

Comments

Stephen Meardon: The gist of Mauricio Mesquita Moreira and Eduardo Mendoza's answer to the question posed in their title is persuasive. I grant their main argument: the CARICOM members' "prospects of trade-related gains are modest and conditional on common market rules being strictly enforced." It is harder to grant the parenthetical point at the end of that sentence: "(and distributional risks being managed)." That is not to say that a concern with the possible distributional consequences of the CARICOM is necessarily misplaced. The distribution of industry among countries, and of income among countries and classes, clearly has consequences. One may worry about those consequences either for moral reasons or for fear of popular resentment and its repercussions on economic policy. But Moreira and Mendoza have in mind a particular "distributional risk" that is overstated. This may seem a narrow point in the context of their expansive article, but it is worth making because their note of concern is not heard just once: it is carried throughout the paper. Yet it seems discordant with reason and evidence.

The distributional risk that preoccupies the authors is that of "the agglomeration of economic activities" in the big and rich CARICOM countries at the expense of the small and poor ones. The authors state that the larger members, particularly Trinidad and Tobago, have benefited from CARICOM's diversion of trade, to the extent that their shares of intraregional (as well as extraregional) manufacturing exports are increasing. Concerted action is required before the larger and wealthier countries crowd out the smaller countries altogether.

The preoccupation is amiss for three reasons. First, in CARICOM, smaller does not mean poorer, and larger does not necessarily mean wealthier. The authors know this well—hence their avoidance of using common categories like less-developed countries and more-developed countries interchangeably with their chosen categories of OECS countries, which are generally small, and non-OECS countries, which are generally large. In the Caribbean, however,

the association of size and wealth should arguably not just be avoided, but rather reversed.

Generally, small OECS countries, like St. Lucia and St. Kitts and Nevis, are modestly to moderately prosperous. Generally, large non-OECS countries are a mix, including a moderately prosperous country (namely, Trinidad and Tobago), a less prosperous one (Guyana), and an even less prosperous one that also happens to be one of the largest (Jamaica). All of the OECS countries had higher per capita income levels in 2003 than Guyana and Jamaica. Moreover, based on figure 1 in the paper, the smaller countries, most of which are in the OECS, appear at least vaguely to have seen higher growth rates of per capita income from 1971 to 2003 than the larger countries. Moreira and Mendoza themselves call attention to this fact early in the paper. Consider what this implies for their distributional fears!

Second, inasmuch as agglomeration is occurring in one particular big and prosperous country (Trinidad and Tobago), it is a stretch to say that what is being agglomerated there are “economic activities.” In some instances, Moreira and Mendoza speak more precisely of the agglomeration of manufacturing industry or “the production of goods,” but the alarm of the other formulation continues to ring in one’s ears.

The production and export of tangible goods, especially manufactured goods, is fetishized. It is hard to see why. The intraregional division of labor appears to favor a pattern of production and trade that can be characterized simply, if a little crudely, like this: among non-OECS countries, Trinidad and Tobago exports fuels and manufactured goods both intraregionally, to the likes of St. Lucia and St. Kitts and Nevis, and extraregionally, to the United States; Jamaica and Guyana struggle. Among OECS countries, St. Lucia and St. Kitts and Nevis export tourist services extraregionally to the United States and Europe. Judging from the data already surveyed, the pattern appears to be serving St. Kitts and Nevis very well—and St. Lucia, too, in terms of growth rates of income if not yet levels. Instead of giving manufactured goods the privileged place among economic activities and worrying on behalf of the OECS about their agglomeration in Trinidad and Tobago, one might more reasonably give the privileged place to tourist services and worry on behalf of Jamaica and Guyana about their agglomeration in the OECS.

Third, however, even if it is legitimate to worry about the effects on other countries of the agglomeration of manufacturing in Trinidad and Tobago—at least inasmuch as the agglomeration is the result of trade diversion that is costly to the other countries’ taxpayers—the concern with the OECS countries still seems misplaced. Trade diversion, the authors show in figure 6, was not

much of an issue until the late 1970s. It grew throughout most of the 1980s, reaching its most serious point in 1986–87, and then subsided in the late 1980s and vanished (“at the margin”) by 1992. It then reappeared in 1993 and persisted through 2003. To the extent that the trade diversion is related to manufactures, and Trinidad and Tobago is the beneficiary, one might expect the country’s share of CARICOM intraregional exports of manufactures to have grown from the 1980s to the 1990s and again from the 1990s to the 2000s. A glance at table 4 reveals that this expectation is validated: Trinidad and Tobago’s share grew from 32.1 percent in the 1980s to 56.3 percent in the 1990s and 65.1 percent in the early 2000s. But which intraregional partners were importing their wares, and in what values? Although the tables do not say precisely, table 3 outlines the changes in CARICOM countries’ shares of intraregional imports of goods. As Trinidad and Tobago’s share declined by nearly two-thirds, or 16 percentage points, from 1980 to 2000–03, the largest increase was in Jamaica’s share, which more than doubled as it rose over 20 percentage points. The collective share of the OECS countries hardly budged. This does not establish decisively that Jamaican taxpayers, rather than OECS ones, have borne the price of CARICOM’s trade diversion, but it hints at that conclusion.

Concern about the distributional consequences to small and poor countries of establishing trade preferences vis-à-vis big and rich countries is an old trope that may still be valid in some cases. For at least a few reasons, it is probably not so in the particular case of CARICOM. Among the many virtues of Moreira and Mendoza’s article is this: the evidence they offer is enough to bring one to reject the trope, even if the authors cannot bring themselves to do it.

Irene Brambilla: A big part of the discussion by Moreira and Mendoza centers on country and market size. This is only natural. Regional integration is, to some degree, about becoming a larger economy. It is about increasing the extent of the market and having more negotiating power in international forums. In the case of the Caribbean, some of the countries involved are among the smallest countries in the world—three of them with a population below 100,000.

Size can refer to different aspects of the economy, however. One question related to size is whether CARICOM members have access to a larger market because of the agreement. In classical trade models, market size does not matter; gains from trade are derived from the change in relative prices. Nevertheless, firms benefit from larger markets under imperfect competition and

scale economies, when they are able to slide down their average cost curves. Aggregate resources are used more efficiently. The gains from having access to a bigger market are even larger under interfirm technological externalities and dynamic learning by doing. Exports per se do matter.

So, has CARICOM led to an increase in market size for its members? Moreira and Mendoza are skeptical, arguing that the CARICOM member countries already had access to a large export market prior to signing CARICOM. As former colonies of the United Kingdom, they had preferential access to the U.K. market that was later extended to preferential access to the European Union. The United States also granted unilateral preferential access to CARICOM members.

There is a lot of intuition and some verifiable truth to this argument. Data from the U.N. Commodity Trade Statistics Database (COMTRADE) indicate that only 18 percent of CARICOM exports went to other CARICOM members in 2000. This is a relatively small share compared, for example, with the United States and the North American Free Trade Agreement (NAFTA): 34 percent of U.S. exports went to NAFTA that same year.

The interpretation of time series is not as straightforward. One problem is the lack of a clear-cut definition of the periods before and after CARICOM that could serve as a basis for evaluation. CARICOM was signed in 1973, but integration attempts in the region go back as early as the 1950s. At the same time, member countries still apply considerable import taxes to inter-CARICOM imports.

Moreira and Mendoza identify two key time periods for their before-and-after comparisons: the early 1970s, when CARICOM was signed, and the 1990s and early 2000s, when a series of reforms led to significant advances in the implementation of free trade and a common external tariff. Figure 3 in the paper shows the evolution of inter- and intraregional trade from 1970 onward. The graph shows that the two reform periods coincide with an increase in intraregional trade that does not take place at the expense of interregional trade. While this is not enough evidence to establish a direct causality from CARICOM to trade flows, it does suggest that CARICOM signatories did indeed take advantage of the new trade opportunities.

Other relevant issues are related not to market size, but to the size of the trade bloc. Large economies can affect the terms of trade, and they can also exert more influence in multilateral negotiations. Although Moreira and Mendoza do not directly address these issues, they indirectly disregard them by arguing that the combined size of the CARICOM bloc is still small, with a population comparable to Chile and a GDP comparable to Ecuador. This is certainly

true on aggregate, yet the CARICOM countries are important producers of a few products, such as sugar cane and rum. The major exporter of rum within the CARICOM is Jamaica, with a share of 5.7 percent of world exports in 2004. The combined share of the CARICOM bloc is 14 percent, which is hardly insignificant. These are only a few isolated products, but they are significant within such small economies.

Increasing the size of a bloc also opens the door to agglomeration externalities, especially (but not only) under free movement of factors of production. Moreira and Mendoza point out that these forces could lead to regional inequality if Jamaica and Trinidad and Tobago, the largest members of CARICOM, were to capture the bulk of manufacturing sectors that are sensitive to agglomeration externalities.

The discussion about size serves as a starting point for a more systematic empirical evaluation. The authors run a growth regression with decadal panel data at the country level. The main explanatory variables are size, measured as either population or GDP, and openness, measured (imports plus exports) over GDP. The result, as expected, is positive, but the insight is that the positive effect of size is decreasing in openness, meaning that more open economies benefit less from being larger—or that large economies benefit less from being open. The regression results are then used to simulate a change in size in the four CARICOM countries included in the regression, whereby the actual population of each CARICOM country is replaced by the total CARICOM population. The estimated impact on the growth rate is negative for three of the four countries.

The premise of the simulation exercise and the interpretation of the results are somewhat unclear. The idea behind the exercise is that full integration is equal to an increase in size as measured by population. But does population size refer to market size, which is associated with the exploitation of scale economies, or to bloc size? Surely it does not fully capture market size. First, as argued in the paper, international markets also count for market size, and this is partly captured by the openness variable. Second, CARICOM was signed in 1973 and spans three of the four decades of data (so the simulation is not really counterfactual), meaning that the CARICOM countries already had an expanded market as a result of CARICOM during this period. Moreover, even if the data were pre-CARICOM, CARICOM (or any other preferential trade agreement) does not represent a movement from autarky to free trade; the CARICOM market would have been partially available to its members even in the absence of a free trade agreement. Such a big change in population overstates the change in market size generated by CARICOM. Third, full

integration implies a change in openness, which is, however, kept constant in the simulation exercise. Should the exercise then be interpreted as a change in bloc size while keeping market size constant (through the openness variable)? What are the channels through which size is expected to operate in the exercise?

One of the paper's conclusions is that CARICOM countries were already very open economies before signing CARICOM, so they did not benefit much from the agreement and the agreement was not trade creating. This leads to the discussion of two more points: trade creation versus trade diversion; and the integration in nontradables. In some cases, trade creation and diversion need to be specifically defined. This is one such case. In the textbook scenario, when countries sign a preferential trade agreement, either domestic production is replaced by imports that are produced more efficiently by the signing partner (trade creation), or efficiently produced imports from the rest of the world are replaced by the less efficient production from the partner (trade diversion). In the case of CARICOM, long-term negotiations resulted in a reduction of the average common external tariff from 20 percent to 10 percent, thereby allowing for efficient imports from the rest of the world to replace domestic production. This situation is not contemplated in the textbook analysis of trade creation and trade diversion, but it is not uncommon among countries that sign preferential trade agreements amidst liberalization episodes and broad structural reform programs.

There is no undisputed procedure to measure aggregate trade creation and diversion empirically, and most studies, including this one, rely on gravity regressions that use bilateral trade data. The portion of bilateral trade that is not explained by "natural forces" such as income and distance is attributed to "institutional forces"—in this case, the CARICOM agreement. The results of this reduced-form analysis reflect the net effect of changes in trade policy, including both the reduction of intra-CARICOM tariffs and taxes and the reduction in the common external tariff.

The ideal gravity exercise is one in which data are available before and after the CARICOM agreement. This is important for two reasons. First, in this ideal scenario, identification comes from both the time and cross-country dimensions; second, it allows for the inclusion of country-pair fixed effects that capture unobserved predispositions for bilateral trade. As noted above, the periods before and after CARICOM are not clear-cut, and, more importantly, there are no pre-CARICOM data. This leaves Moreira and Mendoza with the deviations from natural forces as the sole source of identification of the CARICOM effects and no possibility to control for country-pair unobservables.

They estimate several specifications, some of them correcting for sample selection issues, some allowing for importer and exporter unobservables, and some allowing for trade creation and diversion coefficients that vary over time. They find that trade creation was greatest in the early stages of the CARICOM and that trade diversion dominated later in the period.

Moreira and Mendoza's view of the trade-related aspects of CARICOM is not rosy. They argue, however, that the CARICOM initiative and further integration through the single-market economy (CSME) offer the potential for economies of scale in nontradables sectors: "Integration gains in nontradables are likely to dwarf the traditional gains from trade." This is an important point, although they do not pursue it in detail. The paper's central message is that policymakers would do well to shift the CARICOM integration efforts from trade policy to other aspects.

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