

The Fiscal Effects of Tariff Reduction in the Caribbean Community[‡]

Prepared by

Amos Peters
Economic Intelligence and Policy Unit
CARICOM Secretariat
P.O. Box 10827
Georgetown
Guyana, SA
Tel: 592-226-9280
Fax: 592-227-4537
E-mail: amosp@caricom.org

Key words – Caribbean Community, tariff, fiscal reform, trade liberalization

[‡] IADB, Washington D.C, September 19, 2002.

Glossary of Acronyms and Abbreviations

CARICOM	Caribbean Community
CARIFORUM	Caribbean Forum
CET	Common External Tariff
COFAP	Council for Finance and Planning
CSME	CARICOM Single Market and Economy
CTAG	Caribbean Trade and Adjustment Group
EU	European Union
FTAA	Free Trade Area of the Americas
FTA	Free Trade Area
GDP	Gross Domestic Product
IMF	International Monetary Fund
MFN	Most Favoured Nation
NAFTA	North American Free Trade Area
OECS	Organisation of Eastern Caribbean States
PTA	Preferential Trading Arrangements
REPA	Regional Economic Partnership Agreement
RPA	Regional Partnership Agreement
VAT	Value Added Tax
WTO	World Trade Organisation

Abstract

This paper explores the fiscal effects of tariff reduction for the Caribbean Community. The paper concludes that Caribbean countries are likely to experience short-run revenue shortfall as a consequence of trade liberalization. Indications are that the shortfall could be as much as a 45 per cent decline in customs duties. In order to mitigate this substantial effect, the ongoing efforts at fiscal reform must continue, paying particular attention to lowering tax exemptions, enhancing indirect tax systems, improving tax collection and administration and modifying the tax structure to reflect lower dependence on trade taxes for fiscal receipts.

I. Introduction

Since the 1973 Treaty of Chaguaramas establishing the Caribbean Community and Common Market, Caribbean leaders have displayed an unequivocal commitment to Free Trade both within Community Member States and internationally. The decision in 1992 to design and implement the CARICOM Single Market and Economy reaffirmed this commitment. The Caribbean Community having achieved free trade in goods is now moving ahead with free trade in services.

At the international levels, Member States of the Caribbean Community signed on to the Marrakesh Agreement that established the World Trade Organisation (WTO) and set the rules that govern global trade. The Caribbean Community has signalled its intention to participate in the hemispheric free trade arrangement, the Free Trade Area of the Americas (FTAA). Moreover Caribbean economies are highly open, and have been participating in global trade for centuries.

It is clear, that CARICOM Member States understand the benefits of free trade, it is clear that Member States are committed to trade liberalization, but unfortunately, in many ways the global environment has not been kind to the Caribbean. The Caribbean continues to experience marginalization in the new international order. The erosion of preferential markets, primarily in Europe, adverse commodity price shocks and stiff competition in tourism services, has seriously affected export earnings and export earnings capacity in all Member States. Finance for development, has become increasingly difficult to access, and this has increased pressure on domestic resources to finance investment, growth and development.

A substantial element of trade liberalization is the lowering of import tariffs and removal of import restrictions. Caribbean governments especially given the backdrop of worsening fiscal deficits are concerned that tariff reduction could have substantial negative revenue effects which could seriously affect their ability to grow their economies, alleviate poverty, and keep debt burdens low.

The concern is acute for those Member States where dependence on import duties as a source of revenue is particularly high. The purpose of this paper is to explore what the impact on revenues might be. The paper is organized as follows: Section II presents a theoretical discussion of the fiscal effects of trade liberalization, Section III outlines the characteristics of Caribbean economies and then Section IV examines the trade structure and trade commitment of the region. A description and analysis of the tax and tariff structure is presented in Sections V and VI. In section VII, we discuss the fiscal effects of tariff reduction on the Caribbean Community given their current fiscal positions, trade structure and tax systems and in section VIII and IX after the likely effects have been established, policy solutions are discussed. Section X concludes the paper.

II. Theoretical Considerations

It is widely acknowledged that there are substantial gains from trade that result from participation in a free trade area, but when fiscal revenue is accounted for, it is not clear what the net welfare effect will be. Bhagwati, Greenaway, and Panagariya (1998) have stated that loss of tariff revenues from inter participant trade can exceed the net gains usually identified in the Harberger-Johnson triangles thus resulting in an overall welfare loss (Nicholls et al: 1999). In this context fiscal loss and adjustment, therefore takes on added significance in the short run.

The elimination of trade barriers among members of a Free Trade Area (FTA), while maintaining barriers with the rest of the world can lead to trade creation and trade diversion of particular products. Trade creation refers to the substitution of high cost production for lower cost source of supply inside the integrated area, leading ultimately to lower domestic prices. Trade diversion is the opposite of trade creation and occurs when higher cost production from the Free Trade Area replaces lower cost sources of supply from third countries (OECD: 2000). The net welfare effect involves a comparison of the trade creating gains with the trade creating losses (Nicholls et al: 1999) an analysis associated with Viner (1950). To determine the scope for trade creation and trade diversion ex ante, a comparison of the production cost structure of the potential Free

Trade Area participants and also the rest of the world must be made for particular products.

Nicholls et al (1999) outline some of the weaknesses of the Vinerian theoretical apparatus. Among them the whole issue of distribution of trade gains. Distribution is of special concern to small vulnerable CARICOM states since as mentioned before, particular distributions could result in overall net welfare losses for particular countries in a Free Trade Area because of the significance and magnitude of fiscal losses.

The fiscal impact of a tariff reduction depends upon a number of factors such as the size of the tariff reduction, the response of imports to the tax change, the relative importance of import tariffs as a source of government revenue, the response of the other tax bases to the tariff reduction and how those tax bases will impact on total revenue, the number of tariff line items that are above and below the maximum revenue tariff, the level of initial tariff, and the share of those imports subject to high tariffs in total imports.

It is expected that countries with heavier dependence on trade taxes as a source of fiscal revenue will be more severely affected, but what is also of critical importance is the response of exporters and importers in CARICOM to the reduction in tariffs. It is important because, the level of imports and exports and overall economic activity affects the revenue that governments collect. The extent of the impact of trade liberalisation on the Caribbean also depends on the extent of substitution of local production for goods and services, which are cheaper from other hemispheric partners (Worrell: 1993).

III. Economic Characteristics of CARICOM countries

Caribbean economies are typically small and highly open to international trade. The total mid-year population of the Caribbean Community, in 1999 was 6,341,382 and with the exception of Guyana and Suriname who take up 87.1 per cent of the Community land mass, the physical size of each Member State are all below 23,000 square kilometres. Most Community countries are islands that lie in the hurricane belt and earthquake zone of the Caribbean Sea, thereby making them acutely vulnerable to natural disasters.

These countries are highly open to international trade relative to other countries and Table 1 illustrates this by presenting the global insertion index for the region and its sub groupings. In 1997 the Community global insertion index¹ was 42 per cent indicating a very globalised economy. Table 1 also shows total GDP, another measure of size.

Caribbean economies also possess highly concentrated production structures, usually focussing very heavily on one or two locomotive sectors such as banana exports, oil and natural gas in the case of Trinidad and Tobago, rice, sugar, bauxite, and tourism services.

Table 1 CARICOM Global Insertion Index: 1990 and 1997

	1990					1997				
	Exports(X)	Imports(M)	(X+M)/2	GDP	Global Insertion Index	Exports(X)	Imports(M)	(X+M)/2	GDP	Global Insertion Index
CARICOM	11,1174.4	14,194.9	12,656.1	36,341.5	0.35	15,872.1	26,030.2	20,951.1	49,335.4	0.42
MDCs	9,826.5	10,974.5	10,400.5	30,874.0	0.34	14,784.4	22,682.9	18,733.6	43,054.7	0.44
Barbados	580.7	1,900.7	1,240.7	4,644.3	0.27	763.9	2,687.9	1,725.9	5,900.3	0.29
Guyana	501.9	595.3	548.6	1069.9	0.51	1,480.6	1,659.8	1,570.2	2,006.9	0.78
Jamaica	3,123.5	5,068.3	4,095.9	11,476.0	0.36	3,742.5	8,404.9	6,073.7	16,737.0	0.36
Suriname	...	...	...	...	...	1,815.9	1,618.1	1,717.0	2,381.6	0.72
Trinidad & Tobago	5620.3	3,410.2	4,515.3	13,683.8	0.33	6,981.4	8,312.2	7,646.8	16,028.9	0.48
LDCs	1,290.9	3,220.4	2,255.6	5467.5	0.41	1,087.7	3,347.3	2,217.5	6,280.7	0.35
Belize	348.4	570.4	459.4	1,094.6	0.42	475.7	772.4	624.1	1,669.4	0.37
OECS	942.5	2,650.0	1,796.2	4,372.9	0.41	612.0	2,574.9	1,593.4	4,611.3	0.35
Antigua & Barbuda	76.7	518.9	297.8	1,057.2	0.28	...	...	...	...	...
Dominica	148.6	318.4	233.5	449.1	0.52	141.3	363.3	252.3	660.0	0.38
Grenada	70.8	294.2	182.5	596.9	0.31	70.1	452.7	261.4	850.2	0.31
Montserrat	4.7	119.2	61.9	181.2	0.34	...	...	...	...	...
St Kitts & Nevis	74.7	299.0	186.8	429.8	0.43	110.9	397.4	254.1	742.3	0.34
St Lucia	343.7	733.0	538.4	1,123.5	0.48	165.3	896.7	531.0	1,565.7	0.34
St Vincent & Gren	223.3	367.4	295.4	535.2	0.55	124.4	464.7	294.6	793.1	0.37

Source: CARICOM Secretariat

Notes: ... means Data not available/Total represents the sum of available data

Table 2 indicates that in all Caribbean economies services form a significant part of total output. For the year 2000, government services ranged from 7.4 per cent of total output in Trinidad and Tobago to 19.8 per cent of total output in St Vincent and the Grenadines, thus indicating the significant role of government in economic activity and underscoring

the importance within a Caribbean context of maintaining revenue stability. Guyana and Dominica have production structures heavily skewed toward agriculture whereas in Trinidad and Tobago, manufacturing contributes significantly to total output. Belize's locomotive sectors are balanced between agriculture and manufacturing whereas St Vincent has a moderate contribution by agriculture to its output. In the other countries tourism services contribute significantly to Gross Domestic Product.

The macro economy of the Caribbean Community is characterised by low to moderate rates of inflation, high levels of unemployment, stable exchange rates and interest rates, and high and sustained inflows of foreign direct investment. In general public sector management has been prudent, with many governments trying to expand public savings, curb spending, improve efficiency in collection and improve implementation of projects. On the monetary side, most Member State Central Banks maintain stable exchange rate regimes and limit lending to the governments. Table (i) in the appendix summarizes economic indicators for Members of the Caribbean Community.

Table 2 Percentage Distribution of Gross Domestic Product by Economic Activity in Current Prices

Economic Activity	Antigua	Barbados	Belize	Dominica	Grenada	Guyana	Jamaica	StKitts	StLucia	StVincent	Suriname	Trinidad
Agriculture	4.0	4.9	12.6	18.2	7.7	34.6	7.0	2.8	7.7	10.8	7.1	1.3
Mining and Quarrying	1.7	0.7	0.7	0.8	0.5	15.4	4.2	0.4	0.4	0.2	12.7	12.8
Manufacturing	2.3	5.8	13.8	7.2	7.6	10.1	13.5	10.5	5.1	5.2	11.8	17.8
Electricity and Water	3.4	3.3	3.3	4.3	5.5	-	3.6	1.8	4.4	6.1	4.6	2.0
Construction	12.9	6.2	7.1	8.2	10.4	4.5	9.6	16.3	8.4	11.7	3.7	10.1
W/Sale and Retail	11.0	17.8	**	13.0	10.8	4.1	20.1	15.2	13.2	17.1	27.6	17.1
Hotels and Restaurant	11.6	11.2	21.6	2.4	9.0			6.6	14.1	2.4	-	3.2
Transport	12.2	**	**	9.6	15.1	**	**	6.9	12.1	13.8	6.6	8.7
Communications	7.9	10.0	9.9	11.4	8.2	6.8	10.1	6.0	7.1	6.7	14.2	**
Banks and Insurance	9.0	**	7.2	13.2	9.9	3.2	7.6	14.2	9.4	8.0	14.2	**
Real Estate and Housing	7.0	22.8	5.9	3.5	3.4	3.7	5.8	2.7	6.1	2.4	-	14.8
Government Services	17.4	17.2	11.6	17.8	16.4	16.2	11.8	19.4	14.9	19.8	12.4	7.4
Other Services	7.6	-	9.9	1.4	3.2	1.5	7.3	4.3	5.0	1.9	1.5	4.5
Less Imputed Charges	8.0	-	3.5	11.0	7.8		7.1	7.0	7.8	6.0	2.2	3.8
Plus Value Added Tax	-	-	-	-	-	-	6.9	-	-	-	-	4.0
Total	100	100	100	100	100	100	100	100	100	100	100	100

Source: CARICOM Secretariat

Note: ** means the item is included in the row below. The data for Barbados, Guyana, Jamaica and Suriname is in 1999 whereas for the others it is 2000.

¹ The Global Insertion Index is calculated by taking the average of exports and imports, as a percentage of GDP.

IV. Caribbean Community Trade Structure

The United States is CARICOM's principal trading partner but in recent times, trade with other hemispheric partners has been growing, largely on account of Trinidad and Tobago and Jamaica. Tables 3 and 4 present the distribution of CARICOM imports and exports respectively by principal source and destination.

Table 3 Distributions of CARICOM Imports by Principal Sources: 1980-1998 (Percentage)

Source of Imports	1980	1985	1990	1995	1996	1997	1998
USA	27.8	38.3	41.2	42.6	44.4	47.7	46.2
European Union	15.8	16.5	15.5	15.2	14.1	14	13.7
CARICOM	8.8	9.7	9.2	9.8	9.7	9.1	9.5
LAIA	5.6	9.1	11.2	9	12.2	9.8	10.4
Selected Asian Countries	6.6	10.2	7.7	8.4	8.2	8.4	9.6
Rest of the World	35.4	16.2	15.2	15	11.4	11	10.6

Source: A Quick Reference to Some Summary Data 1980-1996 and CARICOM Secretariat

Notes: LAIA – Latin America Integration Association

Selected Asian Countries are China, Hong Kong, India, Japan, Singapore, South Korea, Taiwan and Thailand

1990 Excludes data for Antigua and Barbuda

1995 Excludes data for Antigua and Barbuda, Guyana and Montserrat

1996 Excludes data for Antigua & Barbuda, Guyana, Montserrat, St Vincent & the Grenadines and Suriname

1997 Excludes data for Antigua & Barbuda, Guyana, Montserrat and Suriname

1998 Excludes data for Antigua & Barbuda, Dominica, Guyana, Montserrat St Kitts & Nevis and Suriname

Table 4 Distribution of CARICOM Exports by Principal Destinations.: 1980-1998 (Percentage)

Destination of Exports	1980	1985	1990	1995	1996	1997	1998
USA	48.7	47.2	40.7	34.1	38.5	35.3	35.2
European Union	16.5	17.8	20.6	20.9	18.0	18.1	16.9
CARICOM	8.9	12.8	12.2	16.5	18.3	19	22.5
LAIA	1.9	2.1	2.8	5.4	5.2	4.6	3.7
Selected Asian Countries	0.4	1.3	1.2	1.5	0.9	1	0.6
Rest of the World	23.6	18.8	22.5	21.6	19.1	22	21.1

Source: A Quick Reference to Some Summary Data 1980-1996 and CARICOM Secretariat

Notes: LAIA – Latin America Integration Association

Selected Asian Countries are China, Hong Kong, India, Japan, Singapore, South Korea, Taiwan and Thailand

1990 Excludes data for Antigua and Barbuda and Montserrat's Re-Exports

1995 Excludes data for Antigua and Barbuda and Guyana

1996 Excludes data for Antigua & Barbuda, Guyana and Suriname

1997 Excludes data for Antigua & Barbuda, Guyana, Montserrat and Suriname

1998 Excludes data for Antigua & Barbuda, Dominica, Guyana, Montserrat St Kitts & Nevis and Suriname

Table 5 illustrates CARICOM's small size in the hemisphere. In 1998 CARICOM accounted for 0.3 per cent of Western Hemisphere exports and 0.5 per cent of regional imports.

Table 5 Percentage Share of Western Hemisphere Trade by Regional Arrangement, 1994-1999

	1994	1995	1996	1997	1998	1999
Exports						
NAFTA	86.0	85.9	85.6	85.9	87.1	88.1
United States	59.7	58.8	58.1	58.4	58.7	57.2
LAC	21.3	22.2	23.3	23.5	23.0	23.2
LAC excl Mexico	14.0	14.1	14.4	14.1	12.9	11.9
MERCOSUR	7.2	7.1	7.0	7.0	7.0	6.1
Andean Community	4.0	3.8	4.3	4.0	3.3	3.6
CARICOM	0.6	0.6	0.5	0.5	0.3	n.a.
CACM	0.6	0.7	0.7	0.7	0.9	0.9
Imports						
NAFTA	88.3	86.6	86.8	86.1	87.1	90.2
United States	66.3	65.7	65.6	64.2	64.0	66.9
LAC	19.4	19.8	20.4	22.0	21.7	19.1
LAC excl Mexico	11.7	13.4	13.2	13.9	12.9	9.8
MERCOSUR	6.0	6.7	6.9	7.3	6.7	5.2
Andean Community	3.0	3.4	3.0	3.2	3.1	2.3
CARICOM	0.6	0.7	0.6	0.7	0.5	n.a.
CACM	1.0	1.1	1.0	1.1	1.3	1.2

Source: IDB

Table 6 Significance of the Western Hemisphere in CARICOM Trade

	1994	1996	1998
Western Hemisphere Import Concentration	73.4	73.3	72.2
Western Hemisphere Export Concentration	74.2	76.2	76.2

Source: CARICOM Secretariat

Import Concentration is calculated by taking total imports from the western hemisphere as a percentage of total imports from all sources.

Export Concentration is calculated by taking total exports to the western hemisphere as a percentage of total exports to all destinations.

Table 6 shows the concentration of CARICOM trade within the Western Hemisphere, CARICOMs imports from sources within the hemisphere. CARICOM imports from hemispheric partners amounted to 72.2 per cent of total CARICOM imports in 1998 whereas CARICOM exports to the hemisphere constituted 76.2 per cent of total CARICOM exports. This suggests that the Free Trade Area of the Americas will have the largest impact on Caribbean economies.

CARICOM Trade Commitments

CARICOM has entered into a number of bilateral trading arrangements both as an economic block and also as individual countries. Table 7 shows the hemispheric trade agreements with which CARICOM is involved and Table 8 presents agreements that are currently being negotiated or currently proposed. Most of CARICOM's trade agreements are on a non-reciprocal basis although in recent times many of the bilateral trade agreements have sought to expose Caribbean firms to competition with firms of similar size in neighbouring countries. This is a deliberate attempt by CARICOM to adjust to the inevitable liberalised environment associated with the FTAA. Moreover, it has the effect of expanding the regional common market and allowing for growing production in the region especially in Trinidad and Tobago, the industrial hub of the region. There has been marginal growth in trade between Latin America and CARICOM but not sufficient to cause fiscal problems in the region.

Table 7 CARICOM Trade Agreements

Agreement in Force	Date of Signature	Entry into Force
Caribbean Community (CARICOM)	1973	1973
CARICOM-USA	1984	1984
CARICOM-CANADA	1986	1986
CARICOM-VENEZUELA	1992	1993
CARICOM-COLUMBIA	1994	1995
CARICOM-DOMINICAN REPUBLIC	1998	
CARICOM-CUBA	2000	2000
CARICOM-EU (Cotonou)	2000	2000

Source: 1. Integration, Trade and Hemispheric issues Division, IDB

2. CARICOM Secretariat

Table 8 Currently Negotiated and Proposed Trade Agreements

Country Bilateral	Collective Bilateral	Regional Grouping to Regional Grouping	Sub- Hemispheric	Hemispheric	Hemispheric Grouping to Extra Hemispheric Grouping
Trinidad & Tobago- Panama	CARICOM- Chile	CARICOM- ANDEAN Community	Association of Caribbean States-ACS	FTAA	CARICOM/ACP- EU
Trinidad & Tobago- Costa Rica					
Trinidad & Tobago- Mexico					
Guyana- Brazil					

Source: CARICOM Secretariat

Free Trade Area of the Americas

Within the next five years, the FTAA will remove nearly all barriers to trade and services in a market of nearly 800 million people and over 11 trillion dollars in GDP. This free trade area comprises the United States, Canada, and Latin America and the Caribbean. As with the EU, the FTAA is expected to have a negative impact on fiscal revenues in the short run. However the magnitude of trade from the USA suggests that the impact on tax base may be substantial in the short run. Table 5 indicates that the level of trade with the United States is quite substantial, averaging 60 per cent of all hemispheric trade.

The CARIFORUM-EU REPA

The European Commission has proposed a Regional Economic Partnership Agreement (REPA) as a successor agreement to the non-reciprocal Lomé agreements. According to Bourne et al (1999), this proposal is essentially a Free Trade Area whereby the short run costs for CARIFORUM countries are likely to exceed the gains. Given that this potential agreement would be WTO plus². Bourne et al (1999) conclude that given the overall dependence of CARIFORUM countries on trade tax revenues the short-term effects of a REPA are clear. Tariff reduction would cause revenue loss, which would be further exacerbated by weakness in tax administration and narrowness of the tax base. These characteristics further constrain the ability of the Member States to diversify revenue sources. Bourne et al (1999) use Trinidad and Tobago as an example. They highlight the problems that the country encountered when introducing the value added tax. An underdeveloped business sector and register problems, among other things lead to tax

collection lags, which created divergence between actual and planned revenues. The analysis here is as before, conditional on the import elasticities since positive macro-effects (expansionary import volume) can compensate or mitigate revenue loss.

V. Tax Structure of Caribbean Economies

Peters (2002) indicates that the average tax rate³ over the last two decades ranged from 25% in Belize and the OECS to 38% and 32% in Guyana and Trinidad and Tobago respectively. Tables 9 and 10 further illustrate the characteristics of Caribbean tax structure. In the smaller OECS countries taxes on international trade accounted for over 50 % of tax revenue except in Montserrat where it was 46.1%. In the bigger Caribbean territories such as Trinidad and Jamaica, the dependence on trade taxes is lower but still high; it ranges from 8.5% in Trinidad and Tobago to 24.9% in Jamaica. Direct taxes account for significant portions of total revenue in the bigger Caribbean territories and a very small part in the smaller territories. In Trinidad Direct Taxes account for as much as 60.6% of total revenue on average, whereas for Barbados, Guyana and Jamaica direct taxes are approximately a third of total tax revenue. There is also a dichotomy between smaller states and larger states on the role of domestic consumption taxes because consumption taxes are more significant revenue earners in the bigger territories than in the smaller territories mainly due to the introduction of a broad based consumption type VAT. The VAT accounts for 26.8 per cent of total revenue in Barbados, 20.8 per cent in Jamaica, and 18.0 per cent in Trinidad and Tobago. In the OECS, however, the revenue gained from consumption taxes on imported goods is substantial and in most cases transcends revenue earned from import duties.

² Member States will be expected to lower tariff rates below WTO bound rates.

³ This is defined as total tax divided by total income or GDP.

Table 9 Tax Structure: Taxes as a percentage of Total Tax Revenue in Select Caribbean Countries for the period 1991-1996.

	Barbados	Guyana	Jamaica	Trinidad
DIRECT TAXES	43.1	38.6	37.5	61.6
Taxes on Income, Profits, and Capital Gains of which:	31.5	36.8	36.8	60.6
Companies	10.9	20.2	13.7	29.4
<i>Individual/PAYE</i>	17.9	12.6	20.9	19.5
<i>Employment Levy</i>	1.0	-	-	-
<i>Training Levy</i>	1.2	-	-	-
<i>Transport Levy</i>	1.3	-	-	-
Health Service Levy	1.0	-	-	-
<i>Unemployment Levy</i>	-	-	-	1.2
<i>National Health Surcharge</i>	-	-	-	1.6
<i>Oil Royalties</i>	-	-	-	7.7
<i>Withholding Tax</i>	-	4.0	-	1.4
<i>Bauxite & Alumina</i>	-	-	1.1	-
<i>Business Levy</i>	-	-	-	0.8
<i>Interests & Dividends</i>	-	-	5.5	-
<i>Other Taxes</i>	2.7	-	-	-
Taxes on Property	6.0	1.8	0.7	0.9
INDIRECT TAXES	56.9	61.4	62.5	38.4
Taxes on Domestic Goods and Services of which:	39.1	33.6	31.3	29.3
<i>Consumption Tax/VAT/GCT (Local)</i>	26.8	-	20.8	18.0
<i>Highway Revenue</i>	1.9	-	-	-
<i>Hotel and Restaurant Sales Tax</i>	1.8	-	-	-
<i>Excise Duties</i>	-	0.4	-	9.5
<i>Motor Vehicle Taxes</i>	-	33.0	-	1.6
<i>Education Tax</i>	-	-	0.9	-
<i>Contractor Levy</i>	-	-	4.1	-
<i>Purchase Tax on Cars</i>	-	1.3	0.3	-
<i>Other Taxes</i>	7.3	-	5.0	0.5
Taxes on International Trade and Transactions of which:	17.8	14.8	24.9	8.5
Import Duties	9.1	12.4	0.3	5.5
<i>Export Duties</i>	-	0.8	-	-
<i>Stamp Duties</i>	8.8	-	1.2	2.6
Custom Duty	-	-	11.8	-
<i>Airport Services</i>	1.4	-	-	-
<i>Travel Taxes</i>	-	-	1.5	-
<i>GCT Imports</i>	-	-	12.9	-
<i>Bauxite Levy</i>	-	-	6.2	-
<i>Other Taxes</i>	-	12.2	-	-
Total Tax Revenue	100.0	100.0	100.0	100.0

Source: ECCB

Table 10 Tax Structure: Taxes as a percentage of Total Tax Revenue in 1997 for the Eastern Caribbean

DIRECT TAXES	0.7	16.4	30.2	14.2	41.4	25.2	30.8	31.9
Taxes on Property	0.7	1.6	0.0	3.6	3.7	2.5	0.6	0.9
Consumption Tax	-	-	3.4	10.4	0.0	1.5	3.1	3.4
	Anguilla	Antigua	Dominica	Grenada	Montserrat	StKitts	StLucia	StVincent
Taxes on Income,	0.7	14.8	30.2	11.6	37.7	22.7	30.3	31.0
INDIRECT TAXES	99.3	83.6	69.8	85.8	58.6	74.8	69.2	68.1
Hotel Occupancy Tax	14.1	1.6	0.3	-	0.3	5.6	3.9	1.9
Entertainment Tax	0.0	0.0	0.1	-	0.0	0.0	0.0	0.0
Telecommunications Tax	-	3.4	-	-	-	1.0	0.7	1.4
Insurance Levy	-	0.5	-	-	1.4	0.7	0.9	1.4
Licenses	9.4	5.0	4.5	3.4	8.1	3.1	2.3	3.9
Taxes on International Trade and Transactions of which:	61.9	61.7	54.9	65.3	46.1	54.7	55.8	50.9
Import Duties	55.2	18.9	13.8	14.8	8.6	30.4	17.9	12.0
Export Duties	0.0	0.0	-	-	-	0.2	0.0	0.2
Consumption Tax	-	27.6	37.4	37.1	16.9	23.1	26.6	31.3
Customs Service Tax	-	7.7	2.3	0.0	14.5	7.4	9.0	4.7
Foreign Exchange Tax	2.5	1.0	-	-	3.6	-	-	-
Travel Tax	-	2.4	-	0.0	-	0.8	0.3	0.0
Embarkation Tax	4.2	2.6	1.2	1.5	0.8	1.6	0.0	1.3
Total Tax Revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECCB

Table 11 Tax Buoyancy in Select Caribbean Countries

	ANG	ANU	DCA	GDA	MON	SKN	SLU	SVG	BAR	GUY	JAM	TNT
Direct Taxes	-1.7	1.4	4.6	11.5	-1.2	1.1	0.4	2.1	-0.9	1.4	0.9	0.9
Taxes on Income, Profits, Capital Gains	-1.7	1.6	3.5	-0.5	-1.4	1.1	0.4	2.1	-0.8	1.4	0.9	0.9
Taxes on Property	-	-	-	-	-	-	-	-	0.3	1.9	1.2	1.4
Indirect Taxes	2.4	1.1	2.2	0.5	-1.0	0.8	0.9	1.2	1.0	1.2	1.1	1.3
Taxes on Domestic Goods and Services	3.0	1.2	5.2	0.6	0.9	1.2	1.6	1.6	-0.4	1.3	1.0	1.5
Taxes on Int'l Trade & Transactions	2.1	1.1	1.4	0.6	-1.3	0.7	0.7	1.1	2.5	1.1	1.2	0.9
Total Tax Revenue	2.5	2.9	3.0	0.7	-1.1	0.9	0.7	1.5	0.1	1.3	1.0	1.0

Source: ECCB

Note: For Barbados, Guyana, Jamaica, and Trinidad and Tobago the period 1991-1996 was used to derive an average whereas for the other countries the year 1997 was employed.

Table 11 illustrates the responsiveness of tax revenues in the Caribbean to changes in income or GDP. Over the period 1991 to 1996, the tax buoyancy coefficient was 1.0 per cent in Jamaica and Guyana due mainly to the high buoyancy for the indirect taxes. Barbados recorded low tax buoyancy overall and for both direct and indirect taxes. For the OECS countries, the indirect tax buoyancy coefficient ranges between 0.5 and 2.4, whereas the overall average tax buoyancy coefficient stood at 1.3, thus indicating a degree of elasticity between tax revenue and income.

The reduction of import duties, associated with trade liberalisation often has the effect of reducing fiscal revenues because the level of tax receipts in small open economies is heavily dependent on import and export trends. There are a number of measures of dependence on trade taxes most notably the ratio of tax receipts from international trade to total tax revenue, which is employed by this paper. Another measure is the ratio of import duties to Gross Domestic Product⁴.

⁴ For a detailed description and analysis of CARICOM fiscal dependence on trade taxes, using various measures, see Nicholls et al (1999).

Generally, import duty⁵ as a percentage of total tax receipts is considered significant if it is in excess of 15 per cent (ECLAC: 1998). In a study of the impact of a EU-CARICOM Regional Partnership Agreement (RPA), Bourne et al (1999) classified degrees of dependence (ratio of import duties to total tax receipts) as low, moderate and high. Low dependence was characterised by ratios between 0 per cent and 15 per cent, moderate degrees of dependence were between 15 per cent and 30 per cent and high dependence was in excess of 30 per cent.

Table 12: Import Taxes as a Percentage of Fiscal Revenue, 1990-1999

Country	Year									
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Antigua & Barbuda	52.08	54.84	54.75	54.12	51.48	51.83	51.08	49.71	50.36	48.08
Anguilla	...	65.97	67.84	48.33	54.92	53.23	58.25	57.04	65.57	63.18
Bahamas	65.94	62.23	55.62	54.97	53.65	52.62	52.77	52.10	49.79	52.67
Barbados	13.21	9.44	8.08	8.08	8.63	8.61	8.08	9.26	9.35	9.57
Belize	51.54	51.86	47.82	49.20	49.70	52.97	34.41	31.57	33.50	34.77
Dominica	17.84	18.21	17.45	17.61	14.67	14.27	13.99	14.98	13.53	14.61
Guyana	11.39	10.23	9.50	12.59	12.82	11.58	11.67	11.80	12.06	n.a.
Jamaica	n..	13.44	13.71	13.57	10.89	11.86	10.83	11.27	10.60	10.42
St. Kitts & Nevis	53.49	50.29	48.29	26.24	49.13	45.57	45.33	44.23	42.04	43.57
St. Lucia	51.92	50.49	50.01	50.57	48.34	48.01	47.89	44.71	48.61	47.08
St. Vincent	51.09	49.62	48.71	47.60	45.91	48.94	43.60	44.93	42.75	43.26
Trinidad and Tobago	8.17	8.08	9.36	9.35	7.71	5.80	5.20	6.25	7.22	7.23

Source: ECLAC database

Table 12 shows that in 1999, the ratio of import taxes to total tax revenue ranged from 7.23 per cent in Trinidad and Tobago to 48.08 per cent in Antigua and Barbuda. The average degree of dependence for the CARICOM region was 29.39 per cent. What is easily discerned from Table 12 is that the OECS countries and Belize (the LDCs) are highly dependent on trade taxes as a source of revenue whereas the other countries (MDCs) are less dependent, fitting into the low dependency category. CARICOM as a region is moderately dependent on trade taxes as a source of revenue. Past evidence has indicated that declines in revenue have normally been smaller than expected given the stimulation of demand for imports.

⁵ In the Caribbean Community taxes on international trade and import duties are usually one and the same since export duties are rarely levied.

VI. Tariff Levels within CARICOM

Generally CARICOM has duty free trade among its members and a Common External Tariff against third parties. CARICOM also has multilateral commitments in relation to third countries, including tariff bindings. The Free Trade Area of the Americas (FTAA) is likely to create further WTO plus tariff commitments.

Indications are that WTO agreements and outcomes of the Uruguay Round are incorporated into domestic legislation at varying degrees within the Community, but generally the Community has been slow in the implementation of these commitments.

Tariff bindings differ considerably among CARICOM States and sometimes conflict with CET rates. It is not anticipated that WTO bound rates or phase CET reductions would have a significant revenue effects since considerable time for adjustment and reform enables Member States to take advantage of the opportunities presented by trade liberalisation while avoiding the pitfalls.

The Common External Tariff (CET) governs trade between the Caribbean Community and third parties and serves as a protective trade instrument for the Community. In an effort to reduce protection, Member States agreed in 1992 to a four-stage reduction in the tariff rates, spanning over five (5) years. Table 2 below presents the proposed schedule of reductions. Few Member States have complied with the CET reduction tariff schedule. Member States do make an effort to introduce offsetting measures by increasing other duties and charges (most falling almost exclusively on imports).

Table 14 Tariff Reduction Schedule for CARICOM Member States

Period of Application	Period Allowed to Effect Implementation	Rate Structure	
		MDC%	LDC%
1 Jan 1993 – 31 Dec 1994	1 Jan 1993 to 30 June 1993	5-30/35	0-5 to 0/35
1 Jan 1995 – 31 Dec 1996	1 Jan 1995 to 30 June 1995	2-25/30	0-5 to 5/30
1 Jan 1997 – 31 Dec 1997	1 Jan 1997 to 30 June 1997	5-20/25	0-5 to 0/25
1 Jan 1998 onwards	1 Jan 1998 to 30 June 1998	5-20	0-5 to 20

Source: CARICOM Secretariat

Most CARICOM countries bound their tariffs in the Uruguay Round at levels considerably higher than what is applied. For most Member States, the MFN bound rates transcend the CET. For example Jamaica bound its tariffs on imports of industrial products at a uniform rate at 50%, Agricultural tariffs were bound at 100% (Chaitoo: 2002). The WTO estimates that 55 per cent of Jamaica's MFN tariff lines were duty free in 1998, 21 per cent of tariffs were between 20-25 per cent ad valorem, and approximately 7 per cent of tariffs were between 35-40 per cent.

The fourth and final phase of the CET caps tariffs at 20 per cent, though agricultural commodities have higher rates. The OECS have been slow to implement phase IV of the CET and this in part reflects the adjustment difficulties that accrue as a result of high dependence on trade taxes.

Table 13

CARICOM Tariffs in 1998- by Sections of the Harmonized System 1993 –(average Most Favoured Nation Applied Tariff)														
	ANU	BAR	BLZ	DCA	GDA	GUY	JAM	MON	SKN	SLU	SVG	SUR	TNT	CARICOM
Live Animal/ Products	19.2	21.1	27.4	20.2	22.9	26.1	24.2	20.4	15.8	19.9	19.5	22.5	23.7	21.8
Vegetable Products	16.2	18.9	18.8	19.2	18.7	19	18.9	18.8	15.7	19.1	19	18.7	18.6	18.4
Animal/Vegetable Fats	32.2	24.7	22.5	24.7	24.7	24.7	24.7	24.7	23.2	24.7	24.7	24.7	24.7	24.3
Processing Foods/Tobacco	16.2	15.2	19.5	19.9	17.3	24.2	16.6	15.9	15.8	19.1	16.6	18.9	15.7	17.7
Mineral Products	4.7	5.1	5.1	5.2	5.3	5.8	5.3	3.9	5.1	5	4.9	4.7	7.3	5.2
Animal Hides/Skin	8.6	8.6	8.6	8.6	8.6	0.6	8.6	8.6	8.5	8.6	8.6	8.6	8.6	8.6
Wood/Wood Articles	8.6	8.6	9.5	8	8.6	8.6	8.6	8.6	8.5	8.6	8.6	8.6	8.5	8.6
Paper/Cellulose Material	6.8	6.8	6.8	6.8	6.8	6.8	6.8	6.7	6.9	6.9	6.9	6.8	6.8	6.8
Chemical/Industrial Products	5.2	5.1	5	5.4	5.1	5.1	5.1	5.2	4.9	5.5	5.1	5.1	5.1	5.1
Plastic/Rubber	7.8	7.8	7.6	7.7	7.6	7.7	7.9	7.6	7.9	7.8	7.6	7.6	7.9	7.7
Textiles	11	9.9	14.7	11.1	9.9	9.9	9.9	9.9	11.9	12.2	9.9	9.9	9.9	10.8
Footwear/ Misc. Articles	16.5	15.8	18	16.5	15.8	15.8	15.8	15.8	17.4	18.4	15.8	15.8	15.8	16.4
Stone/Glassware	8.9	9	9.2	8.8	8.6	9	8.7	7.7	9.1	8.6	8.1	8.1	9	8.7
Precious/Semiprec. Mat	17	29.7	29.7	19.7	19.6	29.7	17	19.7	16.8	14.4	22.4	22.4	19.7	21
Base Metals	5.7	5.5	5.8	5.6	5.5	5.5	5.5	5.5	5.7	5.5	5.5	5.5	5.5	5.6
Machinery/Electrical Equip.	6.4	5.9	6	5.9	6.1	0.9	5.8	5.8	6.3	5.9	5.6	5.6	6.1	6
Motor Vehicles/Vessels	9.6	0.9	8.9	8.6	8.3	8.9	7.6	5.5	11.2	8.3	6.3	6.3	8.5	8.5
Precious Instruments	9.5	12.4	12.5	10.1	10.2	12.7	10	9	9.7	10.2	10	10	10.8	10.5
Arms/Munitions	41.4	41.4	41.4	28.9	23.9	41.4	21.4	21.4	41.1	23.9	18.9	18.9	23.9	31.6
Misc. Manufactured Articles	15.4	14.9	15.6	15.2	14.9	14.9	14.9	14.9	15	14.9	14.9	14.9	14.9	15.1
Art/Antiques	17.5	20	18.1	20.8	20	20	20	20	20.6	20	20	20	20	19.8
Overall	9.7	9.8	11.2	10.1	9.8	10.6	9.7	9.3	9.6	10.3	9.5	9.7	9.8	9.9
Residual	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9

ANU: Antigua & Barbuda; BAR: Barbados; BLZ: Belize; DCA: Dominica; GDA: Grenada; GUY: Guyana; JAM: Jamaica; MON: Montserrat; SKN: St Kitts and Nevis; SLU: St Lucia; SVG: St Vincent & Grenadines; SUR: Suriname; TNT: Trinidad & Tobago.

Source: Jessen and Rodriguez (1999)

VIII. The Fiscal Impact

According to a report on ‘Improving competitiveness for Caribbean Development’, prepared by the Caribbean Trade and Adjustment Group, estimates indicate that a 50 per cent multilateral liberalisation will result in 42 to 45 per cent decline in customs revenue. The Trade and Adjustment Group anticipates that this decline would be somewhat off-set by expansion in the taxable base that would occur as a result of increased imports and exports.

Devarajan, Go and Li (1999) estimate import and export elasticities for 60 countries including some Caribbean territories. Table 14 displays those results.

Table 14 Import and Export Elasticities for selected CARICOM States

Country	Import Elasticity	Export Elasticity
The Bahamas	1.50; 1.44	...
Belize	0.66; 0.81	...
Grenada	0.22	...
Haiti	0.69; 0.62; 0.64; 1.62	0.43; 0.40; 0.37; 0.32; 0.30;
Jamaica	0.24; 0.37; 0.24	0.45; 0.22; 0.30; 0.29; 0.38; 1.55; 1.47
St Kitts & Nevis	2.80; 2.67	...
St Vincent & the Grenadines	1.09; 0.47	...
Trinidad & Tobago	0.81; 0.62; 0.78; 0.76; 0.61; 1.01	...

Source: Devarajan, Go and Li (1999)

... means not available.

Note: For details of estimation methodology, number of observations and statistical attributes of estimates, see above captioned reference.

Devarajan, Go and Li (1999) state that even if one of the elasticities is close to zero, revenue will decline unequivocally, reaching close to zero regardless whether the other elasticity is high. Moreover for imports to grow and tariff collection to compensate for the fall in tariffs, the import elasticity has to be high. They argue that due the balance of

trade constraint imports cannot substitute perfectly for domestic goods unless the supply responds by exporting. This means export elasticities must be high as well for tariff cuts to be self-financing. In the example they give, both elasticities have to be greater than 20. Clearly based on these criteria, tariff reduction in the Caribbean Community will not be self financing.

Nicholls et al (1999) examine using an Almost Ideal Demand System (AIDS) model⁶, the impact of tariff removal from the CARIFORUM-EU REPA on revenues. Their results indicate that for the OECS, Jamaica, and Trinidad and Tobago, tariff removal under a FTA would result in a decline of revenues from trade taxes. The estimated magnitudes of those changes tell a story because in Jamaica and Trinidad and Tobago, revenues from trade taxes were projected to decline by 3.4 and 2.36 per cent respectively. The OECS revenues on the other hand would decline by 8.4 per cent. This outcome obviously is a direct function of dependence on trade taxes, since the OECS is highly dependent. In the OECS as whole tax collected on international trade represented 57.4 per cent of tax revenue in 1999 and 26.3 per cent of the value of imports. Consumption tax was the main source of tax revenue (28.3 per cent of tax revenue), followed by tariffs (17.8 per cent) and customs service charges (7.3 per cent). Currently the OECS Member States are working on reform of the tax system with a view to introduce a value added tax.

⁶ This is an import expenditure function.

CARICOM countries are extremely open, and not only are they big importers of consumer goods, but they are also big importers of production and intermediate goods. Merchandise trade accounts for in excess of 50 per cent of GDP (ECLAC: 1998) and when services are included this percentage is much higher. On the supply side their production base is fairly narrow, relying in most cases on a single commodity export for earnings. This constrains the ability of Caribbean economies to adjust quickly so as to mitigate the effects of short-term shocks. Moreover the highly specialised nature of CARICOM production structures greatly increases their fiscal vulnerability. Solutions, therefore, lie not only in tax reform but also in longer-term structural reform. It can already be inferred that the smaller countries of CARICOM will be more severely affected. Most available literature on this issue supports this conclusion.

The 1997 Report on Small Economies and Western Hemispheric Integration (Independent Group of Experts) indicated that a major challenge with establishing a Free Trade Area of the Americas is to integrate countries of diverse size and levels of development. The Caribbean faces two constraints, namely small size and a lower level of development. Associated with small size are structural features such as high dependence on external trade, small domestic markets, un-diversified and sometimes mono-production structures with narrow tax bases. Mature and highly developed countries usually depend more on sales or value added taxes and hardly if at all on trade taxes, so high dependence on trade taxes is in some sense symptomatic of the level of maturity in an economy. CARICOM countries have attempted to reposition themselves in the new global economy by pursuing prudent macroeconomic management and regional integration.

Naturally there are costs and benefits associated with any action, and in the case of the Caribbean lowering tariffs has immense potential especially in the area of expanding tourism and service production. The costs however are real in the short run, so the only alternative for Member States is to pursue alternative sources of income such as sales or value added tax. Because reforming the tax structure requires a new level sophistication, new more efficient methods of tax collection and administration, and a search for

alternative tax bases, fiscal reform can be a timely but worthwhile exercise. Many Member States have already started this process, and this must be an ongoing one. It is important that Member States design and implement fiscal reform to maximise compliance while simultaneously providing incentives for savings and investment and the overall promotion of economic development.

Over the years 1994 to 1998, the CARICOM region became more integrated with the international economy, as measured by their increasing degrees of openness. Government consumption on average has fallen relative to GDP. Trade shocks have taken the form of diminished preferential trading arrangements (PTA). In general, the revenue effects of trade liberalisation are uncertain. Blejer and Cheasty (1990), Tanzi (1989) conclude that ultimately the net impact of trade liberalisation on tax revenue is an empirical matter. Much depends on countries initial conditions and other tax measures that they introduce at the time of tariff reduction. Indeed depending on the level of import elasticities of substitution, revenues could possibly increase. If however import levels remained the same, the effect of a reduction in tariff rates would be to immediately lower revenue. However, imports are likely to expand given the reduced cost of importing, thus compensating at least partially for the lower taxation rates. How pronounced the net effect will be, is highly dependent on the initial level of tax rates as mentioned in the introduction.

Ebrill et al (1999) state that revenue will least likely be affected or could even expand when:

- The initial position is highly restrictive;
- Trade liberalisation involves the tariffication of quantitative restrictions, the auctioning of licenses to import, or both;
- Trade liberalisation includes such reforms as a reduction in tariff dispersion, the introduction of a minimum tariff, or the elimination of exemptions;

- Trade liberalisation is accompanied by reforms in customs and tax administrations, which also reduce the incentives to evade taxes; and
- Trade liberalisation is supported by sound macroeconomic policies that ensure that liberalisation is consistent with external balance.

The erosion of trade preferences in the European Union market and Caribbean Basin Initiative (CBI) preferences under NAFTA⁷ and the concomitant reduction in concessional finance and/or official development assistance (ODA) has made adjustment all the more challenging for CARICOM Member States. Weak tax administration in the Less Developed Countries (LDC) of CARICOM exacerbate the problem as they constrain the ability of the Member States to accumulate much needed public savings. Most states continue to reform their tax administrative systems and some have made substantial gains in this area.

Moreover, intense competition among Member States for Foreign Direct Investment has caused Member States to offer overly generous duties and tax exemptions and diverse subsidies. This has put severe downward pressure on corporate income receipts (Loser: 1999). As a result of this CARICOM States must streamline and rationalise their tax and investment incentive regimes⁸. This is best accomplished through regional tax harmonisation and co-ordination efforts to reduce the brutal effects of competition for capital. This will enable Member States to shore up public savings and better deal with tariff reductions.

⁷ See List of Acronyms and Abbreviations, p2.

⁸ See Exploring Caribbean Tax Structure and Harmonisation Strategies, CARICOM Secretariat (5th COFAP Meeting Research Paper).

Tanzi and Zee (2000) state that nominal tariff reductions are likely to cause short-term revenue loss, though in the long-run the response is conditional on import elasticities. They advocate three compensatory measures, namely:

1. Reducing the scope of tariff exemptions in the existing system⁹
2. Compensating for the tariff reductions on excisable imports by a commensurate increase in their excise rates;
3. Adjusting the rate of the general consumption tax (such as the VAT) to meet remaining revenue needs.

With regard to introducing a Value Added Tax valuable lessons can be drawn from the success of Trinidad and Tobago and Barbados. Countries need to remove overly generous tax incentive regimes.¹⁰ Evidence from different sources (Devarajan, 1999; ECLAC, 1999; IMF, 2000) indicate that ‘trade liberalization may produce a revenue depleting effect.’

VIII. Trade Negotiation Solutions

The Caribbean Community faces a number of challenges in the near future. The region will have to negotiate its way through a growing maze of trade negotiations at the regional, hemispheric, and international levels. At the regional level CARICOM countries are negotiating among themselves free trade in services, as part of a move toward the CARICOM Single Market and Economy. The FTAA and CARICOM-EU regional partnership agreements are major negotiations that involve CARICOM’s major trading partners namely the United States, Canada, and the European Union. Other negotiations include hemispheric bilateral agreements and the WTO (to include GATS).

⁹ This can be done by imposing a low minimum tariff on all imports.

¹⁰ For detailed policy solutions, see Caribbean Trade and Adjustment Group report on Improving Competitiveness for Caribbean Development.

It is fair to state that given that CARICOM has non-reciprocal market access agreements with all of its major trading partners and with other countries (under the Generalised System of Preferences), CARICOM has little to gain from tariff negotiations with their main trading partners (Chaitoo: 2002). Over 95 per cent of Commonwealth Caribbean country exports receive preferential, non-reciprocal duty free entry into Canada and up to 63.4 per cent of CARICOM exports receive duty free entry into the United States. Approximately 21.2 per cent of CARICOM exports face a 0-5 per cent tariff. CARICOM's market access, therefore, compares favourably with other regional groupings such as the Andean Community (39.7 % duty free imports into the USA), Mercosur (61.4% duty free imports into the USA) and CACM (40.4 duty free imports into the United States).

In general CARICOM's approach has been one of promoting limited reciprocity for small countries with longer phase-ins of agreement terms and requisite safeguards (INTAL: 2002). The underlying rationale for this approach is that CARICOM countries are acutely vulnerable to adverse economic shocks and these 'special' circumstances should be taken into account when applying XXIV of the General Agreement on Tariffs and Trade (GATT).

Chaitoo (2002) states Trade Ministers under the FTAA market Access Negotiations decided in March 1998 at San Jose on the following:

- The FTAA will be consistent with the provisions of the WTO, including GATT Article XXIV (1994) and its understanding on the Interpretation of Article XXIV of the GATT 1994 to progressively eliminate tariffs and non-tariff barriers as well as other measures with equivalent effect, that restrict trade between participating countries.
- All tariffs will be subject to negotiation
- Different trade liberalisation timetables may be negotiated.

- To facilitate the integration of smaller economies and their full participation in the FTAA negotiations.

Even though the FTAA is designed to be WTO compatible, it has been so structured to extend special and differential treatments to smaller economies (Arthur: 2001). Special and Differential treatments is therefore an obvious solution and CARICOM has continued to argue with success that their special circumstances warrant different treatment. Based on the analysis presented so far, it is clear that CARICOM countries will have to make a relatively greater economic and fiscal adjustment than other participating groups in the FTAA. This is due to CARICOM's high dependence on trade taxes for government revenue, and its economic structure with a higher ratio of trade preference induced activity to GDP than anywhere else. The small size of CARICOM countries and high fixed costs associated with introducing replacement taxes means that effective participation in the FTAA will require extended phase-in periods to allow these economies to adjust their production and fiscal structures.

Special and Differential treatment should comprise the following:

- FTAA must have longer phase-in periods;
- Special derogations from agreed liberalisations where necessary;
- Very high thresholds in particular sectors before liberalisation, for example government procurement;
- Longer lists of sensitive industries than is normally the case;
- Special arrangements to allow the small economies affordable access to costly dispute settlement mechanisms;
- Technical assistance in relation to capacity building and institutional reform; and

- Access to a social cohesion or adjustment fund.

The final trade negotiation solution is to start tariff negotiations at rates that are not too low, so as to concede before the process begins. The base rate should be as close to the WTO MFN rate as possible taking into consideration that the FTAA must be WTO-plus.

IX. Fiscal Solutions

The magnitude of the impact of trade liberalisation is conditional on the type of fiscal structure a country may have. In the case of CARICOM, the governments are highly dependent on trade taxes. Hence, there is an obvious case for fiscal reform.

First of all it is imperative that Member States pursue prudent fiscal management. This entails increasing public sector savings, efficient and effective public sector investment, and reducing wasteful transfers to loss-making state enterprises, cutting the 'fat' in civil service payrolls, and reducing the scope for wasteful spending. In this regard, there is urgent need for civil service reform. CARICOM countries have already seen improvements in their expenditure control systems and enhancement of tax and administration. Overly generous discretionary and distortionary fiscal incentive regimes need to be replaced with tax environments that are stable and credible.

As mentioned earlier in the paper, countries can introduce compensatory measures like reducing the scope of tariff exemptions in the system in favour of imposing low minimum tariffs on all imports. This has the added benefit of removing distortions and raising the credibility of the tax system. Caribbean governments can also raise excisable duties on excisable imports to mitigate or compensate for revenue loss from lower tariffs. In fact many Caribbean governments have introduced environmental levies, raised customs charges and raised consumption tax rates.

One of the major fiscal adjustments solutions is to introduce and/or strengthen broad based taxes, such as the value-added tax and corporate and personal income taxes while

simultaneously developing alternative revenue or underused revenue sources such as property taxes and taxes on the self employed.

The specific form a general broad-based indirect tax should assume is debatable but Barbados and Trinidad and Tobago have had success with the introduction of the VAT. The VAT collections have exceeded revenue expectations in Barbados and indeed this tax is known for its ability to enhance revenues.

In conclusion, adjustment solutions revolve around improving efficiency and prudence in fiscal management both on the revenue and the expenditure side. CARICOM must reform its fiscal system to reflect a lower dependence on trade taxes and improve the credibility of the tax and incentive regime.

X. Conclusion

Trade Liberalisation will engender decreased reliance on border taxes and loss of fiscal receipts for Member States. The magnitude is difficult to assess, but indications are that in the short run revenue, shortfall could be substantial. Member States must pursue prudent fiscal management, keeping expenditures roughly in line with revenues, if possible expanding public savings. Member States must widen the tax net and develop new tax bases. This includes improving tax collection and administration.

References

Arthur, Owen, (2001), 'The Promise and the Peril: A Caribbean Perspective on the FTAA', Keynote Address at the 2001 CLAA Miami Conference.

Blejer, Mario, and Adrienne Cheasty, (1990), 'Fiscal Implications of Trade Liberalisation', in *Fiscal Policy in Open Developing Economies*, ed. By Vito Tanzi (Washington: International Monetary Fund), pp.66-81

Bourne, Compton, (1999), 'Regional Economic Partnership Agreement between the European Union and CARIFORUM ACP countries Volume One: Economic Aspects of a Regional Economic Partnership Agreement' (unpublished: Regional Negotiating Machinery-RNM).

Caribbean Centre For Monetary Studies, Report on the Economic Performance and Convergence of the CARICOM Region (for the year ending December 2001), May 24, CARICOM Central Bank Governors Meeting.

Caribbean Community Secretariat, (2000), Caribbean Trade and Investment Report 2000: Dynamic Interface of Regionalism and Globalisation, Ian Randle Publishers, Kingston.

Caribbean Community Secretariat, (2001), 'Exploring Caribbean Tax Structure and Harmonisation Strategies', 5th Meeting of the COFAP, St Georges, Grenada.

Caribbean Group for Economic Co-operation in Economic Development, (2000) 'Caribbean Economic Overview, World Bank.

Caribbean Trade and Adjustment Group, (2001), 'Improving Competitiveness for Caribbean Development', CARICOM Negotiating Machinery and CARICOM Secretariat

Chaitoo, Ramesh, (2002), 'Tariff Negotiation Methods and Modalities in the FTAA: Implications for CARICOM', Caribbean Regional Negotiating Machinery, Barbados.

Deaton A. and J. Muellbauer, (1980), 'An almost ideal demand system', *American Economic Review*, Vol.70 (3), pp. 312-326.

Devarajan, Shantayanan, Delfis S. Go, Hongyi Li, (1999), 'Quantifying the fiscal effects of trade reform: A general equilibrium model estimated for 60 countries', World Bank.

Eastern Caribbean Central Bank, (1999), ECCB Area Annual Statistical Digest 1999.

Ebrill, Liam, Janet Stotsky, Reint Gropp, (1999), Revenue Implications of Trade Liberalization, IMF Occasional Paper No. 180.

ECLAC, (1998), *The Fiscal Covenant: Strengths, Weaknesses, Challenges*, Chile.

FTAA- Consultative Group on Smaller Economies (Tripartite Committee), (2001), 'The Fiscal Implication of Trade Liberalisation: Issues for the Free Trade Area of Americas'.

Greene, William H., *Econometric Analysis*, 3rd Edition, Prentice Hall, New Jersey.

Hamilton, J.D., (1994), *Time Series Analysis*, Princeton University Press, New Jersey.

Independent Group of Experts, (1997), 'Overcoming Obstacles and Maximizing Opportunities: Smaller Economies and Western Hemispheric Integration',

Johnston, Jack J., and John Dinardo, *Econometric Methods*, 1997, McGraw-Hill, New York.

Loser, Claudio M., (1999), 'Globalisation: Challenges and Opportunities for the Eastern Caribbean Region', Address given at the Seminar organised by the St Kitts-Nevis Economics Society, July 15, Basseterre.

Nicholls, Shelton., Janice Christopher-Nicholls, Philip Colthrust, (1999), 'Evaluating the Fiscal Impact of a Potential Regional Economic Partnership Agreement (REPA) between the European Union and the Small Island Economies of CARICOM', University of the West Indies Department of Economics.

OECD, (2000), *The European Union's Trade Policies and their Economic Effects*, Paris

Peters, Amos, and Marlon Bristol, (2002), 'Value Added Tax: Is it Suitable for the Caribbean Community?', CARICOM Secretariat.

Peters, Amos C., (2002), 'Exploring Caribbean Tax Structure and Harmonisation Strategies', *Bulletin for International Fiscal Documentation*, Vol. 56, No. 5.

Tanzi, Vito, (1989), 'Impact of Macroeconomic Policies on the Level of Taxation and the Fiscal Balance in Developing Countries', *Staff Papers*, International Monetary Fund, Vol. 36 (September), pp.633-56.

Tanzi, Vito, and Howell H. Zee, (2000), 'Tax Policy for Emerging Markets: Developing Countries', *IMF Working Paper*, International Monetary Fund, WP/00/35 (March).

Viner J., (1950), *The Customs Union Issue*, New York: Carnegie Endowment for Peace.

World Bank, (2000), *World Development Indicators CD ROM 2000*.

World Trade Organisation, (2001), *OECS Trade Policy Review*.

Worrell, D, (1993), 'Economic Integration with Unequal Partners: The Caribbean and North America', Central Bank of Barbados.

[Www.imf.org](http://www.imf.org)

Appendix

Table (i) Selected Indicators

Some macroeconomic indicators of CARICOM Member States										
Country	GDP (US\$ billions 1998)	Inflation Rate (1998)	GNP per capita annual growth rate (1990- 1998)	Population	Agriculture (in % of GDP) 1998	Manufacturing (in % of GDP) 1998	Services (in % of GDP) 1998	Human Development Index (HDI) 1998	Land Area (Square Km)	GDP per capita (US\$2001)
Antigua&Barbuda	0.6	2.8	3.5	0.1	4	18.9	77.1	0.833	442	8050
Bahamas	3.7e	...	-0.9	0.3	...	...	...	0.844		
Barbados	2.3	3.8	0.7	0.3	6.6	20	73.4	0.858	431	9121
Belize	0.7	0.9	0.5	0.2	18.7	25.5	55.8	0.777	22,972	3,218
Dominica	0.2	-0.4	1.4	0.1	20.2	22.5	57.3	0.793	750	3,668
Grenada	0.3	3.6	2.2	0.1	8.4	22.2	69.4	0.785	344	4,040
Guyana	0.7	3.2	8.9	0.8	34.7	32.5	32.8	0.709	214,970	761
Jamaica	6.4	5	0.6	2.5	8	33.7	58.4	0.735	10,990	2,866
Montserrat	-	-	-	-	-	-	-	-	-	-
St Kitts-Nevis	0.3	3.3	4.5	...	4.6	24.3	71.1	0.798	269.4	6,420
St Lucia	0.6	2	1.4	0.2	8.1	18.9	72.9	0.728	616	4,206
St Vincent	0.3	2.3	2.6	0.1	10.9	26.9	62.2	0.738	389	2,907
Trinidad&Tobago	6.4	6.7	2.1	1.3	1.8	47.5	50.7	0.793	5,128	4,230*
Suriname	0.3f	...	0.5	0.4	...	...	...	0.766	163,820	1,660*

Source: CARICOM Secretariat, IMF

* means in the year 1999

Table (ii) Current Fiscal Balance in Millions of National Currency (Absolute)

Countries	Actual		
	1991	1996	2001
Bahamas	-14.5	40.7	57.4
Barbados	100.4	51.7	121.5
Belize	73.8	41.9	38.6
Guyana	-6,559.3	11,173.6	-5,567.8
Jamaica	3,872.1	-1,788.4	-12,410.0
EC Currency Union	90.6	100.7	-85.4
Suriname	-655.4	-6,082.0	22,190.0
Trinidad & Tobago	651.7	745.8	784.9

Source: Caribbean Centre for Monetary Studies

Table (iii) Current Fiscal Balances (in % of GDP)

Countries	1991	Actual	
		1996	2001
Bahamas	-1.1	1.0	2.4
Barbados	3.0	1.3	4.0
Belize	8.5	3.5	2.7
Guyana	-0.3	11.3	-1.2
Jamaica	8.0	-0.8	1.1
EC Currency Union	1.6	1.6	1.0
Suriname	-17.6	-3.0	-10.2
Trinidad & Tobago	2.9	2.2	4.0
Average	0.9	2.3	0.2

Source: Caribbean Centre for Monetary Studies

Table (iv) Overall Fiscal Balance (in % of GDP)

Countries	1991	Actual	
		1996	2001
Bahamas	-3.9	-0.9	-1.9
Barbados	-1.4	-3.2	-3.7
Belize	4.9	-0.4	-11.4
Guyana	-0.2	-1.6	-8.3
Jamaica	3.6	-5.1	-6.9
EC Currency Union	-2.1	-1.7	-6.5
Suriname	-16.6	-3.0	-1.1
Trinidad & Tobago	-0.2	0.5	-0.1
Average	-2.0	-1.9	-5.0

Source: Caribbean Centre for Monetary Studies