. Jamaica has not been able to take full advantage of the market opportunities that it already has. It is in this context that the cooperation and technical assistance to identify and break supply constraints that is a central part of the EPA may turn out to be even more important than access to the EU market.

Tariff Levels and Trade Restrictions

The gradual reduction of tariffs on Jamaica's imports from the European Union obligated by the EPA is to be understood as part of the trade liberalization process that has been underway in Jamaica for some time. By 1990, Jamaica had already completed the removal of almost all of its quantitative restrictions on imports and had come to rely entirely on (relatively high) ad valorem tariffs for its industrial policy. The process of trade liberalization gained impetus in the early 1990s when the PNP (People's National Party) administration returned to power. In that first phase, the tariff structure was simplified as well as lowered. Simplification was effected by a reduction in the number and dispersion of rates. Between 1990 and 1993, both the average rate and the standard deviation in the tariff table fell by a third.

¹¹ A regional trade area is broadly defined as a group of countries that adopt zero or significantly low tariffs and no other restrictions on trade, among themselves, while not necessarily changing the barriers that each member country has on trade with the countries outside the group.

The second phase, covering the remainder of the decade, was conducted under the auspices of Jamaica's faithful and early implementation of CARICOM's Common External Tariff (CET). With an already simplified tariff structure, this period was characterized largely by further tariff reductions, the weighted average import tariff falling from 20 percent in 1993 to 15.5 in 1999. At same time, there was complete elimination of the tariff on certain raw materials and capital goods. An examination of the top 30 commodities imported by Jamaica during that period from its CARICOM partners, showed that the average CET rate had fallen from 15% in 1993 to 11% in 1998.¹² Since 2000, import and stamp duties have continued on their downward trajectory, albeit at a much reduced rate. By 2007, the average import tariff had fallen by another percentage point and a half to 14.

In order to increase confidence and predictability of its trade regime, Jamaica has bound all of its tariff lines -- which is a commitment to not raise tariffs above the levels that obtained at the completion of the Uruguay Round in 1994. Tariff rates in Jamaica can and have varied in both directions below that bound rate.

Duties on agricultural products, which range up to 100 percent, tend to be higher than those on non-agricultural commodities, which are rarely more than 40 percent. For some products, other duties and charges are generally bound at 15%; in the case of agricultural products, they are bound at higher levels. Custom user-fees and, in some cases, stamp duty are also applied to imports. An additional stamp duty is levied on the customs value plus tariffs in a compound manner. In the case of vegetables, there is a 100% tariff plus an additional stamp duty of 80%; at the end of the process, the aggregate import duty could be as high as 260%. Almost all imports from CARICOM members enter Jamaica duty-free.

Jamaica makes limited use of import licensing in order to regulate the inflow of products that will have an impact on the environment, health and safety. No charges apply to exports and export prohibitions are applied to only a few products such as spirits and wines. Jamaica uses a plethora of disguised export subsidies, mostly in the form of tax relief on profits or gains, import duties, excise duties and GCT for export and related industries. Explicit export subsidies are applied in only four instances – the Foreign Sales Corporation (FSC), Export Free Zones (EFZ), Export Industry Encouragement (EIE) and the Simulation Results

In the Jamaican case, we find that the hypothesis of considerable or even noticeable damage to the economy is rejected, while the concern in relation to revenue-loss is warranted, though the problem is manageable. The overall picture which emerges is of an agreement whose trade element will not require significant restructuring of the Jamaican economy, while the fiscal adjustment will, at worst, be small.

¹² Bank of Jamaica Pamphlet, 2003.

Tariff Changes under the EPA

At a glance, the tariff reductions obligated by the EPA seem large. Tariffs on imports into Jamaica from the European Union will be cut, on average by, two-thirds. However, closer scrutiny reveals enough qualifications and obstacles considerably diminish the expected impact of those tariff reductions. A large number of commodities from the European Union are already admissible into Jamaica with a low or zero tariff, including grains, cereals, seeds, a variety of chemicals, animal skins, paper, some fabric, pre-fabricated iron and steel, and manufacturing machinery and equipment. Many of these no- or low-tariff items already encompass the commodity groups that are likely to have significant trade potential. Similarly, some of the commodities to which new tariff reductions apply, such as fur-skins, have no significant trade potential (though Jamaican bobsledders and dog-mushers may be grateful).

Another reason why EU-Jamaica trade liberalization will have limited impact is the 25-year length of the implementation timetable. Such a long period of implementation distributes the impact over a sufficiently long time that each year's adjustment is necessarily small. Moreover, the global trading environment is changing with sufficient rapidity that one or two decades hence, many of the commodities in the schedule will become irrelevant before they are liberalized.

A further contributing factor limiting the impact of the trade liberalization is the small amount of EU imports into Jamaica. While some 23 percent of the island's share of total imports originates in the European Union, if we omit services and consider only goods, to which the tariff liberalization largely applies, the EU share drops to only six percent. And the small size of this activity is not largely due to prohibitive tariffs. Rather, it reflects a combination of the many factors that determine trade patterns, such as proximity, language, and historical ties. Few of these other determinants can be influenced by the EPA.

Within this limited context, the more significant tariff reductions amongst the slate of goods affected apply to a range of agricultural and manufactured products. In agriculture, non-negligible tariff reductions apply to a variety of vegetables and nuts, for which the average tariff has fallen from 19 percent to eight – an eleven percentage point difference, which roughly approximates the proportional effect it will have on the import price. Prepared and preserved food along with other food items will experience a 7 percentage point reduction. The tariff on garments and textiles, which currently averages 7.5 percent, will be eliminated altogether. And the tariff reduction on a limited range of manufactured items including, jewellery, handbags, lighting, and sporting equipment falls from an average of just over 10 percent to near zero. We examine the effects of these tariff reductions first on trade flows and then on the rest of the economy and the fiscal accounts.

SIMULATION RESULTS

After the completion of the drawn-out schedule of tariff reductions, commodity imports from the European Union rise by just over a quarter – an impressive

response. But this will likely have little effect on the Jamaican economy, due to the small share of EU imports in total domestic supply, the diversion of trade from other import sources, and the small share that the affected sectors occupy in the Jamaican economy.

The tariff reductions that result in an average price cut of 5.2 percent on EU imports stimulate growth of almost 28 percent in imports from the EU. This effect is concentrated heavily in only a handful of sectors, namely non-traditional crops, meats and poultry, food products, textiles and apparel, and manufactures with wood.

However, with the EU accountable for only a six percent share of Jamaica’s commodity import bill, the potential increase in total imports would only be a small fraction of that, less than two percent. But even that will contain a share of trade diverted from other sources. It turns out that more than three-quarters of the increase in merchandise imports from the EU is due to trade diversion. So ultimately, the increase in total commodity imports as a result of the EPA is less than half a percent. With imports being less than a half of domestic production, the potential negative impact on domestic producers becomes negligible.

A remaining, and potentially important, question is the extent to which that negligible impact is sufficiently concentrated to necessitate a substantial adjustment for particular local industries. That, however, turns out not to be the case (*Table 1*). Agriculture is one sector to have the potential to suffer in that way. The 10 percentage point tariff reduction on agricultural produce leads to a 156 percent increase in imports from the EU, but that is on a small base. Only 5 percent of Jamaica’s agricultural imports originate in the EU so that quantity increase is only 8 percent of Jamaica’s imports of produce. Further, only half of that is trade creation and therefore potentially harmful to the domestic producers being replaced. With only a small share, 15 percent, of the supply of agricultural produce imported, not even the 4 percent growth in imports can have noticeable effect on local farmers.

Table 1: Simulation Results, Trade and Gross Output, Jamaica

	Change in...		
	Tariff Rates (% pts.)	Total Imports (%)	Gross Output (%)
Trad. Agriculture	0.0	-0.1	0.2
Other Crops	-10.7	3.7	-0.4
Animal Farming	-9.0	-0.3	0.0
Forestry	-1.2	-0.4	0.0
Fishing	-12.0	-0.3	0.2
Mining	-2.3	0.0	0.1
Other Food	-6.8	0.8	-0.1
Sugar Proc	-0.9	-0.3	1.0
Bev. & Tobac.	-0.6	-0.1	0.1
Garments	-6.7	0.0	0.0
Paper & Print	-2.8	0.0	0.0
Petrol Prod.	-5.4	0.1	0.1
Chem Prod.	-1.8	-0.3	0.2
Non-metal	-8.6	0.3	-0.2
Metal Prod.	-3.6	0.7	-1.2
Wood Prod.	-10.6	0.5	-0.5

Processed food products is another sector potentially at risk because of a large tariff reduction, almost 9 percentage points. The simulation suggests that the tariff reduction yields a 20 percent increase in imports from the EU. But the EU share is currently only two percent and the majority of the increase on that small base is trade diverted from other sources. In the end, the impact on the sub-sector is a contraction of a tenth of a percent.

The sector with the largest impact is manufactured metal products, such as appliances, tools, and motors. The simulation suggests that the sector could contract by 1.2 percent – hardly, a crisis, even for those in the industry. (See Table 2 for structural results.)

The employment impact of the EPA-induced adjustment is equally small and proportionate to the change in gross output. Only just over half a percent of the labour force would be dislocated, with the largest economic movement of persons being associated with the one percent contraction in metal products.

Table 2: Simulation Results, GDP and Employment, Jamaica

	Share of GDP	% Change in GDP	% Chng in Employment
Agriculture	6	-0.2	-0.2
Extraction	4	0.1	0.2
Food Processing	5	0.0	0.0
Manufacturing	4	-0.2	-0.2
Tourism	5	0.2	0.2
Finance	18	0.1	0.1
Utilities & Pub. Svcs	21	0.0	0.0
Other Services	38	0.0	0.0

Merchandise exports (not just those to the European Union) are estimated to increase by less than half a percent, or roughly J\$700 million. If there are export opportunities to be exploited under EPA, they will lie mostly in services.

The likelihood, therefore that the EPA’s tariff liberalization will have a strong trade effect and require substantial adjustment to the structure of the Jamaican economy is low. This is to be expected with the small actual and potential share of EU trade with Jamaica and the small ratio of imports to domestic production in the most-affected sectors. The protracted liberalization timetable makes the adjustment required all the less important.

In Jamaica, border taxes have consistently amounted to more than a quarter of total revenue and around 16 percent of GDP. The net loss of indirect tax revenue from the liberalization of trade with the European Union is estimated to be around one percent of the country’s indirect tax revenue earnings, or J\$1b in 2005 dollars. Such a loss potentially adds 0.2 percent of GDP to the fiscal deficit. Jamaica currently has the largest fiscal gap in the region and has been teetering on the precipice of fiscal unsustainability for some time now. In that context, any revenue loss is problematic. However, given the 25-year time horizon of the liberalization schedule, with good fiscal management, this level of replacement is manageable.

To the extent that integration and development assistance raise total factor productivity, Jamaica could experience a steady-state income increase of 3.2 percent.

In Jamaica's case, such a productivity increase eventually raises the level of GDP by 2.7 percent. This is an obviously positive outcome and will be a boon to the industries where the productivity increase is concentrated. From a macroeconomic viewpoint, however, it will not be transformative.

We are unsurprised to find that the impact of the EPA on the Jamaican economy is small. Much of the challenge to the EPA in the public discourse was based on the enormity of the EU economy compared to the relatively miniscule size of the economies in the Caribbean. As it turns out, the space for EU trade in the Jamaican economy is itself miniscule. Trade in services, not directly affected by the tariff-reduction on goods, accounts for the vast majority of the trade with Jamaica. That, and the combination of trade diversion and non-price factors, accounts for the limited existing and potential level of trade with Jamaica. With such a small impact from the trade in goods, the ultimate effect on domestic industries turned out to be tiny. The fiscal impact is of greater consequence in the context of Jamaica's already high fiscal deficit and high tax rates, but manageable nonetheless. In exchange for the revenue loss, the EPA will likely generate productivity increases which will promote a certain amount of economic growth. Ultimately, the economy and the standard-of-living will rise by a few percentage points.

ST. LUCIA

St. Lucia is one of the smallest islands in the CARIFORUM Grouping. Historically, and like much of the Caribbean, St. Lucia's trade policy has been framed within the context of colonial relations with Great Britain which resulted in economic production patterns being geared towards the export of a few primary products. The combination of the colonial legacy and small size, and with the considerable incentive of preferential market access to the U.K. primarily, St. Lucia developed a narrow economic base based the export of primary commodities. As an independent nation, its main preoccupation has been overcoming the challenges associated with being a small island state. Its solution has been to devolve sovereignty to regional groupings, such as CARICOM, the CRNM, the Organisation of Eastern Caribbean States (OECS), and the Eastern Caribbean Central Bank (ECCB).

CHARACTERISTICS OF TRADE

Trade Profile and Structure

St. Lucia, smaller than Jamaica in both population and physical size, is correspondingly more open than Jamaica. The ratio of imports to GDP in St. Lucia is around 70 percent. St. Lucia's trade imports consist of almost the full range of

manufactured consumption goods, financed by tourism receipts and foreign direct investment. As tourism has grown, so has imports and therefore the country's merchandise trade deficit (Figure 1). Over the last two decades, earnings from services has doubled to more than US\$300m. financing imports of almost US\$550m. The remainder of the financing for the import bill is derived from foreign direct investment which has averaged US\$150m. over the last five years.

In the presence of tourism and strong FDI, there has not been much of a role for merchandise exports. Though exports are now twice as high as they were at their trough in 2001, they remain lower than the levels attained two decades ago.

Re-exported petroleum products constitute nearly a third of total exports, with much of the remainder of the highly concentrated exports being accounted for by Bananas. St. Lucia also exports a range of light manufactured items. Almost all of the re-exported petroleum products and manufactured goods are destined for other CARICOM members. Bananas, in contrast, almost all go to the European Union.

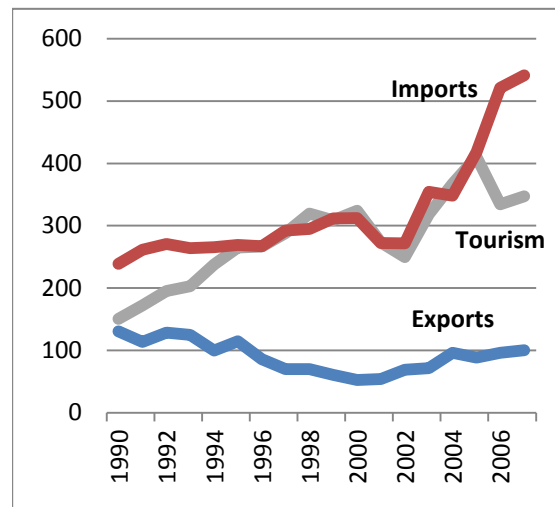
There is therefore considerable concentration of exports both across commodities and trading partners. St. Lucia has been unable to penetrate outside of CARICOM with manufactured exports and Europe with other than traditional Bananas. This would seem to suggest that considerable obstacles lie between the present structure of the economy and one that will be able to take advantage of opportunities afforded by the EPA.

On the import side, the largest component is the crude oil that is largely re-exported. Other than that, imports cover the full range of capital and manufactured consumer goods. The largest category, as it is in most of the small islands of the eastern Caribbean, is motor vehicles. Only 13 percent of these imports now originate in the European Union. This would suggest that there is considerable potential for trade diversion – for imports that are now sourced from outside the EU to shift towards that block, with correspondingly very little opportunity for trade creation – where imports from the EU will replace domestic production.

Trade Commitments

St. Lucia has undertaken a number of institutional arrangements at the sub-regional, regional and international level to leverage its unenviable position as a

Figure 1: St. Lucia Trade



small player in large global market. Through institutions such as the OECS and CARICOM, St. Lucia has participated in a number of multilateral and bilateral negotiated agreements such as the World Trade Organisation (WTO), the Free Trade Area of the Americas (FTAA), the Caribbean Single Market and Economy (CSME), the African, Caribbean / Pacific and European Union (ACP/EU), among others. In the same context, St. Lucia has also signed a number of bilateral trade arrangements.

St. Lucia is an original member of the WTO and has consistently honoured its WTO obligations in spite of the resource constraints it faces as a small-island developing state. Limited financial and human resources has prevented St. Lucia from establishing an institutional presence in Geneva for WTO negotiations. However, evidence of its fidelity to the principles and rules of the WTO can be found in the country's tariff binding coverage which stands at 99.6% of the entire tariff structure. St. Lucia did not participate in the extended negotiations on telecommunications and financial services, but made commitments under the General Agreements on Trade in Services (GATS), which covered the areas of tourism, recreational, financial and maritime transport services.

St. Lucia has been an active promoter of the special and differential treatment principle for vulnerable countries, in regional, multilateral and hemispheric negotiations. Undertaking commitments at these levels requires all parties to accept the same levels of obligations and commitments regardless of the levels of participation and factor endowments. St. Lucia argues that small, vulnerable economies should be allowed longer phase in periods for compliance with regulations as well complete exemption from certain obligations. They should also be granted lower levels of commitments and easier market access. St. Lucia has joined the other CARICOM members in pushing for flexibility in negotiations and the recognition of the consequences of preference erosion, extension of period for providing subsidies until 2018, and the recognition of the principle of non-reciprocity in the Non-Agricultural Market Access (NAMA).

St. Lucia uses a multi-layered approach to negotiations in order to overcome the challenges of small size and limited resources. There are some activities can be better handled at the regional level than at the national level. At the sub-regional level, the country is a member of the OECS Free Trade Area and the Eastern Caribbean Common Market (ECCM). At the regional level, St. Lucia is a founding member of CARICOM and a member of the CARICOM Single Market and Economy. Because of its small size, St. Lucia is designated as a Less Developed Country (LDC) within CARICOM, despite having a higher per capita than Jamaica. It is within this framework that St. Lucia has articulated its Trade Policy, which has resulted in the conclusion of a number preferential trade agreements. Bilateral agreements have been signed with Venezuela, the Dominican Republic, Colombia, Cuba, Costa Rica, Canada, the USA and the EU.

The number of bilateral trade agreements, aggregating those negotiated by St Lucia itself and those that derive from its membership in CARICOM, is large. Further,

being a member of the OECS, St. Lucia enjoys non-reciprocal status in almost all agreements with preferential provisions. Market access is therefore not a binding constraint on St. Lucia in the pursuit of its development objectives. St. Lucia has not been able to take advantage of the opportunities that were created under these agreements. The main challenges are small size, reliance on agriculture and mono-crop production, small population, limited human and financial capacity.

The economy faces structural constraints which limit the benefits from economies of scale which is necessary for states to be competitive at the international level in the production of goods and services. A central part of the EPA is to provide the technical assistance and cooperation that will enhance St. Lucia's capacity to export by going beyond the narrow focus of market access issues. It will assist St. Lucia to identify and break some of the supply side constraints by promoting measures for facilitating market access penetration when exporting to the EU market and by extension, to other trading partners.

Tariff Levels and Trade Restrictions

Within the context of the Latin American and the Caribbean. St. Lucia uses the harmonised tariff schedule of the ECCM. There were 14 tariff rates with a range of 0% to 70%, and average tariff rates and dispersion rates were lower than those for the non-ECCM, CARICOM states. Compared to the larger and more diversified economies of the region, therefore, St. Lucia has pursued a more open trade stance than would follow merely from its small size.

St Lucia's relatively liberal regime has been executed through its membership in the OECS, ECCM, and CARICOM. In the early 1980's little was done by way of trade reforms as it relates to tariff levels. Some reform measures were implemented during this period, such as the abolishing of stamp duties in 1988. St. Lucia's tariff structure, previously governed by its ECCM membership, changed when St. Lucia implemented the rate structure of the CET in 1993. The CARICOM Treaty made provisions for the imposition of a CET by its members on all commodities imported from non-CARICOM countries.¹³ With the CET, St. Lucia's maximum tariff rate fell from 45 to 20 percent in decrements throughout the decade of the 1990s (Table 3). The weighted average tariff rates of the ECCM was 16.5 percent and 15.8 percent under the CET, while the unweighted averages were 15.7 and 7.8 percent respectively.¹⁴ Table 3 shows the time periods and rate structure.

In the first phase of the implementation, the tariff structure was simplified with the new structure having fewer rates. The ECCM had 14 tariff lines while the CET had only 11 tariff lines.

¹³ The CET applied by the OECS was different from the MDC's, Belize and Montserrat as four different tariff schedules covered CARICOM member's external trade with third countries.

¹⁴ Trade Prices in St. Lucia

St. Lucia has limited flexibility in setting its tariff rates as they can only be adjusted within the framework of CARICOM. Tariff rates under the CET are in the range of 15% to 30%; capital competing goods were subjected to Tariff of 15%, competing intermediate inputs to 20% and non-competing final goods, general manufactured goods, agro-industry products and garments attracted customs duties of 25-30%. This framework has increased this consistency of rates and the classification of goods imported into the region. Derogations from the CET are allowed only in the exceptions to the CET List.¹⁵

Table 3: CET Implementation, St. Lucia

Period of Application	Implementation Period	Rate Structure
1.1.93 – 31.12.94	1.1.93 – 1.7.93	0/5% – 30/35%
1.1.95 – 31.12.96	1.1.95 – 1.7.95	0/5% – 25/30%
1.1.97 – 31.12.97	1.1.97 – 1.7.97	0/5% – 20/25%
1.1.98 onwards	1.1.98 – 1.7.98	0/5% – 20%

ST. Lucia is an original member of the WTO and also a founding member of CARICOM, that has faithfully carried out its obligations under both treaties. These include the granting MFN treatment to all its trading partners and the binding of substantially all its tariff lines. St. Lucia has tariff binding coverage in excess of 99 percent. Like most CARICOM countries, it made its task of adhering to its bound rates rather easier by binding its MFN tariffs at levels much higher than the then applied rates during the Uruguay Round, and the gap has only widened with liberalization. The simple average of bound import duties on all goods stands 61.9 percent while the average of its applied rates is now 8.9 percent.

In conjunction with the CET, St. Lucia also applies Para-Tariffs on imports.¹⁶ The application of these tariffs are not harmonised across CARICOM members nor regulated at the regional level. There is a Custom Service Charge of 5 percent on the c.i.f. value of most imports, with some specific exceptions. There are other trade-related taxes such as a service charge on imports. And there is an environmental levy at a general rate of 1.5 percent of the c.i.f. value of articles of plastics, glass, metals, etc., and one percent on all other items except foodstuffs, clothes, pharmaceuticals and footwear.

St. Lucia has made only limited use of import restrictions in the context of regulating and monitoring the inflow of goods and services that will impact on national security, public health, public safety, animal health and moral issues.

¹⁵ Exceptions are in Lists A, B, C and D, in which the rates applied by each individual country are stated. The tariffs applied by CARICOM members under list A and C allows for greater flexibility. List A covers foodstuffs, where the average tariffs applied are usually lower than the CET rates, the items in List C covers spirits, beer, tobacco, firearms, motor vehicles, some electrical appliances, and jewellery and precious stones are generally higher than the CET rates

¹⁶ They are measures applied on imports similar to tariff measures and are often used to protect the domestic industry of the member state from foreign competition.

There are no taxes and levies on exports and all exports are exempt from internal taxes. Export prohibitions are placed on some certain seafood such as lobster, conch and sea eggs during the closed seasons. In 2004, St. Lucia advised the WTO that it did not provide export subsidies; they did not consider the programmes of incentives under the Customs Act No. 23 of 1990 such as the Free Zone Act, the Micro and Small Business Enterprise Act and the Fiscal Incentives Act as constituting subsidies. These programmes were subsequently found to be not WTO-compatible. St. Lucia, along with the other OECS countries, were granted an extension to 2015, to take steps to eliminate those incentives classified as export subsidies.

The EPA Tariff Changes

Under the EPA, St. Lucia will undertake further reductions in tariff levels on a gradual basis for goods from the European Union. The unweighted average of the tariffs on all goods in the Tariff code is 9 percent if imported from the EU. By the completion of the adjustment process in 2033, the average tariff will be 2 percent. Using the smaller set of commodities that have a non-zero tariff to begin with, the corresponding average falls from the current level of nearly 15 percent to 3 percent in 2033.

The most significant area of tariff reduction is for textiles, apparel, and footwear. This is the commodity group that is most likely to pose a competitive challenge to domestic production in St. Lucia. Tariff rates of 25 and 30 percent are being eliminated on almost all categories of clothing and footwear. The category includes a large range of commodities that already enter at low or no duties, such as textiles and fabrics. With all commodities included, the average tariff reduction in this commodity is ten percentage points.

Tariffs are being eliminated on fresh fruit not produced in St. Lucia. Tariffs, currently 40 percent, are being eliminated on fruit such as strawberries, cranberries and kiwifruit. Much of this category, including bananas, plantains, and pineapples, have been excluded from tariff reductions by the St. Lucian government. Taken together, the average tariff on fresh fruit, including the unchanged tariff on the excluded product, will fall by 13 percentage points.

There is a deceptively high degree of tariff reduction in the seafood category in the tariff liberalization schedule. Tariffs, currently at 40 percent, are slated to be eliminated on a range of seafood items, including lobster and shrimp. The St. Lucian government, however, has eliminated from liberalization all frozen product, allowing the tariff-free importation of fresh product, which will pose a challenge for a trans-Atlantic crossing. So the average tariff reduction of 15.6 percent for this category greatly exaggerates the impact that tariff reductions will have on the domestic fishing industry.

Significant tariff reductions are slated for a range of consumer items that pose no competitive threat to the St. Lucian economy. Leguminous vegetables, nuts, jewellery and precious stones, kitchen appliances, motor vehicles and engine parts,

and miscellaneous manufactures such as watches are all in the schedule for tariff elimination.

The exclusion provision has been utilized to remove almost competitive threats to the local economy. Of more than 5,000 items in the tariff code, more than 400 have been excluded from tariff reductions. The exclusions, as one would expect, fall precisely in the areas in which local producers would expect the strongest challenge from European product. In the processed food sector, almost half the commodities have been excluded from tariff reductions. And for beverages and tobacco products, almost the entire category has been excluded, some 80 percent of the tariff lines. Looking at tariff reductions in terms of averages, therefore, will almost certainly over-estimate the impact on the St. Lucian economy.

The tariff reductions with respect to goods from the European Union entering St. Lucia can therefore be made to seem significant in terms of the number of items affected and the size of the tariff reductions. But they have been designed to have minimum impact on the economy through the use of exclusions and the extended time frame for adjustment.

SIMULATION RESULTS

St. Lucia is the most service-dominated economy in the group with 88 percent of its economy so devoted. This fact underlies the paradoxical result that St. Lucia experiences the most dramatic structural shifts of the countries studied, yet sees little overall economic impact because of the small share of the economy affected. EPA, our model implies, will likely motivate a structural shift away from the shallow and small manufacturing sector towards the country's obvious comparative advantage in tourism. This is not surprising, since any expansion of a trading space is expected to promote specialization and concentration. Since concentration increases the vulnerability of the economy in its exposure to the vicissitudes of a single, fragile industry, some mitigating action may be called for.

Overall, St. Lucia exhibits the most significant structural impact of the EPA amongst the four economies studied. One percent of its GDP contracts and 1.2 percent of its labour force will have to shift jobs during the period of structural adjustment. While this level of adjustment is some ten times larger than the negligible levels that obtained in other economies, it is still small by historical standards.

As a consequent of an average tariff reduction of 6.9 percent, imports from the EU increase by a large 77 percent. This is at least potentially impactful, as the former French colony already sources fully a quarter of its imports from Europe; thus, overall imports

Table 4: Simulation Results, Trade and Gross Output, St. Lucia

	Change in...		
	Tariff Rates (% pts.)	Total Imports (%)	Gross Output (%)
Non-trad. Agri.	-9.7	11.4	-1.0
Non-crop Agri.	-8.1	188.2	-5.2
Petrol	-5.8	10.4	
Manufacturing	-6.9	7.2	-4.9

could grow by as much as 20 percent (Table 4). The reasons for the modesty of the dislocation are, as in Jamaica, that three-quarters of the resultant imports are diverted from other import sources and the small share, at 12 percent, while commodities represent a small share of St. Lucia’s overwhelmingly service economy.

But within that modest macroeconomic impact, the small manufacturing sector is the hardest hit of any sector in any of the economies in this study (Table 5). St. Lucian manufacturing could contract by as much as seven percent as the EPA unfolds. The shrinkage is motivated by a seven percentage point tariff-reduction on EU manufactures, which are likely to incentivise a tripling of manufactured imports from that region. Further, imports make up a large share, 60 percent, of the total domestic supply of manufactured goods. However, with the EU providing only a small share of manufactured imports into the island and with a portion of that representing imports diverted from some other international source, the net increase in imports ends up at seven percent. The employment impact mirrors the structural one, with manufacturing employment also likely to fall by seven percent.

Table 5: Simulation Results, GDP and Employment, St. Lucia

	Share of GDP	% Change in GDP	% Chng in Employment
Agriculture	6	-0.4	2.0
Mining	0	-3.3	-5.2
Manufacturing	6	-6.8	-6.9
Tourism	11	7.1	6.8
Finance	24	-0.5	-0.3
Utilities, Pub. Svcs	20	-0.2	-0.2
Other Services	32	-0.5	-1.6

The resources that shift out of manufacturing, and to a much lesser extent out of agriculture as well, are likely to move into the tourism sector, which it is estimated should grow by seven percent. Since the hotel sector comprises more than a tenth of the St. Lucian economy, this is a significant expansion.

Even in the absence of productivity growth, the shift of resources out of manufacturing and into tourism will raise average productivity, pushing GDP up by 2.6 percent. With the most significant adjustment, St. Lucia correspondingly gains the most income growth in the long run. With productivity growth, the increase in steady-state income could be as high as 6.7 percent, again the highest of the group.

With or without productivity growth, the expansion of trade opportunities provided by the EPA will motivate a structural shift out of goods towards a greater concentration of the economy in services, particularly tourism, with its attendant volatility and risks.

With St. Lucia’s smaller economy and therefore bigger trade ratios, it would be expected that the relative fiscal impact of the EPA would be greater than in the cases of its larger Caribbean counterparts. The implementation of the full tariff

reductions with respect to imports of goods from the European Union can be expected to be accompanied by a loss of 13 percent of its current indirect tax revenue – approximately EC\$58m. This is a massive fiscal loss by an measure – equivalent to 3 percent of GDP, and more than twice the relative loss estimated in any of the three other cases.

St. Lucia starts this adjustment with the advantage of a relatively modest fiscal gap in the Caribbean context, and some of the revenue impact will eventually be mitigated by the expected productivity growth. It will nonetheless present an enormous challenge to the government to manage the transition period between implementation and any subsequent productivity growth.

The relatively large EPA impact on St. Lucia seems to be conditioned by two structural factors. The greater openness of the economy that follows from its relatively small size implies that any trade induced adjustment will have a larger proportional impact on the economy. This is reflected in the structural adjustment that is induced by the EPA along with the relatively and absolutely large fiscal fallout. At the same time, the structure of the St. Lucian economy with its tiny goods-producing share mitigates the overall dislocation of the European imports, all while providing a larger space for productivity improvements in services to impact the economy.

The fiscal impact and relatively larger sectoral shifts suggest that fiscal and economic management will be more challenging in the case of St. Lucia. The payoff is that the upside potential is greater for St. Lucia if the government and the private sector work to exploit the opportunities in services.

TRINIDAD & TOBAGO

CHARACTERISTICS OF TRADE

Trade Profile and Structure

Unlike the structure of any other English-speaking CARICOM country, the natural gas, petroleum and petrochemical sector, the latter producing chemicals using oil and natural gas dominates the economy of Trinidad & Tobago like no other sector dominates any other economy in the region. Activities directly associated with the extraction and refining of petroleum and related chemical manufacturing constitutes 30 percent of GDP. Extraction of crude alone is a fifth of the economy.

This dominance is reflected, even more persuasively, in the structure of trade. Importation of mineral fuels for these sectors accounts for one-third of all merchandise imports. Like much of the rest of the Caribbean – small economies that lack a heavy industry sector, T&T devotes a sizable share of import bill to machinery and equipment – 13 percent in the case of T&T.

Exports even more reflect the dominance of petroleum and gas. Total exports of mineral fuels make up no less than two-thirds of merchandise exports. Trinidad & Tobago is now the largest of supplier of liquefied natural gas (LNG) to the United States. Petrochemicals account for another tenth of exports. Together with the exports of organic chemicals, the petroleum, gas, and chemical industries account for 82 percent of merchandise exports.

This degree of dominance by one set of related activities results in an economy which is highly vulnerable in respect of global developments, especially as it affects the world oil market. T&T's history of volatile macroeconomic fluctuations is testimony that vulnerability, notwithstanding recent efforts to diversify the economy. At the same time, the dominance of those activities underlies a clear distinction between the production structures of Trinidad & Tobago and the economies of the European Union which suggests that there will be little opportunity for disruptive trade creation between the two.

This expectation is strengthened by an examination of Trinidad & Tobago's trading patterns. Over the last decade, T&T has taken full advantage of the export opportunities provided by CARICOM, almost tripling its exports to the region, such that CARICOM now accounts for more than a fifth of its total exports. More than half of T&T's exports are destined for the United States. In sharp contrast, the European Union accounts for just only 11 percent of exports.

On the import side, only a tiny three percent of imports originate within CARICOM. As is the case in the rest of the Caribbean, most imports come from the United States, nearly 40 percent in the case of Trinidad & Tobago. As T&T has become a more globalized economy over the last two decades and so more integrated into the global economy, its trading partnerships have broadened. The share of imports that originate in "non-traditional" sources such as those in South America and the near and far east have grown by more than ten percentage points to nearly 45 percent. In all this, imports from the European Union make up only 14 percent of the total.

Within the context of trying to estimate the potential impact on the economy of Trinidad and Tobago of new trade opportunities with the EU, both of the structural characteristics exposed here mitigate against a significant impact. Trade with the EU currently represents only a small share of the T&T total trade. And almost the entire oil economy, a third of the total, does not face a potential competitive threat from the EU.

Trade Commitments

Trinidad & Tobago has undertaken trade commitments at the bilateral, regional and international level to promote its interest in regional and international trade integration. However, it has shown a preference in negotiating regional and bilateral agreements. T&T has used a dual approach to ensure its viability in external markets, pursuing trade initiatives with Trinidad's traditional trading partners in blocks such as the EU and in the Western Hemisphere and non-

traditional partners in MERCOSUR, the Andean Community, the Central American Common Market (CACM), the Association of South East Asian nations, amongst others.

The country's stated development policy objectives are to become a major economic hub of the Western Hemisphere and to achieve full integration into Latin America in the context of being a CARICOM Member. To this achieve this end, Trinidad & Tobago has pursued direct bilateral free trade relations with Mexico, Costa Rica and Panama. They had also sought entry into the North American Free Trade Agreement (NAFTA), unsuccessfully, however, as their little political sentiment for expansion in the USA and any that existed was focused on Chile as a partner. Trinidad & Tobago also entered into a Bilateral (Partial Scope) Agreement¹⁷ with Venezuela in 1989, aimed at stimulating trade through preferential arrangements that reduce and or eliminate tariff and non-tariff barriers on certain products from both countries.

At the regional level, T&T is one of the most active trading members of CARICOM and has implemented the provisions of the revised treaty and also the provisions of the CSME since 2005. Trade policy decisions have been formulated within the context of CARICOM, with the implementation of the CSME, to achieve the harmonisation of trade policies at the regional level. Successful implementation of the CSME, which will result in the removal of restrictions and constraints throughout the Community to facilitate the free movements of goods, services and capital, will likely have significant benefit for Trinidad & Tobago which already has the infrastructure and institutions to fully exploit regional trade opportunities.

Trinidad & Tobago's Membership in CARICOM has allowed it to participate in bilateral trade agreements with Costa Rica, the Dominican Republic, Venezuela, Colombia and Cuba and in preferential trading arrangements under CARIBCAN, Cotonou and CBI, GSP and GSTP. T&T also tries to have access to the wider Caribbean region through the framework of the Association of Caribbean States (ACS) comprising CARICOM, the non-English speaking Caribbean, as well as Latin American countries bordering the Caribbean.

At multilateral level, Trinidad & Tobago is an original Member of the WTO from its formation in 1995. It applies at least MFN treatment to all its trading partners. At the Uruguay round negotiations, Trinidad & Tobago bound all of its tariffs at the maximum rates for trade in goods. Commitments were also made under the GATS, trade in services, in eight of the 12 sectors identified in the GATS classification, in sectors such as telecommunications, business services, insurance, transport and tourism.

Trinidad & Tobago is an active participant in WTO negotiations, especially on issues related to special and differential treatment for developing countries. It

¹⁷ Partial scope agreements are trade agreements which gives preferences in the form of reduced tariffs or duty-free treatment on some specific products, usually signed by sub-groups within a group, normally two countries.

made a submission on behalf of ACP states, pushing for momentum in the discussions on the implementation of special and differential treatment in the post Doha era. In the area of tariff reduction, Trinidad has advocated for 'less than full reciprocity' for weaker developing countries, as a principle which should be considered when negotiating tariff liberalisation.

This stance is relevant to the terms of the EPA which is predicated on full reciprocity. Where trade agreements involve economies with small domestic markets and limited possibilities for economies of scale and scope, Trinidad & Tobago has advocated for the acquisition of rights and privileges that would have compensatory effect. The development assistance part of the EPA may be interpreted as part of such compensation.

Tariff Levels and Trade Restrictions

Trade policy in Trinidad & Tobago has followed a similar pattern to that in Jamaica, with limited reform in the 1980s followed by accelerated reform in the 1990s largely under the umbrella of the CET. Trade reforms in Trinidad and Tobago in the 1980's reflected a shift from an industrialization policy based on import substitution, supported by a system of incentives based on tax holidays, high tariffs on competing imports, duty concessions and quantitative restrictions (QRs) to one based on export-led growth through trade liberalisation measures which aimed at developing both the oil and the non-oil manufacturing sectors.

Trade reform gained momentum in the 1990s under both multi-lateral and regional imperatives. Stand By Agreements were entered into with the IMF in 1989 and 1990 and Structural Adjustment Programme was signed with the World Bank in 1991. These provided part of the impetus for trade liberalization. At the same time, the economies in the region implemented the Common External Tariff. Trinidad & Tobago's implementation of the agreement and the tariff reductions it implied began in 1993.

Quantitative Restrictions had been the main policy instrument used to control the levels of imports and to protect domestic economic activity. The 1990's Trade reforms included the conversion of quantitative restrictions from the "imports negative list" to equivalent tariffs as well as the removal of stamp duty on imported goods. The tariffication of non-tariff measures such as QRs were done on a phased basis – In 1991, 40% of the goods covered under quantitative restrictions – under the negative list were removed and the other 60% removed in 1992.

After 1992 and before the full adoption of the CET, imports were subject to stamp duties and import surtaxes. The stamp duty was phased out between 1992 and 1994 so that by 1995 the only applicable import duty was the CARICOM CET¹⁸ along with import surtaxes that applied mainly to agricultural produce.

¹⁸ Liberalization And Openness Of The Trinidad and Tobago Economy In The 1990s
Central Bank Of Barbados, 2005, by Lester Henry and Sandra Sookram

T&T now applies the CARICOM Common External Tariff (CET), for virtually all intra-regional trade in goods. Between 1995 and 1998, T&T implemented the four phase schedule of CET reductions, during this period, maximum tariff on industrial goods were reduced from 35 to 20 percent. For agricultural products, the range remained at zero to 40 percent. The unweighted average applied MFN CET rate on imports into T&T was reduced from 11.25 percent in 1994 to 9.1 percent in 1997.¹⁹

The relative protection afforded agriculture is greater than that for industrial products and the gap widened during the reform. While average CET for agricultural produce fell from 19.6 percent to 19.1, that for manufactured goods started at 9 percent and fell to 7. The tariff structure of the CET also offers a higher level of protection to final consumption goods, while inputs and capital goods enter at a maximum of CET rate of 5%. Trinidad and Tobago allows access on these items duty-free or a maximum duty of 2.5%.

Where it relates to trade in services, there has been no liberalization under the terms of the CET treaty, however the treaty does provide for preferential treatment to CARICOM service providers viz-a viz third countries suppliers.

At the multilateral level, T&T has bound all of its tariff lines at the WTO. Trade in goods – almost all agricultural goods are bound at 100% while most non-agricultural goods are bound at 50% and some exceptional goods at 70%. There are a number of tariff lines where the MFN rates are higher than the bound rates. Other duties and charges were bound at 15% at the Uruguay Round; however, import surcharges are applied on a number of agricultural products (60% on Sugar, 75% on icing sugar and 86% on poultry cuts).

There are a number of products that were bound prior to the Uruguay round at rates that were less than the CET rates such as plants, beans, saddlery and harness for animals, hydraulic lime, furs. CET MFN rates are designed to be uniform at the regional level, whereas the bound rates were determined at the national level based on historical legacy. The former were therefore necessarily going to be inconsistent with the latter for at least some countries.

The EPA Tariff Changes

Once again, the overall tariff reductions are not large. The average tariff reduction accumulated over the 25-year adjustment period for Trinidad & Tobago is 4.9 percentage points, bringing the average tariff on imported goods from the European Union down to 2.9 percent. This reduction is almost identical to Jamaica's 5.0.

¹⁹ While the tariff structure under the CET is supposed to be common to all signatory members, differences in implementation as well as differences in each country's import structure result in differences in the average, weighted applied CET. For Jamaica, for example, the applicable averages are 10.9, 20.2 and 8.4 percent, respectively.

Naturally, the commodity groups with the highest tariff levels are the ones with the greatest potential for tariff reductions. Thus, export agriculture, which begins with an average tariff rate of 27.6 percent, experiences a reduction by 13.8 percentage points and textiles and apparel with an average tariff rate of 7.5 percent is scheduled to be reduced by 6.7 percentage points. The other sectors with the relatively large reductions are refined petroleum, by 7.2 percentage points, and miscellaneous manufacturers, by 8.1 percentage points.

Some commodities, though, have high tariffs because of a policy of domestic protection. An attempt has been made to preserve a large measure of that protection under the EPA by excluding potentially vulnerable industries from liberalization. So, for example, manufactured food products, which occupy a significant share of T&T's non-petroleum manufacturing capacity and which at the start of EPA enjoyed an average tariff of 26 percent, will see a tariff reduction of only 5.7 percentage points. While less than 10 percent of the 6-digit HS (Harmonised System) commodities codes have been excluded from tariff reduction, more than half of the food products category have been.

These are tariff reductions are not large, however. Given the multiplicity of factors that determine trade – geography, tastes and preferences, history, language – it would be surprise of an average relative price change of just 5 percent were to lead to significant increases in the amount of trade.

SIMULATION RESULTS

The economy of Trinidad & Tobago is by far the most industrialized in the region. Manufacturing, making up a fifth of economic activity, is more than double the relative size of the next largest, that of Jamaica. Meanwhile T&T's agriculture, at a miniscule one percent of the economy, is the tiniest in the Caribbean. And while both Jamaica and Guyana have a significant extractive industry in bauxite mining, the extraction of crude dwarfs both of them in its share of GDP, accounting for another fifth of the total.

Notwithstanding these differences, the economy of Trinidad & Tobago is a reproduction of many of the structures and patterns that constrain adjustment in the other economies studied. The weighted average tariff reduction on goods imported from the European Union is 4.7 percentage points. Notwithstanding the limited overlap between the production structures of the two sets of economies, that modest price reduction on EU goods can stimulate a 27 percent increase in total imports from the EU, revealing a high price. But as in the other country cases in the Caribbean, because of structural limitations, such a large increase in imports from Europe has a small negative impact on the economies.

Less than 14 percent of the twin-island's imports currently originate in the EU. So even if imports from the EU were to grow by a quarter, the increased quantity represents less than three percent of T&T's total imports. Even that, if directly competitive with domestic production, could necessitate a painful shift amongst economic activities. But the particular commodities affected are more similar to

ones that are already imported than those produced domestically, as one would expect. So only four percent of the new imports from Europe constitutes trade creation, the remainder being diverted from other import sources. Therefore, the overall change in T&T's total imports is negligible at 0.1 percent, leaving no room for production and employment to be impacted significantly.

Even if there were a significant increase in imports, the impact on domestic production would have been less than in the other economies in the present study. Merchandise imports make up only 21 percent of the gross value of domestically produced goods in Trinidad & Tobago, while total imports are only 40 percent of GDP. Furthermore, services account for 60 percent of the T&T economy, so the ultimate impact on aggregate GDP would have been small anyway, even in the presence of large sectoral impacts. In the end, aggregate GDP is unchanged.

A large part of the explanation for the limited impact of EPA-generated competitive imports from Europe is the dominance of oil in the T&T economy. Extraction alone is almost 20 percent of GDP while the oil and petrochemical sectors accounts for nearly a third of economic activity. None of scheduled tariff changes will have any direct effect on the extraction and refining of petroleum.

Further, Trinidad & Tobago's tiny agricultural sector, at only 1.2 percent of GDP, is too small to have a noticeable macroeconomic effect. So the tariff reductions, which average around 13 percentage points on produce and up to 40 percent on some fruit and vegetables, will not have a noticeable effect at the macro level (Table 6).

The large manufacturing sector is the other potential vulnerability to competitive imports. The sector constitutes 36 percent of gross output. But nearly half of that is the refining of petroleum and the production of related products.

Of the remaining non-petroleum based manufacturing activity, food products present a potential vulnerability. Tariffs on food

products will fall by an average of 5.7 percentage points over the liberalization period, which it is estimated will stimulate a 28 percent increase in imports in this category from the EU. In consideration of the EU share of imports (14 percent), the degree of trade diversion (70 percent), and the small share of imports in total

Table 6: Simulation Results, Trade and Gross Output, Trinidad & Tobago

	Change in...		
	Tariff Rates (% pts.)	Total Imports (%)	Gross Output (%)
Dom. agri. goods	-13.3	2.3	-0.3
Exp. agri. Goods	-13.8	5.0	-1.6
Non-competing agri.	0.0	-0.1	0.0
Other minerals	-3.4	-0.5	-0.1
Processed food	-5.7	1.2	-0.2
Paper and Printing	-2.9	0.3	-0.5
Textiles, clothing	-6.7	0.3	0.0
Non-metal min. prod.	-6.6	2.3	-0.6
Chemical goods	-2.4	0.0	0.7
Refined petrol	-7.2	1.0	-0.5
Metal products	-2.7	0.4	1.4
Machinery, equip.	-4.9	0.4	-1.1
Other manufactures	-9.3	1.6	-1.0

domestic supply (also 15 percent), the negative impact of competitive imports on domestic production of manufactured food products is negligible, at 0.2 percent.

With a smaller tariff reduction (of 3.9 percentage points), the remainder of the manufacturing sector that is not concerned with either oil or food is likely to fare no worse. T&T's relatively sophisticated manufacturing sector already produces a range of products for itself and the rest of the Caribbean. Almost all (88 percent) of what it can now bring from the EU more cheaply under the EPA will be diverted from other import sources. So there will be no negative impact on this sub-sector either.

The employment effects correspond to the negligible production impacts (Table 7). The small agricultural sector may suffer a one percent loss of employment. At a more disaggregated level, manufacturers of machinery and equipment may also suffer a one percent loss of employment.

Overall trade, both imports and exports, grow by approximately two percent, corroborating the less than overwhelming effect of the EPA on the T&T economy.

When the full schedule of tariff liberalization is complete, the government can expect to lose no more than 2.7 percent of indirect tax revenue from foregone import tariffs. This is a smaller decline than is to be incurred in St. Lucia and Guyana, but larger than Jamaica's. At 0.16 percent of GDP, the small size of the revenue loss reflects the stronger domestic tax base in T&T. This amount of revenue loss is small, especially when spread over the quarter century of the liberalization schedule.

The above results suppress any growth to total factor productivity in order to isolate the cost of structural adjustment to the new competitive environment. But, again, some productivity growth is likely. With a capital/GDP ratio of 0.67, the growth of factor productivity could eventually add more than 4 percent to real incomes.

Of the economies studies, Trinidad & Tobago experiences the least impact. The presence of the large petroleum and petro-chemical sector, the small size of the country's agriculture, and its low dependence on trade revenue, all provide for a negligible change. Since policy-makers in the twin island republic are already in a programme for accelerated economic development, the advent of the EPA should not occasion any change in those plans.

Table 7: Structure Results, GDP and Employment, Trinidad & Tobago

	Share of GDP	% Change in GDP	% Chng in Employment
Agriculture	1	-0.9	-0.8
Extraction	19	0.0	0.4
Food Processing	5	-0.2	-0.2
Manufacturing	16	0.0	-0.2
Tourism	2	0.1	0.1
Finance	17	0.0	0.0
Utilities, Pub. Svcs	16	0.0	0.0
Other Services	24	0.1	0.1

GUYANA

TRADE CHARACTERISTICS

Profile and Structure

Guyana's trade profile is characterized by the fact that the country does so little of it. Trinidad & Tobago, for example, exports some seventeen times the value of Guyana's exports of just under than a U.S. billion. But even that low level represents a degree of engagement with the world economy that was not present two decades ago when Guyana's exports amounted to approximately US\$250m.

During that time, Canada has become an increasingly important trading partner. Guyana's export to that country has grown from a small six percent share as recently as 1989 to 26 percent by 2007. At the same time, the share of exports destined for Europe has shrunk from an impressive 43 percent in 1985 to a still impressive 30 percent twenty years later.

Most of Guyana's exports to Europe is accounted for by sugar. Indeed, the dominance of the EU in Guyana's export structure is a reflection of the country's continued dependence on its traditional crop. Sugar accounts for 20 percent of total exports. The remainder of its exports is made up of rice, which is exported largely within CARICOM, and bauxite and gold, which are sent throughout the world.

Reflecting its lack of domestic energy sources and its thin industrial capacity, Guyana's import bill is dominated by oil and fuels and capital equipment of various kinds. Its oil and fuels come mostly from Trinidad & Tobago next door while Europe is the source of heavy equipment, machinery, and electrical and electronic equipment. This will be important in understanding the minimal structural impact of the EPA described below.

As in the other three cases studied, the European Union is not an important source of imports, accounting for only 11 percent of the total. CARICOM accounts for more than a quarter of the country's imports, mainly light manufactured items and processed food.

Trade Commitments

Guyana has always had an ambivalent attitude to international trade. True, it has had a long history in the multilateral trading system, becoming a contracting party of the GATT upon independence in 1966 and, like Jamaica and Trinidad & Tobago, was a founding member of the WTO in 1995. At the same time, the country has always had a strong voice in regional and international trade issues and often has used it to advocate for special and differential treatment, that is to say, exemption, for developing countries. Its strong opposition to signing the EPA can be seen as a continuation of this advocacy and as well its resistance on trade matters.

At the bilateral level, Guyana has negotiated or is negotiating agreements with Brazil, Canada, China, Indonesia, Japan and Venezuela, including partial scope agreements with Venezuela and Brazil. Notwithstanding these efforts, Guyana has been less enthusiastic at engaging such agreements, and has attempted fewer of them, than most of its Caribbean neighbours, reflecting its ambivalence to trade.

Guyana, a committed member of the regional institutions, implements its trade policy within the framework of CARICOM. Indeed, the country is one of the three original signatories to the original Caribbean Free Trade Area (CARIFTA) Agreement in 1965. Through CARICOM, Guyana participates in asymmetrical free trade agreements with Costa Rica and the Dominican Republic, and partial preferential agreements with Colombia, Cuba, and Venezuela. Also within the ambit of its CARICOM membership is the country's participation in the U.S. Caribbean Basin Initiative, CaribCan (with Canada), and the Lomé and Cotonou Agreements with the EU.

Finally, Guyana benefits from the Generalized System of Preferences of a number of countries (e.g., Australia, Bulgaria, Japan, New Zealand, Norway, Russia, and others). All together, more than three quarters of Guyana's exports benefit from preferential market access arrangements, including many export to the European Union.

Tariff Levels and Trade Restrictions

The liberalisation of Guyana's economy started in the late 1980's with a number of domestic policy reforms and the 1989 implementation of the *Economic Recovery Programme* (ERP). As one of the main objectives of this programme was the easing of trade restrictions, under the ESP the usual gamut of import prohibitions were reduced, including: elimination of export restrictions; tariffication of non-tariff barriers; reduction in the application of import licencing; easing of exchange controls; removal of the sugar subsidy; and simplification of the tariff structure.

Guyana adopted the CARICOM Common External Tariff (CET) in 1991 whereby it allows for duty-free imports from other CARICOM members. Harmonisation of the CET was achieved when the CARICOM-wide CET went into effect in 1993. Guyana started the programmed reductions in the CET in 1994, completing them in five years. With the implementation of phase IV, the maximum tariffs were 20 percent for industrial goods and 40 percent for agricultural products (notwithstanding provisions for a few exceptions).

Joining the WTO in 1995 did not require major trade policy adjustments as Guyana had already removed its most egregious trade-distorting policies. The country had binding coverage of 100 percent of its tariff lines. The simple average MFN tariff rate is 12 percent, with more than two-thirds of its tariff lines at or less than a rate of 10 percent. The average MFN tariff rate for agricultural products is 21.6% while it is 10.3% for non-agricultural products. A limited number of

products maintain high average tariff rates, up to 100 percent – some agricultural products, beverages, tobacco precious stones, oils and fats, and a few others.²⁰

The complete binding of its tariff lines was intended to ensure transparency and predictability of its trade regime. Guyana, however, like other CARICOM members, uses a variety of duty relief schemes and exemptions from the CET which serves to obscure predictability and transparency in the applied tariffs. To further complicate the structure, there are also a plethora of other levies that apply to imports. Guyana also applies a 30 percent value-added tax on most goods including imports, and applies at higher rates, up to 128 percent, on a few items. A tariff of 45 percent is applied to all non-commercial imports that is dutiable, contained in passengers baggage or gift parcels imported via air, sea or parcel post.

The EPA Tariff Changes

The weighted average tariff reduction over the course of the liberalization schedule in Guyana is 7.1 percentage points. As in the other cases, this average masks a wide range of reductions all the way from none on unaffected and excluded items such as rice to the 60 percentage point reduction of tariffs on some items of jewellery and precious stones.

In general the highest tariff reductions apply to commodities that are not produced in large amounts in Guyana if they are produced at all. The 10 percentage point reduction on agricultural crops excludes almost every crop produced in significant quantities in Guyana, such as carrots, cucumbers, peas and rice. The 12 percentage point reduction on forestry products applies to a commodity group for which there were no EU imports previously. Finally, reductions of 11 percentage points apply to machinery and electrical and electronic equipment, little of which is produced in Guyana.

Tariff levels on many manufactured items were already low on those originating in the EU. The average tariffs on chemical and plastic products was only 6.2 percent. Under the EPA, the tariff largely disappears, but with an already low starting point, will likely not be sufficient to make a big difference. Similarly, the 9.8 percent average tariff on non-metallic mineral products eventually will be reduced to near zero.

The structure of tariff changes described above is designed precisely to minimize the impact on the local economy. Any commodity for which there would be a significant domestic impact is placed on the exclusion list. It is therefore a designed outcome that the largest tariff reductions apply to commodities not produced domestically in large amounts.

²⁰ WTO Trade Policy Review, 2003

SIMULATION RESULTS

Guyana's strongly agricultural economy would always likely to be the least vulnerable to competitive imports from the European Union. Agricultural activity constitutes almost a third of GDP, nearly five times the share for any other country in the region, and employs more than 20 percent of the employed labour force. Manufacturing, in contrast to agriculture and as well to the structures in the remainder of the Caribbean, constitutes a tiny 2 percent of the economy. Not taking any competitive chances, in addition to the insulation provided by Guyana's economic structure, the government has placed nearly ten percent of the items in the tariff code on its exclusion list.

The average tariff reduction on imports from the European Union entering Guyana under the EPA is 7.1 percent (Table 8) – the highest of the four cases – stimulating a 36.5 percent increase in imports out of the EU. The share of total Guyanese imports that originates in Europe is currently only ten percent, so the increase represents only 3.7 percent of total imports. Of that, the overwhelming majority, more than nine-tenths, would be imports diverted from elsewhere, leaving a mere 0.3 percent net increase in total imports. Given that half the economy is in service production, the aggregate effect of the EPA inspired trade in Guyana is likely to be, once again, negligible. Indeed, the impact in Guyana is smallest of the four cases studied.

Guyana's economy presents fewer opportunities than anywhere else in the Caribbean for structural rationalization with Europe. It's large agricultural sector, much of which is in rice growing, does not produce many of the crops produced in Europe. Further, non-food manufacturing is a tiny part of the economy. There is little scope, therefore, for competitive imports from the EU to impact Guyana. Ignoring labour and capacity reallocation and increases demand from expenditure reallocation, the aggregate negative effect will be no greater than a tenth of a percent of both GDP and employment (Table 9).

Table 8: Simulation Results, Trade and Gross Output, Guyana

	Change in...		
	Tariff Rates (% pts.)	Total Imports (%)	Gross Output (%)
Crops	-10.3	4.0	-0.1
Animal products	-0.6	-1.3	-0.1
Forestry products	-11.7	-1.0	-0.1
Fish	-7.3	1.3	-0.1
Minerals	-6.6	0.1	0.0
Other processed food	-7.1	0.9	0.1
Wood products	-9.7	0.9	-0.5
Fuels	-9.4	-0.1	0.0
Plastics & chemicals	-5.5	0.0	-0.7
Non-metal min. prdcts.	-9.8	0.5	0.0
Machinery	-5.1	0.1	0.0
Electrical equipment	-11.0	0.6	0.0
Transport equipment	-10.7	0.7	0.0
Other manufactures	-11.7	0.7	-0.2
Transport and comm.	0.0	-0.5	-0.1
Other services	0.0	-0.7	0.0

At a disaggregated level, there are five commodities that will experience double-digit tariff reductions – non-excluded crops, forest products, electrical equipment, transport equipment, and miscellaneous manufactures. Imports of these commodities, with the expected elasticities, could experience growth of more than 60 percent. But with the small EU share and the large potential for trade diversion combined with the fact that these manufactured items are barely produced in Guyana at all, the impact will be hardly noticeable. Forest products are not exported from the EU to the Caribbean at all.

Table 9: Simulation Results, GDP and Employment, Guyana

	Share of GDP	% Change in GDP	% Chng in Employment
Agriculture	31	-0.1	-0.1
Extraction	10	0.1	0.2
Food Processing	6	0.4	0.4
Manufacturing	2	-0.2	-0.2
Utilities & Pub. Svcs	17	0.0	0.0
Other Services	34	0.0	0.0

Guyana, like St. Lucia, depends greatly on border taxes for its public funding. As a result, the tariff reductions result in the loss of six percent of indirect tax revenue, equivalent to one percent of GDP. While this loss is not as bad as in St. Lucia, it represents several times the relative revenue losses in Jamaica and Trinidad & Tobago. Raising one percent of GDP in taxation from alternative sources in a largely informal and agrarian economy like Guyana’s is not the straight-forward exercise that it would be in, say, Trinidad & Tobago.

Because of the limited structural overlap between the economy of Guyana and those of the EU, the likely static income gain from trade opening is by far the lowest of the four cases at 0.8 percent. Combined with the low penetration of capital in the economy, the potential for productivity growth to increase income is only 1.6 percent.

CONCLUSION

The sectoral restructuring that follows the opening of trade is not the downside of trade agreements, it is the very point of them. It is the rationalization of production between newly-trading economies that manifests as contracting and expanding industries in each of the economies. But the process is never frictionless. The contraction precedes the expansion, sometimes by several years, during which time displaced workers and their families suffer. For this reason, governments have an interest in the extent and duration of the dislocation. This study has been an attempt to estimate the degree of restructuring that will likely occur as the Economic Partnership Agreement between Caribbean Economies and the European Union unfolds.

The EPA includes a broad range of initiatives that includes reciprocal tariff liberalization, access for services, and development assistance. Of these, tariff liberalization has most exercised commentators on the merits and demerits of the agreement. Since many Caribbean products previously entered the EU at low or zero duties as a legacy of the previous non-reciprocal arrangements, the impact of the agreement's tariff liberalization is substantial only on the Caribbean side. This analysis, therefore, focused on the tariff reductions for estimating the impact of the agreement on the region's economies.

Tariff liberalization has direct impacts on the economy in terms of the potential displacement of domestic production, due to the switch of expenditure to cheaper imports, and in terms of forgone tax revenue. The indirect effects then derive from the reduction in demand for the inputs to the directly affected activities, the resultant reallocation of productive resources and budgets, and the consequences of compensatory taxation.

It is these impacts, the direct and indirect effects of tariff liberalization, that the simulations in the present exercise were intended to capture. The broad result obtained is that any disruptive effect of competitive importation on the four economies studied – Jamaica, St. Lucia, Trinidad & Tobago, and Guyana – will be limited and small. This conclusion derives from three structural characteristics. First, trading patterns are derived from a large number of influences of which price is just one. The tariff reductions of the order 5 to 7 percent on average are not sufficient, even in the presence of large elasticities, to overcome history, language, culture, proximity, and endowments. Second, Caribbean economies import mostly what they cannot reasonably and competitively produce already, so a cheaper European source largely serves to divert trade from another imported source. Third, the particular commodities to which tariff reductions apply represent only a small fraction of the productive activities of the region. Some apply to products that the Caribbean will never import, such as fur coats, and some have been deliberately excluded. But most of the economic activity in the Caribbean lies in the production of services or mineral extraction, and goods production is only a small part of GDP and employment.

The three larger economies experience negligible impacts. Ignoring both the likelihood of productivity growth and the redeployment of any productive factors, Jamaica, Trinidad & Tobago, and Guyana suffer production contractions of one-tenth of a percent of GDP and employment. St. Lucia's contraction is as much as one percent.

The loss of tax revenue presents a somewhat bigger challenge for some of these economies; nonetheless, spread the over the 25 years of the liberalization schedule, it is manageable. The impacts vary widely across the four cases. Indirect tax revenue contracts by as little as one percent in Jamaica but by nearly 13 percent in St. Lucia. The loss is barely noticeable in Jamaica and Trinidad & Tobago, but at one percent of GDP in Guyana and almost 3 percent in St. Lucia, it will take some management to replace.

In the presence of negligible effects, it is difficult to discern finely disaggregated sectoral impacts. If one is to be discerned, the production of machinery and equipment in both Jamaica and Trinidad & Tobago suffer a one percent contraction. Even that may be the difference between life and closure for some firms.

The minimal overlap between the productive structures of Caribbean economies on the one hand and the European Union on the other, suggest that the likelihood for disruptive production displacement was minimal to begin with. Unfortunately, that lack of overlap simultaneously limits the static efficiency gains – that is, the exploitation of traditional comparative advantage – to be had from facilitating trade in goods between these two regions.

If there is to be an upside from the EPA, the hope lies in the service sectors. That is where much development aid will go and that is where the productivity gains are likely to be concentrated.

While all generalizations must be done with some caution, we may generalize from the four cases studied here to the rest of the Caribbean with some confidence. The four cases were chosen because they represent the variety of economic structures in the Caribbean – agrarian Guyana, industrialized Trinidad & Tobago, large Jamaica, and small, service oriented St. Lucia. Revenue loss will be a challenge for the smaller economies in the region, but apart from that, policy-makers in the Caribbean need to turn their attention to exploiting the service access opportunities opened up by the Economic Partnership Agreement.

APPENDIX: GENDERED IMPACTS

Sustainable development and gender equality are important components of trade agreements because trade, even as it promotes productivity growth economy-wide, always has significant distributional impacts. The main objective of the EPA is to promote sustainable development through the promotion of trade with the goal of achieving poverty reduction. Trade liberalisation will have different effects on men and women because of the different occupational roles they play in the economy. As tariff reduction and trade promotion brings its distributional challenges, the effect on gender is of particularly significance because of the role of gender in the profile of poverty and also because of existing gender inequities.

There is a general understanding that women are disadvantaged in economic and trade relations in various societies because of their dual role. They form the majority of unskilled workers. Women tend to have less access to resources, lower levels of education, higher rates of exclusion to productive resources, less access to employment opportunities, uncertain tenure and property rights, less political participation and less involvement in decision making processes. It is therefore important that trade policies are implemented in a framework that recognises that there are weak economic actors that may need special and differential treatment

because of their vulnerability and their ability to absorb the adjustment cost associated with economic transformation.

The EPA can have differentiated effects on gender in two ways. First, it may lead to income redistribution through the restructuring and the shifting employment opportunities that follow trade opening. Second, these same processes may create differentiated gender impacts through the skewed vertical distribution of women in the organization chart.

There was no specific provision on gender written into the EPA to address gender sensitive issues. The Cotonou Partnership Agreement (CPA) which created the legal basis for negotiating the EPA has provisions that clearly speaks to gender equality and access to resources, along with giving clear commitments on these issues. The market access arrangement under the EPA can have significant implications on gender relations, both in terms of market access received and market access granted. A large number of households in the Caribbean are headed by women, and even for those that are headed by men, consumption decisions may be made by women, therefore any improvements in welfare usually benefits women. As well, improved market access could lead to increased production in old and new sectors; this could lead to increased labour force participation by women.

Trade in services is a significant contributor to GDP in all CARIFORUM countries. Investments in service related industries will likely be significant because of the opportunities created by the market access opening on both sides and will have an impact on gender because the gender composition of employment in services is different from those in the goods-producing sectors. The sectors that produce services such as the distributive trade, tourism, infomatics, elementary occupations are the largest employers of people. Women outnumber men in almost all of the service enterprises. For trade in services, the EU has opened its market to CARIFORUM suppliers and investors in most sectors by way of the four modes of supply while CARIFORUM has made limited offers in development driven sectors such as transport, tourism, telecommunications, manufacturing and environmental services. The gender impact of improved market access to the EU could result in skilled professional women, temporarily migrating to take advantage of mode four opportunities.

JAMAICA

The Jamaican workforce has always had a high labour participation rate by women. This level of participation has increased progressively since independence in 1962. During the period 1993 to 2002, women made up approximately 43 percent of the total labour force. Distribution, restaurants, hotels, financial services and community, social and personal services had a female share of employment of over 60 percent. The analysis above reveals that much of the increase in economic activity from the EPA will be in the area of services, with corresponding relative reductions in the shares of both manufacturing and agriculture. While agriculture has witnessed an increase in female employment in recent years, with women sometimes using agriculture as a steadier source income

than urban employment, the potential growth in the services sector may reverse that trend.

The most vulnerable often depend on government largesse for assistance and women tend to be poorer and more vulnerable due to their additional responsibility as caregivers to children and the elderly. The loss of tariff revenue through liberalisation potentially impacts on the government's ability to provide assistance by way of social services such as education, health care and security. Women are therefore likely to be more adversely impacted than men if there is a cut back in the provision of social services.

There is some compensation if the public provision of these services is compromised. The EPA, through its improved market access opportunities and development funding through the NIP and RIP, provides assistance in the form of budgetary support and technical assistance that potentially could help. Further, the productivity increases that are expected from the dynamic changes to take place will provide additional resources to balance the loss of tariff revenues.

ST. LUCIA

The St. Lucian economy is structurally skewed towards services even more than is Jamaica's, which may explain the higher participation rate of females in the labour force, with women comprising 47 percent. Female workers tend to dominate in the sectors for service and clerical workers while men tend to dominate in sectors such as plant and machinery operators, farming and fishing, and craft and related trades. The main beneficiary sectors that emerge from the EPA simulation above are financial services and tourism, which accommodate many occupations which tend to favour the employment of women. The findings predict that this pattern of employment is expected to continue as there are expected declines in the manufacturing sector of the order of 5 percent. While the employment shift may favour sectors where women have traditionally found employment, any relative loss of opportunities for male employment inevitably shifts the burden support towards women.

With a much greater relative revenue loss than in the case of Jamaica, the government will be constrained in its expenditure on social services, which is more likely to impact on women. At the same time, the extensive services provisions in the EPA creates disproportionate opportunities for women.

Trinidad and Tobago

The composition of the labour force of Trinidad and Tobago is representative of most countries in the world in that it has a higher representation of men. In 2005, the female labour participation rate was 49 percent while the male rate was 67 percent. These figures are in keeping with the figures for Latin America and the Caribbean which averages approximately 80.5 percent for males and 49.2 percent

for females. The share of women in the labour force, 37.9 percent in 1996, rose to 38.6 percent by 2000 and on to 40 percent by 2005.²¹

The sectors which contributed to the largest shares of employment were agriculture, construction, manufacturing, distribution, and other services (business services and community, social services) which employed the majority of the 587, 800 employed persons in 2007. Of this amount over 233,000 persons are females. The services industry is the largest employer, employing over 75 percent of the labour force and contributing to over 60 percent of GDP. The agricultural small sector employs a little over 22,000 persons, 4,200 of them women. On the other hand, the LNG and petro-chemicals sector, which accounts for over 40 percent of GDP, 90 percent of exports, and 60 percent of government revenue, absorbs only a small fraction of the labour force.

The gendered structure of production is clearly evident among the various occupational groups, men dominate in most areas such as professionals, skilled workers, plant and machine operators, and elementary occupations, craft and related trade; these areas are usually the high income earning group, while women dominate as clerks and technicians. The EPA holds the potential for expansion and diversification of the economy into sectors where value-add production can be facilitated by the creative use of petroleum earnings and resources, creating new sources employments for women and elevating their status in the income generating stream.

The EPA holds some trade creating potential for Trinidad and Tobago given the structure of production, the structure of imports and exports and existing external market penetration. The most industrialized economy in the region, with over 90 percent of its exports going to the NAFTA countries, will likely make an easier transition than its Caribbean neighbors to expanding exports into the EU market in similar products. Trinidad & Tobago's imports from the EU is made up of capital goods used as inputs into the manufacturing and petro-chemicals industry, therefore the expected increase in imports and the decline in manufacturing activities, as suggested in the main text, will likely be negligible. With the expansion in production resulting from the increased importation of machinery and equipment, matched up with the earnings from the petroleum sectors and diversification of the economy, female participation in the labour force is bound to increase as more jobs are created in the various sectors. This expansion could also be fueled by an expansion in FDI as Trinidad and Tobago is already the premier destinations for foreign investment in the region. The result could be to reductions in the level of poverty.

²¹ Data collected from the Central statistical Office and the ILO database on Employment.

Guyana

The economy of Guyana is the most agrarian in the Caribbean region with a large percentage of its population depending on the agricultural and natural resources sectors for a livelihood. The main exports are bauxite, gold, sugar and rice. The land area is the largest in the Caribbean with the lowest population density, the second highest level of poverty, the deepest ethnic divide, and the lowest labour force participation rate.²² The agrarian dominance of the economy along with the diversity and the wide population dispersion hold significant challenges for gender relations (access to resources, roles, power) and gender equity. Consequently, gender disparities in the composition of the labour force vary widely across the ten geographic regions of Guyana as each region undertakes different types of economic and social activities.

In Guyana, there is high disparity in the gender composition of the workforce. The last census done in 2002 showed that the adult population was 476,682 with a labour force of 263,149, of which the share of females was 31 percent. Of this amount, three of the ten regions account for over 74 percent of the labour force. In the goods sectors, men dominated the employment rolls. The female share of the employed labour force in agriculture is only 10 percent while women are more involved in root crop production and backyard activities. In manufacturing, women are clustered in the Textile and Apparel production, for which they constitute 80 of the labour. Women are dominant in the distributive trade.

The results from the CGE exercise above suggest that the impact of the EPA will most likely affect the agricultural, fishery and forestry sector and the machinery and electrical equipment sector. In both sectors, female employment is comparatively low, so the impact on gender should be a closing of the gap between male and female employment rates. The expected overall impact on female participation rates is limited because the structural effects of the EPA will be small. A significant portion of agricultural production is for domestic consumption. Therefore, it is not likely that imported agricultural food products from the EU will displace domestic production. For heavy machinery and equipment, there is no domestic production to be replaced. The EPA holds potential in the expansion of the services sector, which is the second largest employer of labour, with the expected strengthening of the regional and national institutions and the attraction of investments, Guyana holds vast opportunities for economic diversification into areas of agriculture, tourism and the creative industries.

The fiscal losses from the liberalisation measures, which is estimated to be approximately one percent of GDP, is significant for Guyana, given the agrarian nature of the economy. In Guyana, as well, these may have an impact on women and vulnerable groups who are more dependent on the state for social services. Policy makers in Guyana will be challenged to craft policies that redistributes the gains from the EPA to these groups.

²² Labour Force and Employment in the Guyana Economy, Private Sector Commission April 2007

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