Development Policy

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Nontraditional Exports from Caribbean Countries: A Comparative Analysis of Performance

Exports have always been the economic lifeblood of the Caribbean. In the past decade, however, Caribbean export performance has dropped below that of developing countries as a whole. At the same time, far reaching changes are occurring in the world economy, most imminently the changes associated with the North American Free Trade Agreement (NAFTA) and the overhaul of Caribbean relations with the European Community (EC) under the Lome Convention. These and other changes challenge Caribbean economies to improve their competitive position in world markets.

In this context, a primary goal of economic policy must be to diversify exports into new areas of comparative advantage while consolidating gains from existing product lines. To formulate and implement such policy, policy makers need to know the factors that can spell success or failure in export growth and diversification. They also need to know what can be done to improve and accelerate the diversification and growth processes.

The Caribbean Export Performance Project analyzes the main determinants of that performance over the past 20-25 years in a selected sample of Caribbean Basin countries: Barbados, Costa Rica, the Dominican Republic, Jamaica, and Trinidad and Tobago. The emphasis is on nontraditional exports in agriculture, manufacturing, and services, and on their performance relative to traditional exports. Because of the diversity of export performance in these particular countries, the study provides rich insights into the determinants of performance and strategic mechanisms for improving it.

The countries of the sample have shown widely differing levels of aggregate exports of goods and nonfactor services. Costa Rica's exports grew steadily throughout the period at a high average rate of 7 percent annually, well above the norm of 4.5 percent for all of Latin America, though below that of the high-performing Asian economies. In the cases of Barbados, Dominican Republic, and Trinidad and Tobago, the export growth rate declined sharply from the 1970s to 1980s before plunging to negative rates in 1991. Jamaica's exports declined during the decade of the 1970s but picked up again in the 1980s, growing at an average rate of 5 percent until 1992.

The share of manufactures in total merchandise exports has increased markedly (less so for Costa Rica than for the

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Steps Toward Freer Trade

IDB/ECLAC Conference on Trade Liberalization in the Western Hemisphere

The IDB and the United Nations Commission for Latin America and the Caribbean (ECLAC) held the last of a series of colloquia and conferences on "Trade Liberalization in the Western Hemisphere" at Bank headquarters in Washington on November 1 and 2. The conference was the final step in the IDB/ECLAC project on "Support for the Process of Hemispheric Trade Liberalization." For two years the project has brought together scholars, policy makers, and representatives of the private sector to discuss the prospects for trade liberalization in the Western Hemisphere. Sixty-seven working papers were prepared during the course of the project.

The two days of the conference featured presentations on six large studies on topics ranging from alternative strategies for Western Hemispheric integration to economic assessments of their impact using computable general equilibrium models. Each presentation was discussed by a panel of specialists and policy makers. Three roundtables dealt with "NAFTA", "The Negotiating Agenda", and "Strategies for Individual Countries."

In his opening remarks, IDB President Enrique V. Iglesias reviewed the success of structural reforms in Latin America over the last decade and stressed the im-

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Sustainable Outward-Oriented Industrialization Policies

Macroeconomic policies and trade and industrialization regimes were reoriented in many small and medium-sized countries in Latin America in the late 1980s and early 1990s. The objective of the new trade and industrialization policies was to stimulate manufacturing production by increasing international competitiveness and exports. The history and success of those policies, as well as the growing influence of global environmental standards on international trade and national production processes, are the subject of this project.

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Nontraditional Exports

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other countries), indicating a relative decline in traditional primary-product exports. But this trend masks a complex of underlying circumstances that emerge on closer examination of the disaggregated data. In the Dominican Republic, for instance, there has been absolute, not just relative, decline in traditional agricultural and mineral exports, but this has been accompanied by significant growth in nontraditional agricultural exports. In Trinidad and Tobago, where the oil sector has grown rapidly, a case of "Dutch Disease" has affected the main areas of export agriculture. Costa Rica presents a special case of balanced growth of exports in the areas of agriculture, manufactures, and tourism.

Within the category of manufactured exports, the top performer has been Trinidad and Tobago, where manufactured exports grew at a rate of 12 percent overall, with the highest growth in iron and steel products, chemicals, and fertilizers. Other countries have done well in a few product lines; for instance, garments in Jamaica and the Dominican Republic, electronic components in Barbados (in the 1970s), and processed foods, garments, and pharmaceutical products in Costa Rica. In some cases, much of the manufacturing export activity has been based on foreign operations in export processing zones offering liberal incentives and subsidies.

Some of the biggest export successes in the period under study have been in the area of tourism services. In recent years, the Dominican Republic and Costa Rica have recorded the most rapid and continuous growth in tourism as Jamaica's leadership has come under challenge and Barbados has undergone a decline in earnings. Some diversification has been achieved also in export markets for tourism. Other newly emerging service areas are data processing, health care, and financial services.

Several issues must be addressed before we can draw meaningful policy inferences from this record of export performance. First, through disaggregation of the export data we must determine the magnitude of export diversification. To what extent has the actual diversification been accompanied by growth of traditional exports? To what extent has it taken place at their expense? Obviously, export diversification by itself is not a panacea. It can have harmful or beneficial effects depending on the spillovers that it produces from newly emerging sectors to traditional sectors. Through what mechanisms do such spillovers occur, and how might they be controlled?

The observed changes in export levels have been conditioned by changes in external demand interacting with supply factors within each country. Notable among the external demand factors relevant for this group of countries are the special system of trade preferences granted by the United States (through the Caribbean Basin Initiative and the Enterprise for the Americas Initiative), by Canada (through CARIBCAN), and by the EC (through the Lome Convention). These arrangements have clearly given special advantages to Caribbean countries. But the underfulfillment of quotas in some cases suggests that internal supply factors play a dominant role in export performance. Whether preferential treatment of traditional exports has inhibited mobility into new product lines and defeated improvements in cost and product quality is another vital concern.

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Nontraditional Exports

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Among the internal supply factors to be considered are natural resource endowments, human capital (labor skills, technical expertise), input costs (labor, fuel, transportation), productivity, technology, financial conditions (level and variability of interest rate, access to credit), and quality of entrepreneurship. The role of the exchange rate — which showed marked volatility in all of the sample countries except Barbados — is key. Economic theory, as well as evidence from countries in other regions, suggests that the exchange rate matters significantly in export performance. One needs to have a measure of its actual significance in the specific context of these countries.

Finally, what has been the role of the policy regime? Historically, a complex mix of special incentives, subsidies, regulations, and rules has characterized the sample countries.That policy mix has evolved over time towards the current stage of liberalization. In recent years, all countries have undertaken, in one degree or another, comprehensive stabilization measures and wide-ranging policy reforms. Has this pattern of policies influenced export performance?

This project develops answers to these questions through detailed analysis of data from existing databases of the IDB, World Bank, IMF, and United Nations, and from national government sources and agencies within each country. Several aspects of the analysis distinguish it from other recent work in this area. First, an effort has been made to disaggregate the data by sector and by product, using as fine a division (SITC 3-, 4- and 5-digit levels) as is useful to exhibit common patterns and distinctive features of country performance. Second, specific variables are identified that affect export performance to assess the significance of their effects across sectors, products, and countries. Third, the analysis approaches the problem of export performance from the standpoint of the investment process conceived in terms of profit maximizing decisions of exporting firms. This approach makes it possible to identify the key variables that affect firms' investment decisions and therefore growth and diversification of exports. This approach provides a rigorous basis for testing hypotheses about the empirical record of export performance. It also provides a direct guide to the relevant behavioral and institutional factors that must be considered in the formulation of economic policy. ■

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Industrialization Policies

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Appropriate macroeconomic policies, the capacity to acquire and absorb best-practice techniques, and the capacity to market domestically produced goods internationally all play a crucial role in any successful transition to an internationally competitive manufacturing sector.

Appropriate macroeconomic policies include the liberalization of imports and an exchange-rate policy that supports the tradable-goods sector. These are crucial for the stimulation of an internationally competitive and outward-oriented industrial sector. This study reviews three types of liberalization strategies that have been pursued in the course of the 1980s and early 1990s: (1) unilateral liberalization, (2) liberalization in a regional or multilateral framework, and (3) so-called secluded liberalization, or liberalization that is highly selective and confined to specific sectors or areas such as free export zones.

What other options do governments have to stimulate manufacturing development? This study answers this question, with specific reference to the acquisition and diffusion of technological knowledge, the penetration of international markets, and the capability of the manufacturing sector to comply with strict environmental regulations. In analyzing the type of instruments that governments may use to stimulate international competitiveness and exports, the experiences of some East and Southeast Asian countries that have been highly successful in stimulating export industries are drawn upon.

Experience shows that government interventions in markets often create unintended distortions. To contribute in an effective and efficient way to industrial growth, government intervention must meet four conditions.

- ❑ Government must be informed about the sources and size of market imperfections.
- ❑ First-best instruments should be used to minimize side effects.
- ❑ Interventions should generate few opportunities for rent-seeking.
- ❑ Interventions should be temporary.

Up to now, environmental standards have had a very limited effect on international trade. In the future, however, such standards will likely have a more pervasive impact. The economic rationale for government efforts to control the environmental effects of manufacturing production is three-fold. First, natural resource prices that do not accurately reflect their social opportunity costs result in a suboptimal allocation of factors of production. Second, negative environmental effects of manufacturing production result in a welfare loss, thus reducing the contribution of manufacturing production. Third, entrance to third markets, particularly in OECD countries, may be hampered if exporting countries do not comply with standards pertaining to the environmental impact of products and production processes. Proactive government initiatives in exporting countries may be required if environmental standards in importing countries are not to become a new type of non-tariff barrier to imports.

Governments may induce or force firms to reduce environmental damage by means of a wide variety of economic and noneconomic instruments. As a practical matter, few negative environmental effects are effectively controlled in the countries of the study. Pollution has been regulated not by means of domestic taxes but by administrative measures and quotas. More often than not such quotas are based on quantities of pollutants permitted to be emitted; pecuniary welfare criteria have seldom figured into the policy making equation. This study attempts to specify the requirements for an effective and efficient environmental policy in the context of outward-oriented industrial development. ■

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