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Report to the Chairman, Subcommittee on Western Hemisphere and Peace Corps Affairs, Committee on Foreign Relations, U.S. Senate

July 1988

CARIBBEAN BASIN INITIATIVE

Impact on Selected Countries

GAO/NSIAD-88-177

Agriculture has not implemented the increased quotas because the Congress neither provided new funds nor authorized the use of existing resources.

Tourism presents a comparative advantage for Caribbean Basin countries, and citrus production holds good potential for some countries. Since 1978, however, AID has discouraged its missions from providing assistance for citrus production due to concerns for its potential impact on the domestic U.S. industry. AID has also generally discouraged its missions from funding tourist facilities, although some missions have provided limited funding for services supporting tourism.

AID's Promotion of CBI Objectives

The CBI-related element of AID's program is country-specific and consists of projects focused on (1) infrastructure, (2) training for skilled workers and business owners and managers, (3) medium- and long-term credit availability, (4) export and investment promotion services, and (5) policy reforms to promote an attractive investment climate. AID projects complement and support CBI objectives and may assist the countries in taking advantage of CBI opportunities.

Despite its efforts, AID is faced with continuing constraints in the various countries. For example, the success of assistance efforts in Haiti depends upon sociopolitical stability, which remains volatile. Inconsistent implementation of reforms by the Dominican Republic has caused concern among importers/exporters and investors and has threatened the success of AID's efforts. The continuing lack of infrastructure and transport facilities, limited labor and resource bases, and an underdeveloped private sector in Belize and the Eastern Caribbean greatly complicate AID's work. Economic Support Fund programs in some of the countries have been used to promote policy reforms which contribute to CBI objectives.

Agency Comments

AID and the U.S. Trade Representative (incorporating the comments of the CBI Task Force Subcommittee on Policy, including the Departments of State, Commerce, and Agriculture) provided comments. AID said that the report was "a thorough, objective and constructive assessment of the CBI..." and noted that since CBI has only been underway since 1984, results have been fairly impressive. AID said that the report should more

thoroughly and prominently address the role played by Economic Support Funds to encourage policy reforms leading to "economic stabilization and structural adjustment which are general prerequisites to private sector export development."

The U.S. Trade Representative also suggested that more prominent treatment be given to AID efforts to promote policy reforms, and noted that an investment survey to be completed May 31, 1988, by the Department of Commerce "will document that benefits [from CBI] have been widespread."

GAO agrees that CBI countries' economic success and ability to benefit from CBI opportunities are contingent upon adoption of rational economic policies. Although AID's Economic Support Fund policy dialogue efforts predate the CBI, GAO has addressed their importance in the report with specific references to the Dominican Republic and Grenada where such efforts are most prominent. To the extent that the policy reform efforts have been successful, they are reflected in the GAO analysis of export and employment performance.

Since the Commerce investment survey has yet to be published, GAO cannot comment on its findings. Additional comments by the executive agencies have been addressed and/or incorporated in the body of the report, where appropriate.

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Abbreviations

AID	Agency for International Development
CBI	Caribbean Basin Initiative
GAO	General Accounting Office

Introduction

The Caribbean Basin Initiative (CBI) was proposed by the Reagan administration in February 1982 as a trade initiative to promote economic and political stability in designated Caribbean and Central American countries by attracting foreign and indigenous investment, thereby diversifying the countries' economies and generating employment and foreign exchange earnings. The Caribbean Basin Economic Recovery Act (Public Law 98-67), which is the centerpiece of CBI, modified the administration's initial proposal and took effect in January 1984. Its principal provision permitted eligible products from designated CBI countries to be imported duty-free into the United States. Subsequent legislation and policy actions complemented the act by providing additional trade preferences, supported by tax concessions for U.S. businesses investing in CBI countries.

In December 1984, the President directed "all Administration officials to give programs relating to the Caribbean Basin their personal attention and the institutional support needed for success." Although no U.S. agency has a specific legislative mandate to implement CBI, the Department of Commerce and the Agency for International Development (AID) fund various programs/projects to encourage investments in CBI countries and to assist the countries in improving their trade regimes by diversifying and expanding their export bases. A multiagency CBI Task Force, chaired by the U.S. Trade Representative, coordinates CBI activities.

CBI Eligibility Requirements

Articles must be grown, produced, or manufactured in a beneficiary country, and must meet the following rules of origin to be eligible, under the Caribbean Basin Economic Recovery Act, for the U.S. duty-free treatment which was intended to stimulate trade and investment:

- The article must be imported directly from a beneficiary country.
- The value of the article must include 35 percent in direct processing costs in one or more beneficiary countries. The 35 percent may be composed of 15 percent in U.S.-made components, with a 20-percent balance contribution of material and/or labor costs from the beneficiary countries.
- Any article made with foreign materials must be substantially transformed in one or more beneficiary countries, as defined by U.S. Customs Service administrative laws.

As an added inducement to CBI export expansion and investment, the President, in February 1986, announced the "Super 807" program, or

807A, which is an expansion of U.S. Tariff Schedule Item 807.00. The 807A program guarantees CBI-country access to the U.S. market outside established quotas for apparel assembled from fabric formed and cut in the United States if the same U.S. business both exports the U.S. components and imports the assembled product. The guaranteed access levels are contingent upon bilateral agreement between the U.S. government and participating CBI beneficiary countries.

In an effort to promote the development of tourism and services sectors in the Caribbean Basin countries, the U.S. government permits U.S. business convention expenses to be treated as an income tax deduction under the U.S. Internal Revenue Service Code, if incurred in CBI countries. To be eligible for this provision, CBI countries must enter bilateral tax information exchange agreements with the United States. These agreements give the U.S. government access to tax information held, for example, by the Grenada government on American citizens and likewise gives the Grenada government access to information held by the U.S. government on Grenada citizens. Also, CBI countries must not discriminate against U.S. convention sites in their own tax laws.

Our Previous Reports on CBI

This is our third report on CBI. Previous reports issued to the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, were:

Caribbean Basin Initiative: Need for More Reliable Data on Business Activity Resulting From the Initiative (GAO/NSIAD-86-201BR, Aug. 1986), which reported that a Department of Commerce study attributing a large number of investments in Caribbean and Central American countries to CBI was unsubstantiated and incorrect. The Department, with assistance from AID, has a new study underway.

Caribbean Basin Initiative: Legislative and Agency Actions Relating to the CBI (GAO/NSIAD-87-58FS, Dec. 1986), which discussed congressional and administration actions that could constrain the effectiveness of CBI.

Objectives, Scope, and Methodology

At the request of the Chairman, Subcommittee on Western Hemisphere and Peace Corps Affairs, Senate Committee on Foreign Relations, we reviewed the impact of CBI on selected Caribbean Basin countries. As specified by the Chairman, in his letter of May 14, 1987, we focused on

- how much CBI has contributed toward alleviating Caribbean debt-servicing problems, created lasting employment opportunities, and fostered broadly based economic growth;
- what, if any, actions have been taken by the executive branch or the Congress that may inadvertently work at cross-purposes with CBI's principal objectives; and
- what AID's CBI-related program has achieved to date, problems encountered in implementation, and prospects for the near future.

For the purposes of this review, we have defined CBI as including the Caribbean Basin Economic Recovery Act, as well as complementary U.S. legislation (e.g., tax concessions to U.S. business making selected investments in CBI countries) and policy actions (e.g., the 807A textile concession) which accord preferential trade and investment treatment to Caribbean Basin countries. Although CBI can affect a country's entire economy, we limited our examination to its impact on the foreign trade sector, including traditional and nontraditional exports, services, and tourism.

As agreed with the Committee, we performed case studies of Haiti, the Dominican Republic, Dominica, St. Vincent and the Grenadines (St. Vincent), and Grenada; we included Belize but specifically excluded other Central American countries. Our case study thus does not assess the overall impact of CBI.

The countries we reviewed vary considerably by population and geographic size, resource base and level of development. Haiti is reportedly the poorest country in the western hemisphere and is severely deficient in elements necessary for economic viability. The Dominican Republic is an established democracy with a diversified economy and good resource base. Dominica and St. Vincent are small islands which lack infrastructure and the labor and resource bases to effectively compete for nontraditional export markets in the international economy at this time. Grenada has an international airport, good port facilities, and a diversifying economy. Belize became independent in 1981 and is a stable democracy; its limited government regulation and encouragement of foreign investment make it attractive, but inadequate infrastructure has hampered development.

Since CBI did not become effective until 1984, we used 1983 economic data as the base from which to do comparisons and assessments. We used domestic value-added, rather than export performance alone, as the measurement by which to determine the foreign exchange earnings

being generated for the countries from CBI opportunities. The value of a country's exports does not provide a complete picture of the impact of these exports on the domestic economy, since the final exports may incorporate imported raw materials and intermediate goods. Thus it is not the total value that generates needed foreign exchange, but the proportion of these exports produced in the country, or domestic value-added, which includes labor and domestically produced goods. To determine the net foreign exchange generated by these exports, the value of imports used in their production is subtracted from the gross value of the exports.

The countries we reviewed lacked detailed data on sectorial employment and inter-industry production structures. However, we used information reported by their trading partners when individual country trade-flow data were unavailable or inaccurate. The annual average percentage change in dollar-value for commodity trade was calculated through regression analysis, using the ordinary least square growth-rate method.[1] Conservative approximations of direct and indirect import components were used to estimate domestic value-added when valued-added could not be directly calculated. We assumed that import component ratios remained constant over 1983-86, and thus changes in domestic value-added are due to changes in the composition of gross exports. Although some countries have aggregate employment data for the agricultural, manufacturing, and services sectors, most do not have breakdowns of employment in the export sector of these industries. As a proxy for the growth of employment in the export sector, we used the growth rate of real domestic value-added, assuming, over the short-term, a fixed relationship between employment and the volume of exports.

In Washington, D.C., we met with officials of AID, the U.S. Trade Representative, the International Trade Commission, the U.S. Customs Service, the Overseas Private Investment Corporation, and the Departments of Agriculture, Commerce, State, and Transportation. We reviewed legislation and numerous studies on CBI, and U.S. government program documents, reports, and economic analyses relating to CBI. We also met with private-sector groups with interests in the Caribbean Basin and with officials of the government of Puerto Rico's Economic Development Administration.

[1]The ordinary least square method computes, by a regression formula, the annual average growth-rate trend incorporating information on intermediate years, as well as for beginning and ending years.

We performed our fieldwork during September-October 1987 in the selected countries, where we met with U.S. embassy and/or AID mission officials in each country. We also met with officials in the respective agencies/departments of finance, investment, tourism, and/or trade, private-sector businessmen, and representatives of private-sector associations/organizations, and with an official of the Central Bank in the Dominican Republic.

Our work was performed between March 1987 and February 1988 in accordance with generally accepted government auditing standards.

CBI and Caribbean Debt, Employment and Economic Growth

We analyzed the types and domestic value-added components of exports being promoted in the countries we reviewed and the investments being undertaken to determine how much CBI has contributed to the (1) creation of broadly based economic growth, (2) alleviation of debt-servicing problems, and (3) generation of lasting employment. To date, benefits derived from CBI have generally not been sufficient to address debt-servicing needs, although some employment has been generated in the Dominican Republic and Grenada and the beginnings of broadly based economic growth are starting in the Dominican Republic. The ability of CBI countries to service their debts has been affected by factors, such as changes in interest rates, trade demands and prices, all of which are outside CBI. However, the CBI emphasis on trade, investment, and export diversification and promotion may, over time, create more broadly based economic growth, help generate foreign exchange to assist countries with debt-servicing problems, and generate lasting employment.

Trade Profile of Selected Countries

Before the implementation of CBI, the United States was the major trading partner of the Dominican Republic, Haiti, and Belize. Other Caribbean countries and Great Britain were the principal trading partners for Dominica, Grenada, and St. Vincent. By 1986, in part as a result of CBI, all of the countries had increased their total exports to the United States. Furthermore, the countries are generally diversifying their export products and attempting to become less dependent on their traditional agricultural commodities. Appendix I provides a breakdown of traditional and nontraditional merchandise exports and tourism on an annual basis.

Table 2.1 summarizes the commodity trade experiences for 1983-86 of the countries we reviewed. Columns 2, 3, and 4 are the annual average growth rates in the U.S. dollar-value of total exports, nontraditional exports, and imports, respectively, between 1983 and 1986. Exports to the United States as a percentage of total exports are in columns 5 and 6. For the Dominican Republic and Belize, nontraditional exports have grown faster than total exports, due to increased volumes, which may be attributable in part to CBI, and to the decline in world prices and/or export quantities of traditional commodity exports. Imports declined somewhat for Haiti and the Dominican Republic; grew moderately for Belize, Dominica, and St. Vincent; and increased rapidly, but at a growth rate which was less than that for exports, for Grenada. There are also changing geographic trade patterns. The growth of nontraditional exports to the United States appears to be additional exports rather

than a diversion of exports from other trading partners for all countries except Belize and Dominica.

Table 2.1: Commodity Trade Profile for 1983-86

Figures in Percentage

(1) Country	(2) Average annual growth rate, 1983-86: Total exports	(3) Average annual growth rate, 1983-86: Nontraditional exports	(4) Average annual growth rate, 1983-86: Total imports	(5) Exports to the United States: Percent of total exports 1983	(6) Exports to the United States: Percent of total exports 1986
Haiti	4.12	4.68	−1.31	76.06	76.99
Dominican Republic	2.61	22.28	−0.08	70.37	82.72
Dominica[a]	12.04	−4.61	5.42	0.76	25.30
St. Vincent[a]	18.24	16.10	6.91	9.31	10.11
Grenada	15.64	12.63	15.13	1.00	9.47
Belize	2.01	8.11	2.64	38.67	58.06

[a]These countries' export growth rates are attributable to increased exports of traditional exports, particularly bananas at guaranteed price levels, to a protected market in Great Britain.

Source: Calculated from AID, U.S. Department of Commerce, United Nations, International Monetary Fund, and World Bank data.

Broadly Based Economic Growth

The diversification and growth of nontraditional exports in most of the countries we reviewed can be viewed as a positive indication of broadly based economic growth. Table 2.2 illustrates the level of diversification and, except for St. Vincent, each country's movement to more diversified bases in exports to the United States.

Table 2.2 describes the percentage share of the five leading products exported to the United States in 1983 and 1986. A small number of mainly traditional products accounts for a large share of each country's exports (see columns 2 and 3). Growing diversification is shown by declining shares for these traditional exports with accompanying increases in mainly nontraditional exports for all countries except St. Vincent. Likewise, growing diversity within nontraditional exports for all countries, again except for St. Vincent, is shown by the declining share of the leading nontraditional exports (columns 4 and 5). This broadening of exports reduces the countries' dependence on a few commodities and thus reduces their vulnerability to declining commodity prices and export quantities.

Table 2: Leading Five-Product Shares in Exports to the United States

Figures in Percentage

(1)	(2)	(3)	(4)	(5)	(6)
	All exports		Nontraditional exports		Number of new products[a]
Country	1983	1986	1983	1986	
Haiti	36.59	33.75	36.71	34.45	0
Dominican Republic	52.82	39.87	34.34	29.02	0
Dominica	94.15	55.25	94.96	55.85	28
St. Vincent	89.00	93.65	90.68	93.78	16
Grenada	98.43	54.23	92.86	52.61	26
Belize	92.39	67.40	91.16	65.56	18

[a]Products exported to the United States in 1986, but not in 1983, from among the top 30 products.
Source: Calculated from U.S. Department of Commerce data.

Broadly based economic growth may also be defined as the creation and/or expansion of related investments. The growth of pineapple exports from the Dominican Republic, for example, has encouraged a local manufacturer to make high-quality, wax-coated boxes to package the fruit for export. Another firm has begun importing sewing thread in bulk from the United States, which it in turn processes on small spools for sale to local garment manufacturers.

CBI encourages investment growth by requiring 35 percent local content or a minimum of 20 percent if U.S. intermediate goods are used before a product is eligible for duty-free access to the American market. Since most Eastern Caribbean countries are too small to produce the quality or quantity of components needed to qualify for duty-free treatment, CBI allows combining local content inputs from all CBI-eligible countries to meet content requirements for a particular product (i.e., an export from Grenada may include components from other CBI countries to meet the 35-percent local content requirement).

However, many nontraditional exports from the countries reviewed do not provide the potential for the production of components resulting from investment expansion. For example, assembly operations use mostly imported materials and machinery, with local content generally restricted to labor and utilities. The U.S. Department of Labor, in its third annual report to the Congress on the effects of the Caribbean Basin Economic Recovery Act on the U.S. economy, stated that most apparel, textile, electronic products, and sporting goods exported to the United States contain over 70 percent in U.S. content. The CBI concession

to allow exports of textiles to the United States under the 807A guaranteed-access level program may actually discourage the development of component production, since to benefit from the program, a CBI country must use cloth which is made, cut, and formed in the United States.

We did find that local content in some assembled products has increased sufficiently to allow the countries to benefit from CBI duty-free provisions. For example, baseballs manufactured in Haiti, which had previously entered the United States under the 807 tariff code with a 3.0-percent duty assessment on their non-U.S. content, were imported duty-free in 1986 under the CBI tariff code because of increased local content. Also, a sports equipment firm deliberately expanded its manufacturing operations in St. Vincent to meet the 20-percent local content requirement.

Since economic growth is a dynamic process, a country may be able to increase its local content and domestic value-added, as well as obtain benefits of expansion of investment in related industries over time. As workers gain skills and experience, they are able to perform more sophisticated assembly and manufacturing tasks; nationals replace foreign managers and the pool of local entrepreneurial talent grows. A factory in a Dominican Republic free-trade zone previously sewed shirts for export, but now assembles women's suits and jackets for export. This requires more attention to detail, better quality control, and production-floor supervision, all of which increase Dominican value-added.

An increase in net exports leads to additional employment which is reflected in increased incomes and expenditures. Expenditures, in turn, generate the demand for additional production and employment. Examples of expanding domestic service sectors responding to growing employment in the export sectors include small-scale entrepreneurs who have set up portable restaurant facilities outside the Santiago free-trade zone in the Dominican Republic to provide inexpensive lunches for workers. Similar facilities were set up for workers at the industrial zone near the airport in Port-au-Prince, Haiti. Workers in the Haitian assembly sector also employ extended-family relatives to shop, prepare meals, and care for children.

In the countries we reviewed, the tourist sector has generated limited investment in related industries. In addition to furniture, appliances, and linen, the tourist industry usually imports food, beverages, and some building materials. A country like the Dominican Republic, with a population of 6.4 million and a more developed manufacturing base that

the other countries, can produce more goods than other countries we reviewed but, nevertheless, imports about 60 percent of its tourism cost-components such as food and furniture. To maintain the standards and atmosphere desired by tourists, tourist enclaves are sometimes isolated from the rest of the country. For example, resorts in Puerto Plata and La Romana in the Dominican Republic are self-contained areas set off from indigenous population centers. This reduces the positive impact on the domestic economy.

A similar enclave is located at Cap-Haitian in northern Haiti. According to a U.S. embassy official, a recently established tourist area caters to day visits by cruise ship visitors, but does not advertise the fact that it is in Haiti because of negative publicity about Haitian sociopolitical violence and health threats from Acquired Immune Deficiency Syndrome.

Therefore, if one looks at broadly based economic growth as the diversification and growth in nontraditional exports, some success might be attributed, in part, to CBI. However, if one considers broadly based economic growth as the creation and/or expansion of related industries, any benefits have been much more limited.

Value-Added Measures Domestic Effects

Although nontraditional exports to the United States are commonly cited as a measurement of CBI's contribution to Caribbean Basin economies, even the total value of a country's exports does not provide a complete picture of its impact on the economy, since it is the proportion produced in-country or domestic value-added that generates employment and the net foreign exchange earnings which may be used for debt-servicing. The value-added component is the difference between the value of a country's exports and the imported intermediate and capital goods (depreciated over time) used to produce those exports. Imported goods include those factors such as cloth used to directly produce an export (e.g, garments) as well as those used indirectly, such as imported oil used to generate electricity.

A primary motivation of CBI was to encourage the diversification and expansion of nontraditional exports in the agricultural, light manufacturing and assembly, and service (tourism and data-processing) sectors. With the exception of some agricultural products, the percentage of value-added in nontraditional exports is less than the percentage in traditional exports. With this changing structure of exports, the value-added may change and may even decline, despite the fact that the total value of exports may remain the same or even increase. The following

illustration indicates how value-added influences foreign exchange and employment generation in the countries reviewed.

Host-government officials said that traditional exports, such as sugar and coffee, have an estimated value-added component of 90 percent, while light manufacturing, such as in textiles, has an approximate 20-percent value-added component. Although a $1 million decline in sugar exports offset by a $1 million increase in textile exports would result in no change in reported export earnings, there would actually be a net loss of $700,000 in value-added, and an associated decline in net foreign exchange earnings. Thus, a $1 million decline in sugar exports would have to be offset by a $4.5 million increase in textile exports to maintain the same level of value-added and generate the same net foreign exchange earnings.

Using the figures of the previous example, but adding the assumption that export values have been adjusted to keep sugar and textile prices constant, and that the value-added component measures workers' wages, the employment effect can be similarly calculated for a change in real value-added. If the average agricultural wage is $750 per year as in the Dominican Republic, the $900,000 decline in value-added from sugar translates into a loss of 1,200 employee years ($900,000 divided by $750). While the $200,000 increase in value-added from textile exports translates into the generation of 200 employee years at the Dominican Republic's average textile real wage of approximately $1,000 per year, a net loss of 1,000 employee years remains. Textile exports would have to increase by $6 million to offset the employment loss from a $1 million decline in sugar exports.

Debt-Servicing Problems

A country's debt-servicing burden is defined as the external debt-service payments (i.e., payment of principal and interest) divided by the export of goods and services. If a country's export-generated net foreign exchange earnings are growing at a faster rate than its debt-service payments, its debt-servicing burden is improving.

If one assumes that a country's existing debt is not being reduced (i.e., payment of principal is not being made) and that no new loans are made except for borrowings for interest payments, the debt-service will grow at the same rate as the interest rate. Thus, the average annual interest rate on a country's foreign debt measures the growth in the country's debt service.

Our review focused on the contribution made by net foreign exchange generated from a country's export sector, since CBI's emphasis on trade and investment for export is intended to stimulate the exports necessary, in part, to permit debt-servicing. Therefore, we did not include in our focus other sources of foreign exchange that a country may use to service its debt, such as new loans, remittances from abroad, foreign assistance, and import reductions. A country with inadequate export earnings may have no difficulty in servicing its debt if large levels of foreign exchange from these other sources can supplement export earnings.

The growth in the value-added of a country's export sector is a measure of exports' ability to generate foreign exchange. A country's debt-servicing burden is reduced if net export earnings grow at a higher rate than does the interest rate on its debt. Conversely, if the interest rate exceeds the growth rate of net export earnings, the debt-servicing burden will worsen, all other things being equal. A comparison of the two indicates the degree to which the export sector is generating the foreign exchange necessary to service a country's debt.

Table 2.3 shows the 1983-86 average annual growth rate of gross export earnings, net foreign exchange and foreign debt, and the average annual interest rate on foreign debt for the countries reviewed. The average growth in net foreign exchange for the Dominican Republic, for example, declined -0.3 percent as shown in column 4 compared to the average interest rate of 5.87 percent as shown in column 5, and thus its ability to service its debt through export-generated earnings has deteriorated.

Similarly, Belize's net foreign exchange earnings from exports declined for 1983-86, since its increase in nontraditional export earnings was not sufficient to offset the decline in earnings from traditional exports (primarily sugar). However, growing remittances from its citizens abroad, and increasing levels of donor assistance which does not directly relate to CBI, have permitted the country to continue to service its debt.

Table 2.3: Foreign Exchange Generation and Debt-Servicing Needs, 1983-86

Figures in Percentage

(1) Country	(2) Average annual growth rate: Foreign debt	(3) Average annual growth rate: Gross export earnings[a]	(4) Average annual growth rate: Net foreign exchange	(5) Average effective interest rate[b]
Haiti	7.03	3.64	2.5	1.42
Dominican Republic	4.89	6.39	−0.3	5.87
Dominica	10.85	10.65	6.0	4.61
St. Vincent	9.65	15.05	18.3	5.44
Grenada	2.86	17.68	18.1	3.94
Belize	7.43	3.26	−0.8	5.42

[a]Export earnings are merchandise exports plus tourism.

[b]The effective interest rate includes concessional elements of loans and reschedulings.

Source: Calculated from AID, International Monetary Fund, World Bank, United Nations, and U.S. Department of Commerce data.

Grenada has had an increase in both traditional and nontraditional exports (see table 2.1), attributable in part to CBI, and its 18.2 percent growth in net foreign exchange considerably exceeds its 3.94 percent interest rate. However, it continues to have a problem servicing its debt because of growing imports (15.13 percent annual growth rate) and fiscal deficits (21.7 percent annual growth rate). The country has become increasingly dependent on U.S. assistance to service its debt.

Haiti's ability to service its debt has improved since its 2.5 percent net foreign exchange annual growth rate exceeds its 1.42 percent interest rate, as shown in table 2.3. There has been a net inflow of foreign assistance as reflected by the 7.03 percent annual growth in foreign debt in excess of its concessional interest rates. However, Haiti continues to have difficulties with reduced revenues from tax collections and may face problems with declining exports and foreign assistance, attributable in part to the social and political unrest which remains following the overthrow of both the Duvalier dictatorship and the succeeding civilian government. Dominica's 12.04 percent growth in exports (see table 2.1), due in part to CBI-related benefits, has helped reduced the country's current account deficit and enhanced its ability to service its debt.

Employment Generation

Each of the countries we reviewed has a small, relatively open economy which is extremely vulnerable to changes and movements in external economic conditions, rendering overall employment generation as well as that possibly attributable to CBI benefits neither necessarily secure

nor long-lasting. Although both capital- and labor-intensive investments may be important for a country, a relatively high capital-intensive investment per worker generally indicates that the investor has made a longer term commitment to operate in the country than has an investor with a low-value investment, and thus employment growth is more secure and longer lasting.

Investment in the tourism sector generally carries a relatively long-term commitment on the part of an investor to a particular country due to the costs of land, buildings, equipment, and training for workers. Similarly, investment in some nontraditional agriculture indicates a fairly strong commitment. For example, tree crops require long gestation periods before they may be harvested and fresh-cut flowers may require irrigation and a closely controlled growing environment. The commitment is even greater when land is purchased rather than leased.

A low capital-intensive investment per worker, on the other hand, may indicate little commitment on the part of the investor since costs are minimized should the investor decide to move from the country. For example, "contracting" investment in light manufacturing/assembly, a major type of recent investment in the countries we reviewed, may be both volatile and short-term. It requires little initial investment since (1) factory space is frequently leased, (2) less costly, second-hand machinery is often used, (3) most materials for assembly are imported, and (4) many production workers can be trained at relatively low cost in a few weeks. Low capital-intensive investments may, however, benefit a country in the short term by generating needed jobs.

While CBI has generated additional employment by promoting nontraditional exports and tourism, this employment should be assessed in the context of each country's needs. Table 2.4 provides insight to both the need for employment generation and the amount of employment generated.

Table 2.4: Growth in Export-Sector Employment Compared to Employment Needs

Figures in Percentage

(1) Country	(2) Annual average growth rate: Real value-added, export sector (1983-86)	(3) Annual average growth rate: Labor force (1980-85)	(4) Unemployment rate (1986)
Haiti	−5.7	2.0	49.0[a]
Dominican Republic	1.2	3.5	26.0
Grenada	5.7	3.3	20.0
Belize	−0.3	3.0[b]	15.0[c]

[a]AID noted in its comments on the draft report that this figure includes 37 percent underemployment. However, AID's own figures, as shown in its fiscal year 1988 congressional presentation, indicate an unemployment rate of 49 percent.

[b]Annual growth rate of population, 1981-85. This underestimates labor-force growth; the age structure has caused the labor force to increase faster than the total population.

[c]1985.

Note: Since employment figures for the export sector are not available, we have used the growth-rate of real value-added as a proxy for the employment growth-rate. Data are not available for Dominica and St. Vincent.

Source: Calculated from AID, World Bank, Inter-American Development Bank, International Monetary Fund, U.S. Department of Commerce, and host country data.

The relative need to generate employment can be assessed by considering both the unemployment rate as shown in column 4 and the growth of the labor force as shown in column 3. For example, the 1985 unemployment rate in Belize was 15.1 percent, while the annual average growth in the labor force (1980-85) has been 3.0 percent. Since 1983, employment in the export sectors (using real value-added increases as a proxy for employment growth) has fallen by an estimated 0.3 percent, primarily due to declines in traditional (sugar) exports.

Conclusions

Over the past few years, most of the countries we reviewed have been restructuring their economies and have increased and diversified their exports, while increasing relative trade with the United States. The countries are also promoting tourism since it is a sector that can generate foreign exchange and domestic employment. For the most part, traditional exports consist of or use indigenously grown agricultural products and are thus of high value-added. Most nontraditional exports and tourism require the use of large percentages of imported materials and thus generate comparatively fewer net foreign exchange earnings.

Where nontraditional export earnings (a major objective of CBI) have supplemented expected traditional export earnings, as in St. Vincent and Grenada, net foreign exchange earnings have increased. Employment has also increased in Grenada. However, declining world sugar prices and reductions in U.S. sugar quotas resulted in lower foreign exchange earnings for Belize and the Dominican Republic, in spite of increases in the countries' net earnings from nontraditional exports. Although this exemplifies the need for these countries to diversify their export bases, it has exacerbated their short-run unemployment situation and made it more difficult for the Dominican Republic to service its foreign debt. Foreign remittances have been sufficient to permit Belize to service its debt despite declines in net foreign exchange earnings from exports. Thus, CBI benefits have not yet generated the necessary levels of foreign exchange earnings for these countries. However, net foreign exchange earnings that have been generated through nontraditional exports may be attributable in part to CBI-related benefits. We therefore believe, given declining net foreign exchange earnings from traditional exports such as sugar, that the countries' situations would have been worse in the absence of CBI. However, to quote from our August 1986 report to the Administrator of AID on AID's promotion of policy reforms,[1] we do

> "not believe that nontraditional exports can generate the needed foreign exchange within the foreseeable future to compensate for the decline in traditional exports' earnings and provide the solution to these countries' economic growth and debt-servicing problems."

The Dominican Republic has better economic potential than the other countries since it has a large labor force, a manufacturing sector, relatively good infrastructure, and a diversified agricultural base. It is capable of eventually producing some products which are now imported for use as components of nontraditional exports. The other countries reviewed have limited labor forces and/or infrastructure and resource bases that restrict the potential for production of components which would free them of dependence upon imports and thus increase their foreign exchange earnings and employment generation resulting from increased value-added. Each of the countries we reviewed has a small, relatively open economy which is extremely vulnerable to changes and movements in external economic conditions. Recent investment in assembly industries suggests limited commitment on the part of investors to a particular country. Therefore, recent employment generation,

[1] Foreign Assistance: U.S. Use of Conditions to Achieve Economic Reforms (GAO/NSIAD-86-157, Aug. 1986).

whether specifically attributable to CBI benefits or not, cannot at this time be termed either secure or long lasting.

Agency Comments and Our Response

The U.S. Trade Representative, incorporating the comments of the CBI Task Force Subcommittee on Policy (including the Departments of State, Commerce, and Agriculture), disagreed with our assessment that benefits derived from CBI to date have been limited, and said that an investment survey to be completed May 31, 1988, by the Department of Commerce "will document that benefits...have been widespread." Since the Commerce survey has not yet been published, we cannot comment on its findings. We have revised the report to note that benefits derived from CBI have generally not been sufficient to address debt-servicing needs, while CBI-related employment has been principally in assembly industries which is not necessarily long term. Broad-based economic growth has not occurred to date.

The Trade Representative also commented that the use of domestic value-added was "interesting," but cautioned that care must be taken in such an analysis and said that we may have "pushed [the concept] beyond what can be supported by the underlying data" because of the (1) difficulty in acquiring accurate information, (2) confusion between export values and volumes, (3) secondary effects on countries' balances of payments, and (4) failure to differentiate between different types of export activities. We believe our use of domestic value-added is appropriate as outlined below.

We agree that caution should always be used because of concern over the accuracy of economic data. However, we used the best available information from host-country sources and their industrialized-country trade partners, including that of the U.S. Department of Commerce, and from the International Monetary Fund, World Bank, and United Nations.

Value-added is not a new concept and is used to construct gross domestic products and to measure the effective impact of tariffs and subsidies. Domestic value-added incorporates the underlying structural change that is occurring in a particular country and provides greater insight into the net impact of exports on the country. We have applied this approach to the countries we reviewed because we believe that looking at gross export data and not at trade balances gives misleading information on economic performance. We have clarified the section on value-added employment effects to avoid confusion between export value and volume.

We do not include in our analysis, as noted in the Trade Representative comments, a discussion of all possible secondary effects on countries' balance of payments of decreased sugar production. However, we did include the net foreign exchange and employment effect from nontraditional as well as traditional exports (including sugar), and we discussed the limited but possible effects these exports may have on the economy. We agree that theoretically, moving resources from an inefficient operation such as money-loosing sugar production to more efficient activities such as textiles and apparel "[will] benefit an economy overall."

In response to the Trade Representative's statement that there was a failure to differentiate among the different types of export activities, we believe that the lack of differentiation among export activities is unimportant in estimating employment effects in the countries we reviewed since virtually all export activities are relatively labor-intensive. The U.S. Trade Representative's comment is theoretically correct but is applicable to countries such as Brazil, which manufactures and exports such capital-intensive products as automobiles, in addition to its labor-intensive exports such as apparel.

Actions Working at Cross-Purposes to CBI Objectives

CBI provided preferential trade and investment opportunities to eligible countries, but specific import-sensitive products such as petroleum, canned tuna, and certain leather goods were excluded from duty-free treatment. U.S. import and health standard requirements, which regulate product entry into the United States to protect the American public, remained applicable to CBI countries. Some subsequent legislation and executive actions and decisions have either imposed restrictions or are viewed to some extent as imposing restrictions, which hamper investment and export growth in CBI countries.

Several public-sector officials and private-sector representatives in the countries we reviewed said that the expectations which were raised by CBI, as it was originally proposed by the administration, have not been fulfilled. They complained about congressional changes to the administration's proposal which restricted the scope of CBI, said that U.S. policy toward CBI lacked consistency, and charged that the "rules" for CBI were subject to what they termed "arbitrary change." The 1986 anti-dumping case involving Costa Rican fresh cut flowers[1] and changes in the duty-free status of ethanol produced in CBI countries[2] were consistently cited by these officials as restrictions placed on CBI as a result of U.S. domestic lobbying efforts. The officials also noted that such actions have negatively impacted on CBI effectiveness since they raise questions among potential investors about U.S. intentions and the dependability of continued benefits. An official with a private-sector trade group in the Eastern Caribbean said "nobody is going to make substantial investments if the rules are changed the moment a successful export attracts the attention of U.S. lobbyists."

U.S. officials disagreed that the Costa Rican cut flowers case was an example of inconsistent rules and arbitrary change in the administration of CBI and said that CBI provisions, as enacted in the Caribbean Basin Economic Recovery Act of 1983, were very clear in not exempting CBI exports from U.S. trade laws. U.S. officials termed the cut flower situation as an example where goods were exported using incentives which were found to be inconsistent with U.S. trade laws on countervailing duties and antidumping measures.

[1]The International Trade Administration of the Department of Commerce found that Costa Rica was subsidizing its cut flower exports to the United States and consequently imposed duties.

[2]Since ethanol exports were originally accorded duty-free treatment, investments in plants in several CBI countries were planned. Between 1985 and 1986 U.S. imports from CBI countries increased by 37 percent. Section 423 of the Tax Reform Act of 1986 placed restrictions on ethanol imports by raising local content requirements to 75 percent over a 3-year period.

Regulations and Procedures for Product Entry to the United States

Some private-sector representatives and government officials in the countries we visited complained about the difficulties exporters had in meeting U.S. import requirements, the complexity and application of U.S. Customs Service procedures, and Department of Agriculture and Food and Drug Administration regulations. For example, a winter vegetable grower from the Dominican Republic complained about a delay in the Department of Agriculture's clearance of a shipment of tomatoes in Miami. An AID consultant in the Eastern Caribbean noted that U.S. Customs Service officers were confused about entry requirements for CBI products during the first 2 years of CBI, but that these problems have now been corrected. The complaints were more pronounced from officials/representatives in Belize and some of the Eastern Caribbean countries where exporters lacked experience in exporting to the United States and were unfamiliar with U.S. health, safety, and sanitation requirements, and U.S. Customs procedures. U.S. regulations and requirements serve the purpose of protecting the American people and cannot reasonably be expected to be eased to accommodate foreign exporters. General experience can smooth product-entry to the United States, as shown by Haitian and Dominican Republic producers and exporters who had more experience in exporting to the United States. These producers and exporters generally understood U.S. requirements or appeared more aggressive in learning U.S. regulations and either (1) did not have problems with U.S. regulations/procedures or (2) knew how to deal with any problems.

U.S. agencies offer various programs to help Caribbean exporters avoid delays or losses in shipping to the United States. For example, the Department of Agriculture's Office of International Cooperation and Development provides technical training on product-entry requirements, and the AID-sponsored agricultural project in the Dominican Republic provides fresh fruit and vegetable pre-clearance which reduces exporters' risks. Also, the Departments of Commerce and Agriculture help Caribbean exporters find U.S. partners who are familiar with product-entry and marketing requirements.

The Bumpers and Lautenberg Amendments

Amendments, contained in the fiscal year 1987 Foreign Assistance Appropriations Act and renewed in the fiscal year 1988 Continuing Resolution, restricted AID financing of some activities that promoted the export of certain agricultural and import-sensitive products.

Section 558 of the fiscal year 1987 Continuing Resolution (generally referred to as the Bumpers Amendment) restricts AID from funding certain activities

"in connection with the growth or production in a foreign country of an agricultural commodity for export which would compete with a similar commodity grown or produced in the United States."

Similarly, section 559 (generally referred to as the Lautenberg Amendment) prohibits AID from providing funds to

"(1) procure directly feasibility studies or prefeasibility studies for, or project profiles of potential investment in, the manufacture, for export to the United States or to third country markets in direct competition with the United States exports of [two categories of import sensitive articles that include certain textile and apparel goods, and certain leather goods and wearing apparel]; or (2) to assist directly in the establishment of facilities designed for the manufacture, for export to the United States or to third country markets in direct competition with United States exports of such import sensitive articles."

Our 1986 report to the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means, noted that AID officials said the amendments posed potential constraints to investment in CBI countries. Although this may be true, host-government officials, private-sector representatives, and AID officials in the countries we visited said that the amendments continue to have no adverse impact on either export development or AID programs. Some officials said that as the exports from CBI countries continue to diversify and expand, the amendments may pose problems. For example, officials in Belize noted that as seafood and beef exports expand, they may begin to compete with U.S. products and thus face constraints from the amendments.

U.S. Sugar Policy

There were persistent criticisms, particularly in Belize and the Dominican Republic, of the U.S. government's sugar policy. CBI countries, except for the Dominican Republic, Guatemala, and Panama, had duty-free trade status, without limitation, for their sugar exports to the United States under the Generalized System of Preferences established in the Trade Act of 1974 (Public Law 93-618). CBI expanded duty-free

importation of sugar, subject to U.S. quotas, to all CBI countries. The concession could have been particularly important for the Dominican Republic, which was the leading exporter to the United States—485,000 tons in 1983. However, the Food Security Act of 1985 (Public Law 99-198, title IX) required that the U.S. sugar program be run at no budgetary cost to the U.S. government, thus requiring the President to limit imports through quota reductions to maintain domestic sugar prices.

The U.S. sugar policy has significantly reduced export earnings for Belize and the Dominican Republic. A private-sector official in Belize estimated that the value-added content in sugar production/export was 97 percent since sugar, unlike citrus, requires minimal imports of fertilizer, fuel, or machinery. Belize's sugar quota has been halved since 1983, and nontraditional and other exports that have lower value-added components are not compensating for the foreign exchange losses attributable to sugar exports. For example, using a value-added component of a more conservative 90 percent for sugar exports from Belize means that the country must increase garment exports by $8.00 or citrus by $2.00 to compensate for each $1.00 reduction in sugar exports. The Dominican Republic's sugar industry provided about 150,000 jobs and indirectly supported 500,000 people. Dominican officials estimate that the Dominican Republic has had cumulative foreign exchange losses of $500 million since 1982. They said that potential foreign exchange benefits accruing from CBI concessions have been negated by sugar quota losses. Officials recognized that they must diversify their countries' economies from dependence on sugar but said that this takes time and U.S. quota reductions have resulted in severe foreign exchange losses.

Under the fiscal year 1988 Continuing Resolution, the Congress enacted a special, 1-year benefit to CBI countries by increasing their sugar quotas by at least 290,000 tons. However, the program is not being implemented by the Department of Agriculture at this time. The dollar value of U.S. sugar imports under the special allocation were to be set by the Department of Agriculture based on the estimated cost of U.S. commodities which would be made available to CBI countries to compensate for their export reductions in the 1988 sugar quota year. The special allocation permitted the importation of raw sugar to the United States for refining, provided that an equivalent amount of refined sugar is exported from the United States. According to U.S. officials, the special allocation is not being implemented because (1) the Congress neither provided new funds nor authorized the Department of Agriculture to use existing resources to implement the program and (2) the Secretary of Agriculture has determined that U.S. commodities to compensate for

1988 quota reductions, and against which the value of special sugar imports were to be set, will not be available to CBI countries as compensation for the 1988 sugar quota year. With or without the increased quota for 1988, CBI countries' prospects for maintaining viable sugar export industries do not appear to be good. In fact, some U.S. officials believe that under the 1985 Food Security Act, there will be no sugar quotas for CBI countries within a few years.

Citrus Products

Belize and Dominica have a comparative advantage in the production of citrus for export, according to host-government and U.S. officials, and could generate needed employment and foreign exchange earnings. However, AID's 1978 Policy Determination 71 restricts the funding of projects involving the production, processing, or marketing of sugar, palm oil, or citrus for export unless "their development rationale is strong and their likely impact on U.S. producers low." The restriction was implemented in response to lobbying pressures from U.S. producers, and has effectively precluded AID missions from funding citrus projects. U.S. and local officials and citrus growers in Belize and the Eastern Caribbean maintain that technical and credit assistance is needed and could be particularly helpful from AID. These officials also said that citrus exports would be in concentrate form and would essentially compete with exports from Brazil, which is now the largest supplier of concentrate to the United States. These officials and growers further maintained, as does the International Trade Commission, that such exports would have an insignificant impact on the U.S. domestic producers.

Tourism

Tourism ranks as a priority development sector in most of the countries reviewed since it generates considerable employment as well as earns foreign exchange. In a previous report[3], we reported that Department of Commerce officials were concerned that language in the fiscal year 1987 Continuing Resolution might restrict the Department's International Trade Administration from sponsoring seminars, trade shows, and other activities which promote trade with and investment in CBI countries. Conferees to the Continuing Resolution stated that they opposed "any [U.S.] government support of projects designed to attract U.S. companies to relocate outside the United States."

[3]Caribbean Basin Initiative: Legislative and Agency Actions Relating to the CBI (GAO/NSIAD-87-58FS, Dec. 1986).

Congressional concerns over a study by the Commerce Department's U.S. Travel and Tourism Administration, which suggested ways for CBI countries to derive more economic benefits from tourism, also resulted in language in the fiscal year 1987 Continuing Resolution directing the Travel and Tourism Administration to limit its promotional efforts to travel in the United States and its possessions. Explanatory language accompanying the legislation stated that "funding available to [the Administration] is not to be used for policy studies or technical assistance to promote travel to any destination other than the United States and its possessions." Both legislative restrictions, applying only to fiscal year 1987 funding, appear to conflict with the CBI objective of promoting tourism; neither was included in the fiscal year 1988 Continuing Resolution.

Although the Caribbean area is natural for the development of tourism, AID has provided very limited assistance to the sector. According to AID officials, support for tourism projects declined when AID began emphasizing basic human needs in the early 1970s and assistance for tourism came to be viewed as incompatible with this emphasis. Mission officials in the countries we reviewed said that there was an internal understanding in AID that (1) tourism projects would not be funded with AID resources and (2) specific authorization from AID/Washington was necessary before the missions could fund any tourism-related projects, even with tourism being recognized as a sector which generates considerable employment and some foreign exchange. Very limited tourism-related support services, such as technical assistance, training, and infrastructure development, have been funded in some of the countries reviewed. For example, AID has funded hotel employee training in the Dominican Republic and revitalization of the harbor front in Grenada. However, since funding for tourism-related development must compete with other priority projects, some missions were reluctant to propose projects because of both the perception that tourism was not supported as an appropriate sector for AID funding and the lack of guidance from AID/Washington.

AID commented that there is no policy prohibiting or limiting support for tourism in the Caribbean and cited a recently proposed project of its Eastern Caribbean mission as an example of support for tourism. In addition, the Trade Representative said that a CBI Policy Working Group on Tourism is identifying tourism areas for future support.

Conclusions

CBI was intended to stimulate trade and investment in nontraditional export products which would complement Caribbean Basin countries' traditional exports, resulting in increased employment and foreign exchange generation. Although the countries under review have benefitted from CBI trade provisions through increased employment and foreign exchange earnings from nontraditional exports, congressional and/or administration actions in three areas may conflict with CBI objectives.

U.S. sugar quota cuts and declining world sugar prices have severely damaged the foreign exchange positions for major sugar producers like the Dominican Republic. Although the Food Security Act of 1985 poses long-term problems for CBI countries, congressional action in the fiscal year 1988 Continuing Resolution to increase sugar imports from CBI countries, had it been implemented, could have assisted the countries in maintaining employment and generating needed foreign exchange during the U.S. 1988 fiscal year. Congressional actions, which prevented the Department of Commerce's International Trade Administration from funding some trade shows and the Travel and Tourism Administration from assisting foreign tourism development, also may have conflicted with CBI intentions and objectives.

Administration actions that may conflict with CBI objectives include the AID prohibition against assistance in the area of citrus production and the agency understanding which, at the time of our review, discouraged involvement in Caribbean countries' tourism sectors. Both sectors hold considerable potential for CBI countries.

U.S. health and safety regulations and Customs procedures are intended to protect the American public. While exporters from some CBI countries may find these requirements to be both confusing and challenging, their problems should decline as they gain experience in exporting to the United States, as has occurred for exporters in Haiti and the Dominican Republic.

AID's CBI-Related Assistance

AID is the principal U.S. foreign assistance agency, but it has neither a congressional mandate nor internal written policy guidance on how to define or implement CBI. Generally, AID officials said the Agency's private-sector projects (funded through Development Assistance) along with its Economic Support Fund policy dialogue efforts, are considered as their "CBI related program."

AID's private-sector initiative began in 1981, before announcement of CBI, and is being implemented in most CBI countries. Private-sector led growth and development, closely paralleling the trade and investment objectives of the CBI, is the basic strategy of AID missions in the Caribbean Basin. AID officials are working to develop an improved business and policy environment in CBI countries to allow them to take maximum advantage of CBI opportunities. Specifically, AID's CBI-related objectives include

- promoting economic and financial stabilization and an environment conducive to private investment;
- encouraging production, trade, and investment in nontraditional exports; and
- enhancing management and marketing capacities of the nations' business communities.

AID Funding Levels

AID received a supplemental appropriation of $350 million in Economic Support Fund assistance for Caribbean Basin countries in fiscal year 1982 to support the administration's request for an aid component to complement the trade initiative. Of this appropriation, $223 million was allocated to Central America (of which $10 million was for Belize) and $127 went to the Caribbean islands. However, since then AID has received no additional funding specifically earmarked to support CBI[1]. According to AID officials, AID does not maintain an account to identify assistance for CBI-related activities because it does not receive discrete CBI funding, and its efforts to support investment and export-led growth cannot be isolated and readily identified. CBI-related activities can be funded through AID's Development Assistance or Economic Support Fund accounts, or from local currencies generated through the sale of

[1]An additional financing mechanism was established by the Tax Reform Act of 1986 (Public Law 99-514), which amended section 936 of the Internal Revenue Code to encourage investment in CBI countries. The revised section 936 expanded the existing exemption from federal taxes of qualifying profits from investments in Puerto Rico by U.S. companies, to include profits from complementary investments (those which maintain or create jobs in Puerto Rico as well as in a CBI country) in CBI countries which have bilateral tax information agreements with the United States. As of December 1987, only one such investment had been made—$8.7 million for housing in Jamaica.

U.S. agricultural commodities. AID assistance for fiscal years 1983-87, to the countries reviewed, is shown in table 4.1.

Table 4.1: AID Assistance to Selected CBI Countries, Fiscal Years 1983-87

Dollars in millions

	Haiti	Dominican Republic	Belize	Caribbean Regional[a]
Development Assistance	$122.15	$130.94	$32.37	$121.47
Public Law 480 I/III	70.00	132.40	0.00	0.00
Public Law 480 II	51.04	10.19	0.00	0.00
Economic Support Funds	70.58	190.80	28.17	188.69
CBI[b]	10.00	41.00	10.00	24.00
Other[c]	3.28	0.01	0.00	1.63

[a]Caribbean Regional programs include bilateral assistance to the seven English-speaking, less developed countries of the Eastern Caribbean (Antigua/Barbuda, Dominica, Grenada, Montserrat, St. Kitts/Nevis, St. Lucia, St. Vincent/the Grenadines) and regional assistance to five additional countries including Belize. Bilateral U.S. assistance to Grenada, estimated at $81 million for development assistance, Economic Support Funds and disaster relief, is included in the totals for Caribbean Regional programs. Belize also receives bilateral assistance.

[b]This was allocated in the fiscal year 1982 Economic Support Fund supplemental and was available for obligation in fiscal year 1983.

[c]Includes disaster relief assistance and child survival funds.

Source: AID.

AID also provides funding to other executive agencies to support CBI-related activities. For example, in fiscal year 1987 AID provided $115,000 to the Department of Commerce's Caribbean Basin Information Center to support publication of its CBI Business Bulletin and a guidebook for Caribbean exporters. AID also allocated $227,500 in fiscal year 1987 funds to the Department of Agriculture's Office of International Cooperation and Development, which promotes U.S.-owned or joint-venture agribusinesses in the Caribbean. AID also provided $25,000 for a Department of Transportation study of port facilities in the Eastern Caribbean and has funded technical assistance and related travel for Transportation officials in the Caribbean. AID provided $150,000 to the Department of Commerce in fiscal year 1988 to fund publication of CBI promotional materials and to complete CBI investment surveys. In past years, AID also funded the investment exposition held in conjunction with Caribbean/Central American Action's annual CBI conference.

Goals of AID's CBI-Related Program

In the countries reviewed, AID's CBI-related program consisted of projects and policy dialogue intended to promote conditions AID identifies as conducive to trade and investment growth (see app. II for a listing of AID

projects). Although many of the projects were similar from country to country, the relative emphasis placed on specific projects, components within projects, and issues stressed in policy dialogue varied based on AID's assessment of each country's needs and comparative advantages. Given favorable economic and political conditions, AID's objective is the expansion of nontraditional exports in agriculture/agribusiness and light manufacturing, with emphasis on the potential to create jobs and increase foreign exchange. In some cases, where a country has a notable comparative advantage in tourism, AID missions have provided limited funding for supporting services to the sector.

To promote trade and investment, AID's private-sector program focuses on the following areas:

Infrastructure - AID maintains that investors will commit funds where basic infrastructure needs are being met. Projects reviewed in CBI countries include improving and maintaining basic feeder roads, facilitating crop movement to the port in St. Vincent, and funding factory shells to attract light manufacturing in Grenada.

Trained/skilled labor force - As the Caribbean countries move from rural/peasant economies to increased dependency on light industry and agribusiness, skilled laborers, trained supervisors, and prepared mid-level managers are needed. Shortages of these personnel can influence wage rates and overall productivity. In Haiti, the shortage of trained managers results in wages more than double those of managers in the Dominican Republic. AID provides training designed to improve private-sector management and/or worker skill levels in each country we visited.

Credit - We found a common shortage of venture capital and medium- and long-term credit for agribusiness and industrial development. Commercial banks are frequently risk averse and require significant collateral for new or small enterprises. AID supports a variety of credit programs ranging from loan rediscount programs through private-sector development finance institutions in the Eastern Caribbean to programs to lend local currency, generated from the sale of U.S.-donated agricultural commodities, for free zone development and sugar diversification in the Dominican Republic.

Export and investment promotion capacity - The Caribbean countries must compete with each other as well as the rest of the world when attempting to attract businesses. AID supports export and investment

promotion corporations to encourage collaboration between the public and private sectors and to institutionalize the skills necessary to attract foreign investment and assist the indigenous private sector. These projects usually provide for feasibility studies, brokering for joint partnerships, analysis of and input into a country's policies and regulations, and personal contacts with potential investors.

Favorable investment climate - AID officials and private-sector representatives agree that tariff preferences are only one factor in the complex investment decision process. A favorable investment climate, also significant in the investment decision, includes (1) the overall stability of the government, (2) reasonable import and export requirements, (3) the ability to repatriate profits, (4) access to foreign exchange and rationalized exchange rates, and (5) investment incentives such as free trade zones and tax holidays.

AID's CBI-Related Programs in Selected Countries

During our field work, we reviewed most of the 23 AID projects and activities listed in appendix II, identified by the missions as CBI-related, and visited many of these sites. We considered each program within the context of the level of private-sector development and attendant needs within the individual country. Our assessment of program achievements and future potential was hampered by several factors. AID's CBI-related efforts are relatively recent and it will take time before their contribution can be seen. In addition, it is not possible to isolate the effects of AID's programs from the wide array of other factors influencing a country's export-led growth, such as the international financial and trade environment and a country's sociopolitical stability.

Haiti

During our review, AID suspended government-to-government assistance to Haiti following cancellation of the November 29, 1987, election. The election was aborted following widespread violence and failure of the governing military council to ensure civil order. Nongovernmental, humanitarian, and some private-sector funding is continuing. A substitute election was held on January 17, 1988, but the regime which was installed was subsequently overthrown. U.S. officials consistently emphasized that both the success of the AID program and the benefits to be derived from CBI for Haiti depend upon sociopolitical stability, which in turn is dependent upon a stable, democratically elected government.

Haiti's private sector is composed of a large number of subsistence farmers and small-scale businessmen and traders, but is dominated by a rich

elite of closely associated family groupings who control export-import trade, tourism, construction, and the formal manufacturing sector. Haiti had long been attractive for foreign export-assembly investments because of its low wages and previously stable labor environment. AID resources available for private-sector development address constraints, which include a backward agricultural base, high unemployment, and a shortage of trained supervisors and mid-level managers. A constraint frequently cited by U.S. officials and some private-sector representatives is the lack of investor confidence in the country's stability following ouster of the Duvalier dictatorship. They also said that negative media coverage associated with health threats from Acquired Immune Deficiency Syndrome has severely impacted on the tourist industry.

Specific AID projects to promote export-led growth include funding for PROMINEX, Haiti's center for the promotion of exports and investment. Since the current political environment discourages foreign investment, PROMINEX is promoting contract manufacturing which requires minimal capital commitment by foreign investors. PROMINEX began operations in February 1987 and established a trouble desk in the summer 1987 to provide assistance and what was termed "accurate" information to businesses about labor unrest. It plans to hire a consulting firm to develop a public relations strategy to boost investor confidence in Haiti. PROMINEX also intends to promote agribusiness investment, but had not hired the necessary staff as of September 1987.

Officials in Caribbean Basin countries have frequently expressed concern over the difficulties encountered in meeting U.S. health and safety standards. When the U.S. Environmental Protection Agency banned the use of the pesticide ethylene dibromide to fumigate mangoes intended for the U.S. market, AID financed a project to develop a hot-water dip method of fumigation. This technique was approved by the Environmental Protection Agency, and Haitian officials hoped to increase and solidify Haiti's market-share in the United States before competitors, such as Mexico (which had been using ethylene dibromide and was also banned from exporting mangoes to the United States), received approval for their alternative treatment methods.

Additional CBI-related projects include a development finance corporation to provide medium- and long-term capital and support services to new or expanding industry and agribusiness, management training, and policy dialogue that would liberalize import restrictions and eliminate export taxes.

AID's program is focused on areas which should help Haiti take advantage of CBI trade opportunities, but its effectiveness is dependent upon factors which are beyond AID's control.

Dominican Republic

AID's CBI-related program in the Dominican Republic is broad-based and has potential to facilitate further growth in nontraditional exports. AID focused on policy dialogue to encourage reforms that will improve the investment climate, credit availability for export-oriented industry and agribusiness, and development of institutional capabilities to promote investment. AID also provided some technical assistance to the government to educate officials about debt-equity conversion possibilities for addressing the country's external debt problems. The overall success of AID's efforts are greatly dependent upon the Dominican Republic government's adherence to policy reforms, such as a free-market exchange rate, advocated by AID.

The Dominican Republic government has adopted many reforms to encourage the expansion of nontraditional exports and to position the country to take maximum advantage of CBI. The government is promoting diversification of the agricultural base, with an emphasis on nontraditional export crops, and establishment of free-trade zones where semi-finished goods may be imported duty-free for assembly at competitive wage rates and re-exported. In response to discussions with AID over conditions attached to its balance-of-payments assistance, the Dominican Republic government, under a previous administration, agreed to a unified, market-determined exchange rate resulting in devaluation of the peso. This increased the competitiveness of Dominican wage rates, thereby attracting foreign investment and increasing exports. However, in June 1987 the current government imposed administrative controls over the exchange rate, which resulted in foreign exchange shortages with an attendant loss in investor confidence, thus jeopardizing the success of AID's efforts and trade and investment benefits accruing from the CBI.

In September 1987, AID deobligated $6 million of the $19.8 million fiscal year 1987 Economic Support Fund assistance allocated to the Dominican Republic due to the government's unwillingness to adhere to the prior agreement to maintain a unified exchange rate. Following economic disruption and declining foreign exchange earnings, the government reversed itself in mid-November 1987, replaced the governor of the Central Bank, and allowed the exchange rate to float. However, the government also imposed a 20-percent commission on some imports by the

private sector and imposed a 10-percent withholding requirement on exporters' foreign currency earnings. These actions are an attempt by the Dominican Republic government, facing a difficult financial situation, to capture needed foreign exchange to service its large debt and to pay for necessary imports. As of January 1988, no Economic Support Fund moneys were allocated to the Dominican Republic for fiscal year 1988; however, this was due to reductions in available funds rather than problems in negotiating an agreement with the Dominican Republic government.

Diversification into nontraditional agricultural exports is especially important for the Dominican Republic, given its large foreign exchange losses from declining world sugar prices and quota reductions by the United States. To support Dominican efforts, AID funds the Joint Agribusiness Coinvestment Council, Inc., a private nonprofit agribusiness association which (1) identifies and brokers promising joint ventures, (2) provides loans for feasibility studies, and (3) works to influence investment laws related to agribusiness. Through an agreement with the U.S. Department of Agriculture, the Council provides a fresh fruit and vegetable preclearance program, which reduces the exporters' risk of delays and rejections at U.S. ports of entry. AID also provides a $17.3 million line of credit through the Central Bank for agribusiness loans. An additional $20 million equivalent in local currency from the sale of commodities was provided by the United States to compensate for sugar quota cuts and support diversification in areas affected by the sugar quotas. AID also funds a crop diversification research and development project for alternatives to sugar production.

AID supports the government's emphasis on export growth through promotion of free-trade zones by providing credit lines for free-trade zone development. The credit is funded through local currency from Economic Support Fund and U.S. commodity programs. AID also funds an investment promotion council, which focuses on improving the country's investment climate and promoting investment in the free-trade zones. A favorable investment law has been passed by the government which has resulted in more free-trade zone investors than space available in the zones.

Although tourism is a priority development sector in the Dominican Republic, AID does not have a policy on assistance to this sector and has generally discouraged such use of AID funds as incompatible with the AID mandate for basic human needs assistance. However, the AID mission in the Dominican Republic is funding a basic training program for hotel

employees such as receptionists, waiters/waitresses, and kitchen workers.

In the Dominican Republic, AID's CBI-related program supports the government's goals of agricultural diversification and export growth through the promotion of free-trade zones. However, the government's inconsistent adherence to its previous agreement to maintain a unified exchange rate has threatened the program's potential success by undermining investor confidence in Dominican policies.

Dominica and St. Vincent

These Eastern Caribbean islands have a unique set of circumstances that constrain rapid development of the private sector and pose a challenge for AID programming. The islands are small, with limited labor forces and minimal resources, relatively high wages compared to those of Haiti and the Dominican Republic, and seriously underdeveloped infrastructure and transport facilities. The private sector in Dominica is one of the most underdeveloped in the region, and St. Vincent's private sector has been characterized as risk-averse and inexperienced in marketing techniques.

The AID program is attempting to alleviate these constraints in order to place the islands in a position to take better advantage of CBI opportunities. AID's goal is to provide the basis for self-sustained, long-term growth. Its CBI-related program focuses on (1) developing infrastructure, (2) improving productivity of traditional agricultural exports, (3) encouraging diversification into nontraditional crops, and (4) expanding the manufacturing sector through investment promotion.

Poor infrastructure is a serious constraint to private-sector development. Farmers in Dominica and St. Vincent have problems transporting produce to embarkation ports, and transportation to markets is costly and unreliable. AID has funded feeder-roads; however, because of the limited resource base and volume of exports, improvement of transportation facilities, such as port improvements or airport expansions, would not be cost-beneficial.

Some foreign investors in St. Vincent cited the availability of factory shells as the major incentive for choosing to locate there. However, neither island currently has unused factory space available. AID's Infrastructure for Productive Investment Project was designed to finance privately owned and operated industrial estates and related infrastructure. However, private-sector representatives from Dominica criticized the

design of this project because it required borrowers to repay loans in dollars since commercial banks pass the exchange risk on to the borrower. A recent AID evaluation also found limited investor interest in the project because privately developed factory shells in most Eastern Caribbean countries would have to compete with government-owned and subsidized shells. In 1987, $6 million of the $12 million project was deobligated.

Credit for medium- and long-term loans is available through the AID-funded Caribbean Financial Services Corporation, a privately owned regional development bank. As originally proposed, early lending was to be through either discounts of commercial bank loans or direct loans. An AID evaluation reported that the loan discount component was not used, in part because borrowers would not assume the foreign exchange risk, although demand for direct loans reached 150 percent of planned volume. The evaluation found that many of the medium-sized firms that received Corporation loans could not arrange financing elsewhere and described the project as successful in terms of total investment, employment generated, and net foreign exchange earned.

From 1981 to 1987, investment and export promotion efforts for St. Vincent and Dominica were provided through the Project Development Assistance Program, which is a regional project serving the Eastern Caribbean. Under this project, a private consultant was contracted by AID to provide investment promotion activities through resident advisers on each participating island and an investor search component based in Washington. The project was renewed for 3 years in 1984, but the contracted component was terminated in October 1987. A project evaluation found that the Eastern Caribbean's investment promotion program should (1) be more tailored to the needs of each country, (2) place greater emphasis on institution-building and policy reform to create an attractive investment climate, and (3) transfer responsibility for investment promotion to the participating governments. Subsequently, a new project structure was implemented to provide for local investment development corporations in each country, along with a central Eastern Caribbean Investment Promotion Service staffed by Eastern Caribbeans, and located in Washington, D.C.

AID's regional High Impact Agricultural, Marketing and Production Project, started in June 1986, is designed to stimulate new agricultural investment in privately owned and managed commercial enterprises producing for export in Eastern Caribbean countries. High Impact provides technical assistance, brokering for joint ventures, and a trust to

provide equity funds to new ventures. Two High Impact projects for the processing of passion fruit jelly and aloe vera products have been approved for Dominica, and additional projects are pending for both St. Vincent and Dominica. AID recently revised both the design and management of the High Impact venture-trust component because of (1) implementation problems attributable to project management, (2) the limited resource base and underdeveloped private sector, and (3) general lack of expertise and the institutional framework necessary for introducing venture-trust financial instruments. While the High Impact approach is creative and theoretically attractive, it is too early to determine its effectiveness or potential for long-term impact. Inspections for fruit flies can present a problem in the timely clearance of export produce through U.S. Customs. AID was instrumental in helping St. Vincent receive certification that it is free of fruit flies, which should help its export of agricultural products to the United States.

The underdeveloped private sectors and limited resources of Dominica and St. Vincent have hindered their ability to diversify and expand into nontraditional exports to take advantage of CBI benefits, although a few foreign investors have begun assembly operations in St. Vincent. Indigenous exporters in Dominica said they were not ready to use CBI benefits because of the complexity of the U.S. market, and felt more confident in dealing with their traditional markets in the Eastern Caribbean regional area. AID's program acknowledges these limitations, and its success in helping Dominica and St. Vincent take advantage of CBI will be largely influenced by the success of the High Impact and the investment and export promotion project.

Grenada

Whether Grenada can successfully take advantage of CBI opportunities and fully benefit from AID programs depend upon an improved business climate and the continued political stability in the country. Government leaders must also have the political will to undertake difficult but overdue reforms and to increase efforts to strengthen and improve private-sector investment opportunities.

In addition to assistance provided under the Eastern Caribbean regional program, Grenada has received $62.9 million in bilateral U.S. assistance since 1984, targeting economic recovery and subsequent stable growth and financial solvency. The emphasis on public-sector investment by Grenada's Marxist government, which ruled the country until 1983, resulted in a 40-percent drop in private investment and a 75-percent increase in public investment during 1980-84. Because of this past

emphasis on a nonmarket economic system, which resulted in deterioration of the economy and subsequent dependence on external assistance, AID has linked budget support for Grenada to economic policy reforms.

Policy dialogue is focused on restructuring the economy to reduce the Grenada government's role and to promote domestic and foreign private investment. Conditions for disbursements of U.S. funds include reductions of arbitrary market restrictions that impede private-sector development, tax reform, and reduction of public-sector expenditures through privatization of state-owned enterprises and reductions in the number of government employees. However, the Grenada government either has not adopted some agreed-upon reforms or has altered the implementation of the reforms so that they have lost their positive impact. For example, with AID's support, the Grenada government agreed to consolidate, simplify, and rationalize the tax system. However, implementation of a new land-value tax was postponed, and according to U.S. officials, the government is modifying it to make it less effective. A new value-added tax has been inconsistently applied and the government is not collecting all taxes due. The government also has not complied with its schedule to reduce the excessive number of public employees and thus cannot reduce its budget deficit.

According to U.S. officials, the prime minister has complained about U.S. conditions requiring economic and governmental reforms which AID attached to its assistance. After a visit to the United States by the prime minister, U.S. officials relaxed the AID mission's conditions for the disbursement of funds, ordered disbursement of $1.2 million, and promised an additional $1 million. When the Grenada government did not subsequently meet remaining conditions, further disbursements of $4.8 million were halted.

After completing the Port Salines airport, which had been under construction by the Cuban government, AID provided additional funding for needed infrastructure improvements of roads and water systems, electricity distribution, and for development of factory shells and tourism infrastructure. Private-sector representatives in Grenada criticized the factory shells, claiming that they were not designed for tropical climates and did not contain basic features, such as lavatories. Also, AID has required Grenada to set lease rates high enough to provide for full cost-recovery, which may contribute to the fact that some shells remain empty while investors go to other countries.

Grenada's natural beauty, attractive capital, and unique history provide favorable conditions for tourism. Under an infrastructure project, AID funded three restoration/renovation activities designed to enhance the country's tourist appeal. However, Grenada lacks sufficient hotel space to qualify for the number of international airline flights that would consolidate its tourism sector into a major foreign exchange earner.

AID's High Impact project is promoting new agricultural investment in Grenada. Also, AID is assisting in a pest-risk analysis with the goal of having Grenada certified free of fruit flies by the end of 1987.

U.S. officials and private-sector representatives were highly critical of the management of Grenada's Industrial Development Corporation, which was established to attract and retain foreign investment. The Corporation is slow in approving investment applications and has a poor record of providing services to potential investors. It has been unable to finalize lease agreements with firms operating in AID-built factory shells and has thereby failed to collect rent for the shells. AID mission officials are aware of these weaknesses and of the possibility that additional U.S. technical assistance and financial support may be necessary to get the Corporation in viable working order. Despite the completion of the airport, opportunities offered through CBI, and a revision of Grenada's investment code, growth in the manufacturing sector has been well below expectations. An AID contractor representative said that Grenada is still perceived as politically unstable.

The success of AID's CBI-related program in Grenada is related to the (1) performance of the High Impact project, (2) establishment of a more responsive investment and export promotion unit, and (3) continuation of difficult government reforms promoted by AID and necessary to strengthen the investment climate.

Belize

Belize received assistance through AID's regional Caribbean office for almost 2 years, following its independence in 1981. AID subsequently established an in-country mission in 1983. Belize parallels the Eastern Caribbean countries with its problems of a small labor force, underdeveloped infrastructure, and limited credit availability. AID's program emphasizes strengthening the private sector and promoting investment and export diversification.

The success of AID's project to increase available medium- and long-term investment capital is constrained by the reluctance of Belize commercial

banks to approve loans for new investments. In March 1983, AID established a fund with the Central Bank against which local commercial banks could discount new loans for productive investments in agriculture and related industries. The scope was broadened in November 1984 to permit loans to any sector that would provide foreign exchange. However, the commercial banks were reluctant to approve the riskier, longer term loans targeted under this project, and in August 1984, AID deobligated $2.1 million of the $5 million project total. AID is attempting to devise new lending programs which will be outside the traditional commercial banking sector.

Belize's Export and Investment Promotion Unit, funded by AID, began operations in the summer of 1986 under the Belize Chamber of Commerce and Industry. The Unit reported that it contacted over 300 investors during its first year of operations and generated at least 12 new investments. Belize businessmen criticized the Unit for focusing on foreign investment while overlooking opportunities to support export efforts of local producers.

Belize was heavily dependent on foreign exchange earned from sugar exports. Sugar earnings were $34.2 million or 53 percent of its total foreign exchange earnings in 1983, $32.5 million (45 percent) in 1984, $22.9 million (36 percent) in 1985, and $31.4 million (43 percent) in 1986. AID and the Belize government are working to diversify the agricultural sector by developing alternative export crops. AID funded research to identify tropical fruits and winter vegetables appropriate for cultivation. The development of tropical fruit production for export has begun on a trial basis, but with the exception of papaya, these fruits will not be ready for commercial production for 4-7 years after planting. An AID consultant has questioned the viability of producing winter vegetables for export since these products require higher levels of sophisticated planning and management than is currently available in Belize.

The Belize government has designated tourism as a priority development sector. The country has the second longest ocean barrier reef in the world as well as ruins of the Mayan civilization in its interior, both of which could be developed as tourist attractions. The AID mission has indirectly supported tourism through several loans to private developers from the commercial banks' discount fund and through outreach by the government's Export and Investment Promotion Unit, but is reluctant to provide further assistance in the absence of clear policy guidance from headquarters in Washington.

AID's CBI-related portfolio also includes projects to promote cocoa production, build and maintain roads, and improve overall management skills. Recognizing Belize's limited resources, AID's CBI-related program depends upon agricultural diversification away from dependency on sugar exports and on increased credit availability.

Conclusions

Although AID does not have a specific legislative mandate for implementing CBI, its private-sector program is consistent with and supportive of CBI's trade and investment goals. The AID missions in the countries we reviewed emphasize private-sector led growth and development through projects and policy dialogue designed to improve the investment climate and expand nontraditional exports in agriculture, agribusiness, and light manufacturing. In general, the projects address the need for improved infrastructure, employment generation and training, credit availability, and export and investment promotion.

AID's program in Haiti is designed to support Haiti's private-sector led growth; however, its success depends on sociopolitical stability. Without stability and a credible democratic government, U.S. private-sector assistance directed toward CBI-related investment and export promotion may prove ineffective.

The AID program for the Dominican Republic is directed toward supporting development of free-trade zones and diversification from sugar to nontraditional agricultural exports. Continued private-sector investment and economic growth in nontraditional exports and services depend upon the government's willingness to maintain a positive investment-climate, particularly by adhering to a free-market exchange rate. Diversification away from dependency on sugar as a foreign exchange earner continues to be important for the success of CBI in the country.

AID's program for the Eastern Caribbean islands recognizes the constraints posed by inadequate infrastructure and transportation, an underdeveloped private sector, and limited resources. The restructured High Impact project and investment and export promotion approach are too new to evaluate for achievements. Successful private-sector led growth in Grenada depends on improved investment and promotion efforts and on the government leaders' timely adoption of difficult but necessary reforms. AID's CBI-related program in Belize encourages agriculture diversification away from sugar to nontraditional crops and has attempted to increase medium- and long-term credit availability.

Overall, the contribution of AID's CBI-related program to the export-led growth of the countries we reviewed is difficult to assess, in part due to the newness of the effort. In many cases, the benefits from crop diversification and agribusiness projects will only be apparent in the long term. Exporters with limited experience in the U.S. market have encountered difficulties anticipating market changes and in meeting U.S. regulatory requirements. AID programs are attempting to address these complaints. These programs include the Department of Agriculture inspector based in the Dominican Republic, the fruit fly eradication and certification programs in the Eastern Caribbean, and the promotion of joint ventures between indigenous and U.S. investors.

In addition, the impact of AID's CBI-related programs cannot be separated from other factors influencing a country's export growth and foreign investment potential, such as world market prices and economic and sociopolitical stability. However, AID's CBI-related projects are consistent with the overall goals of CBI and have the potential to contribute to export-led growth in countries where the private sector is sufficiently developed and the investment climate remains favorable.

Agency Comments and Our Response

AID commented that the report should more thoroughly and prominently address the role of Economic Support Fund assistance as a policy dialogue and conditionality mechanism for "economic stabilization and structural adjustment, which are general prerequisites to private sector export development." The U.S. Trade Representative also pointed out the importance of AID's policy reform efforts. We agree that CBI countries' economic success and ability to benefit from CBI opportunities is highly contingent upon adoption of rational economic policies. Although AID's Economic Support Fund policy dialogue efforts predate the CBI, we have addressed their importance in the report, with specific references to the Dominican Republic and Grenada where such efforts are most prominent. To the extent that the policy reform efforts have been successful, they are reflected in the our analysis of export and employment performance. In addition, we have issued a number of reports on the importance of Economic Support Fund-supported policy reforms and the mixed success of U.S. efforts, through AID, to encourage developing countries to undertake appropriate reforms. U.S. Use of Conditions to Achieve Economic Reforms (GAO/NSIAD-86-157, Aug. 1986) discussed, for example, the Dominican Republic government's reluctance to comply with AID conditions. Compliance was subsequently achieved when the government recognized the absolute need for reforms and AID increased both its level of assistance and its willingness to withhold disbursements

for noncompliance. Other reports include AID's Assistance to Jamaica (GAO/ID-83-45, Apr. 1983) and Providing Effective Economic Assistance to El Salvador and Honduras (GAO/NSIAD-85-82, July 1985).

Commodity Exports and Tourism, 1983-86

Dollars in millions

	1983	1984	1985	1986
Haiti				
Merchandise exports	**$391.9**	**$447.2**	**$441.8**	**$450.2**
Traditional of which:	61.8	56.3	58.4	63.2
Coffee	50.9	45.1	49.5	56.7
Sisal	4.9	5.6	2.5	1.4
Sugar	1.3	0.5	0.0	0.0
Nontraditional of which:	330.1	390.9	383.3	387.0
Garments[a]	83.9	102.7	131.6	130.5
Tourism	**$85.0**	**$83.4**	**$95.1**	**$84.9**
Export earnings of which:	**$476.9**	**$530.6**	**$536.9**	**$535.1**
Net foreign exchange[b]	$210.9	$224.8	$227.8	$227.7
Dominican Republic				
Merchandise exports	**$996.7**	**$1141.4**	**$1059.8**	**$1113.2**
Traditional of which:	685.7	741.7	569.7	545.1
Sugar	276.4	300.0	190.1	146.1
Coffee	76.4	94.9	57.6	115.9
Cocoa	60.9	75.9	64.8	67.8
Tobacco	24.0	30.4	22.9	25.7
Dore	164.5	131.8	113.6	111.8
Ferronickel	83.5	108.5	120.7	77.8
Nontraditional of which:	311.0	399.7	490.1	568.1
Agriculture	28.3	35.5	37.2	53.5
Manufactures[c]	282.7	364.2	452.9	514.6
Tourism	**$320.5**	**$370.6**	**$451.0**	**$506.3**
Export earnings of which:	**$1317.2**	**$1512.0**	**$1510.8**	**$1619.5**
Net foreign exchange[b]	$873.6	$971.7	$853.0	$903.0
Belize				
Merchandise exports	**$65.0**	**$72.8**	**$64.4**	**$72.4**
Traditional of which:	36.6	35.6	26.2	35.9
Sugar	34.2	32.5	22.9	31.5
Bananas	2.4	3.1	3.3	4.4
Nontraditional of which:	28.4	37.2	38.2	36.5
Citrus	6.8	9.8	12.1	11.1
Fish Products	7.0	6.7	7.5	5.4
Garments	8.2	15.6	15.7	16.1
Tourism	**$9.3**	**$10.7**	**$11.8**	**$12.9**
Export earnings of which:	**$74.3**	**$83.5**	**$76.2**	**$85.3**
Net foreign exchange[b]	$49.5	$50.9	$43.1	$51.0

(continued)

	1983	1984	1985	1986
Grenada				
Merchandise exports	**$18.9**	**$18.2**	**$22.3**	**$28.7**
Traditional of which:	12.6	10.2	13.4	19.7
Nutmeg	2.9	2.1	4.2	9.7
Cocoa	6.0	4.2	5.0	4.2
Bananas	3.0	2.9	3.2	3.7
Mace	0.8	0.9	0.9	2.1
Nontraditional of which:	6.3	7.9	9.0	9.0
Fresh fruit	4.1	4.8	6.4	na
Garments	1.8	0.7	0.6	na
Tourism	**$18.6**	**$21.1**	**$27.9**	**$30.8**
Export earnings of which:	**$37.5**	**$39.3**	**$50.2**	**$59.5**
Net foreign exchange[b]	$20.9	$21.1	$26.9	$33.6
Dominica				
Merchandise exports	**$27.8**	**$26.1**	**$28.6**	**$39.4**
Traditional	11.2	11.1	13.3	25.3
Nontraditional of which:	16.6	15.0	15.3	14.1
Manufactures[c]	2.9	6.7	12.5	13.0
Tourism	**$8.2**	**$10.8**	**$9.8**	**$10.4**
Export earnings of which:	**$36.0**	**$36.9**	**$38.4**	**$49.8**
Net foreign exchange[b]	$26.0	$23.4	$22.4	$32.1
St. Vincent				
Merchandise exports	**$41.1**	**$53.6**	**$63.2**	**$68.0**
Traditional	15.7	16.3	24.6	26.7
Nontraditional of which:	25.4	37.3	38.6	41.3
Manufactures[c]	9.6	7.3	8.6	8.9
Tourism	**$15.7**	**$15.6**	**$17.5**	**$18.1**
Export earnings of which:	**$56.8**	**$69.2**	**$80.7**	**$86.1**
Net foreign exchange[b]	$38.5	$50.8	$59.6	$64.0

[a]Exports to the United States

[b]Domestic value-added.

[c]Reported by importing countries

Source: International Monetary Fund, World Bank, United Nations, U.S. Department of Commerce, and host countries.

Selected AID CBI-Related Projects in Countries Reviewed[a]

Country/Project	Initiation/ Completion	Funding	Purpose
Haiti[b]			
Development Finance Corporation	1983-88	$10 million grant	Provide medium/long-term capital for industrial/agro-industrial projects.
Export and Investment Promotion	1986-90	$7.7 million grant	Improve export promotion services and investment
Crafts Export Resource Center	1985-89	$2 million grant	Provide export-oriented support to crafts producers.
Haitian Development Foundation	1984-86	$2.2 million grant	Meet the credit and managerial needs of micro-business sector.
Management and Productivity Center	1985-90	$3.3 million grant	Upgrade management skills of business owners and managers.
Dominican Republic[c]			
Export and Investment Promotion	1985-88	$6 million	Strengthen the investment and grant export promotion council.
Agribusiness Promotion	1985-88	$19.8 million grant/loan	Promote and finance agribusiness.
Small Industry Development	1982-87	$5.9 million grant/loan	Provide credit, technical assistance & training to small entrepreneurs.
Graduate Management Training	1983-87	$6.5 million grant	Provide graduate MBA and MPA programs and to support research.
Belize			
Commercial Bank Discount Fund	1983-87	$5 million[d] loan	Increase private productive investment in agriculture and industry.
Export and Investment Promotion	1986-91	$2.5 million grant	Develop capacity to promote and facilitate export and tourism.
Commercialization of Alternative Crops	1985-90	$6.8 million grant	Develop alternative agricultural products.
Toledo Agricultural Marketing	1987-92	$2.5 million grant	Establish a viable export industry among small land holders.
Training for Employment and Productivity	1985-90	$5.2 million	Provide management, public administration and skills training for private sector.
Caribbean Regional[e]			
Caribbean Financial Services Corp.	1983-87	$15 million grant/loan	Establish private sector development finance institution.
Private Sector Investment/ Assistance Program	1981-87	$3.5 million grant	Support selected industry and commerce association activities.
Investment Promotion and Export Development	1984-89	$17.2 million grant	Identify and promote private investment in export-oriented business.
High Impact Agricultural Marketing and Production	1986-91	$40 million grant	Stimulate the agricultural sector by improving investment environment and demonstrating profitability.
Small Enterprise Assistance	1986-91	$11.9 million grant	Assist local entrepreneurs produce and sell their goods.
Regional Non-Formal[f] Skills Training	1982-89	$7.6 million grant	Provide non-formal skills training, particularly to 15-25-year-olds.
Infrastructure for Productive Investment	1984-87	$6 million loan	Provide physical infrastructure for expanded private production.

(continued)

Country/Project	Initiation/ Completion	Funding	Purpose
Productive Infra structure Rehab. (St. Vincent)	1982-87	$3.2 million grant	Rehabilitate feeder (farm to market/port) roads.
Grenada[g]			
Infrastructure Revitalization	1984-86	$6 million grant	Improve Grenada's physical infra-structure, including factory shells and tourism infrastructure.

[a]AID missions identified these projects as "CBI related." Other AID projects may also support export growth/private sector objectives.

[b]U.S. government-to-government assistance was suspended following the aborted national elections in November 1987.

[c]Various credit lines are also available for sugar diversification and free-zone development, using local currency from section 416 and Public Law 480 commodities and Economic Support Funds.

[d]This project was terminated and $2.1 of the $5 million was deobligated in August 1987.

[e]Projects apply to Dominica, St. Vincent, and Grenada.

[f]Representatives from the private sector in Grenada identified this project.

[g]AID also bilaterally funded projects for Grenada.

Source: AID.

Comments From the Agency for International Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

ASSISTANT
ADMINISTRATOR

APR 1 1988

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

In response to your letter of March 11, 1988, we have reviewed the draft report entitled, Caribbean Basin Initiative: Impact on Selected Countries (job code 472133). Enclosed you will find the comments of the Agency for International Development (AID) on that report.

Sincerely,

Dwight Ink
Bureau for Latin America
and the Caribbean

Enclosure: a/s

AID Comments on the GAO Draft Report,
Caribbean Basin Initiative: Impact on Selected Countries
(Job Code 472133)

1. Overall, we find the Draft Report to be a thorough, objective and constructive assessment of the CBI program. We expect that the CBI has considerable potential over the long-run to enhance the economic environment in the recipient countries by promoting export growth and diversification. Given that the Draft Report observed only the initial three year period, we believe that the results have been fairly impressive. The report has also done a valuable service by pointing out policy changes such as the cut in sugar quotas and various import restrictions which have adversely affected the CBI countries.

2. The Draft Report correctly identifies A.I.D.'s CBI related program as including the Agency's private sector projects and the policy dialogue efforts. However, the discussion that follows and the Appendix II list of CBI Related Projects largely ignore the major role played by Economic Support Funds (ESF) in the policy dialogue component of A.I.D.'s CBI program. The aim of most ESF policy dialogue and conditionality is economic stabilization and structural adjustments, which are general prerequisites to private sector export development.

See p. 47.

We believe that the Report should address more thoroughly and prominently, the role of ESF in supporting the overall CBI program and positive changes in the Basin's investment climate. In Haiti, for example, ESF assistance in FY 1986 and FY 1987 facilitated significant progress in trade liberalization, income tax reform, and improved financial accountability. In the Dominican Republic, state sugar lands have been leased to private producers of nontraditional crops. Belize has undertaken some privatization. In Dominica, Grenada, and Belize, ESF assistance has supported the construction of infrastructure which will facilitate private investment.

3. As the report makes clear, many other factors affect the results sought by A.I.D. under the CBI Initiative such as the recent sociopolitical upheaval in Haiti cited in the report. However, A.I.D. continues to pursue those actions that are directly supportive and contribute to achievement of CBI objectives. In this regard, attached you will find a paper that highlights several of the key interventions that A.I.D. is undertaking in the CBI area.

See comment 1, p. 61.

4. The Draft Report utilizes export earnings of non-traditional exports to assess the impact of the CBI. It would be useful to also draw upon USDOC data on manufactured imports to the U.S. by CBI countries to more directly measure the impact of the CBI.

- 2 -

This kind of data is especially important for countries, such as those in the Eastern Caribbean, who also have had considerable exports to non-U.S. destinations. The attached table shows that U.S. manufactured imports have increased dramatically from a number of CBI countries, e.g., Jamaica, Dominican Republic, Guatemala, St. Lucia, etc.

The following are recommended changes in the subject report. The changes are listed in sequence; the listing is not in order of priority or importance.

Now on pp. 3, 29.

Page 6. It should be noted that the referenced (pages 6, 47, 61) sugar quota increases in FY 1988 have not materialized to date.

Page 7. For accuracy, we suggested the text "upper-level management" related to training be struck and in substitution, therefore, place "short term functional and skill training and long term scholarship training under the Caribbean and Latin American Scholarship Program". We also suggest the following change be made here and elsewhere, where applicable. We suggest the text "A.I.D. projects complement CBI objectives" be changed to "A.I.D. projects complement and support CBI objectives". We believe this statement is more representative of A.I.D. program support of the CBI and should be made throughout the report where appropriate. For example on page 72, "Conclusions", we recommend the following text: "is consistent with the Initiative's trade and investment goals" be modified to indicate "is consistent with and supportive of the Initiative's trade and investment goals".

Now on p. 46.

Now on p. 17.
See p. 4.

Page 26. While it is true that "if one considers broadly based economic growth as the creation and/or expansion of related industries, benefits have been much more limited", it is unrealistic to expect significant impacts given the short period of time since the CBI became effective. We have completed only the first 4 years of a 12 year program. The development of labor-intensive industries regardless of investment size are expected to develop a skilled labor pool and managerial and entrepreneurial skills over decades, not just several years. Likewise, the inducement for locally produced inputs should not be expected to take place so quickly, but only after considerable time as quality and experience are developed.

See comment 2, p. 61.

Page 29. The discussion of the interest rate serving as a measure of debt-service growth and the related analysis should be re-evaluated. For a given level of debt, the effective interest rate is a measure of the <u>level</u> of a country's debt service, not its <u>growth</u>.

Now on p. 20.

Page 31. The last sentence should preferably read "The country has become <u>increasingly</u> dependent on U.S. assistance to service its debt."

Now on p. 22, table 2.4.

Page 31. The "unemployment" rate of 49% for Haiti includes some 37% under-employment. It is misleading as now stated.

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Now on p. 30.

Page 44. Recommend that after "A.I.D.'s 1978 Policy Determination 71", the words "developed in concert with Congress" be inserted immediately thereafter. We deem it important to signify that this particular provision was developed in response to Congressional interest in this matter. A reassessment of this provision may be appropriate.

Now on p. 31.

Page 46. Here and elsewhere in the report, reference is made to and contains text such as the following: "The Agency has an internal "understanding" that tourism projects will not be funded with A.I.D. resources in the absence of specific authorization from AID/Washington". This is not correct. There is no Agency policy prohibiting or limiting A.I.D. support of tourism activities in the Caribbean, although the comment is true for other LAC areas. Due to limited funding and the magnitude of problems faced in relation to A.I.D.'s resources, tourism activities often are displaced by other more pressing interventions as judged by an individual mission in developing its country program. A vivid example of A.I.D. support of tourism is the recent initiative by A.I.D.'s regional office in Barbados titled: "Tourism Promotion Audiovisual and Feasibility Study for Marketing Campaign in North America to increase Tourism in the Caribbean". Given the regional reach and impact of this project, we believe this particular activity merits listing along side those already cited.

Now on p. 35.

Page 53. Suggested change under "Infrastructure" - A.I.D. maintains that investors will increasingly commit funds where basic infrastructure needs are met.

Now on p. 38.

Page 59. The $6 million ESF was de-obligated in September rather than November. The remaining $13.8 million has been authorized by AID/W for a grant agreement to the GODR but has yet to be obligated by a signed grant agreement.

Information as of
December 1987.

ACCOMPLISHMENTS UNDER A.I.D.
LATIN AMERICA AND CARIBBEAN PRIVATE SECTOR PROGRAM

1. Policy Dialogue. The LAC Bureau has been the leader in utilizing policy dialogue as a tool to achieve policy reform that will improve the investment climate in the LAC countries. The LAC missions have played a significant role in the following policy initiatives which are designed to provide incentives for increased investment that will lead to an expansion in non-traditional exports, and employment generation:

- Policy areas targeted are exchange rates, tax reform, credit allocation and banking regulations, price controls, tariff regimes, and legal and regulatory constraints to investment and export growth.

- A.I.D. policy dialogue has been instrumental in achieving appropriate exchange rate policies in two countries (Costa Rica and Guatemala) where exchange rate misalignment was a major problem.

- Legislation favoring establishment of export processing zones, industrial parks and other measures to increase non-traditional exports, have been implemented in four countries (Costa Rica, Honduras, Guatemala, and El Salvador) stimulated by policy dialogue.

2. Investment and Export Promotion. Each of the 12 LAC country missions have assisted in the creation of private investment and export promotion center or units. Their mandate is to encourage and work with local and foreign investors and exporters by providing a range of business services (i.e., feasibility studies, marketing studies, financial analysis, joint venture brokering, etc.).

For example, in Costa Rica, Honduras, and El Salvador these organizations have been instrumental in:

- the passage of legislation to stimulate investment and exports; the establishment of export processing zones; and other measures aimed at the development of a favorable business climate;

- 2 -

o providing leadership under the CBI that is reflected in the positive trend in the growth of non-traditional manufactured exports to the U.S. (i.e., a 19.5% average annual increase since 1983.)

3. Privatization. All LAC missions have developed a strategy for privatization activities (divestiture of state-owned companies), to support our policy dialogue that seeks a reduction in the size of government in LAC countries. Nearly all of the missions have studies and/or programs for valuation and divestiture under way; several have completed substantial privatization programs. For example, Jamaica is privatizing the National Commercial Bank, a major cement company, and most of the government-owned hotels, now under private contract, are soon to be fully divested. Honduras and Costa Rica have created holding companies to manage the divestiture and sale of an estimated 60 parastatals.

4. Credit/Banking Programs. The LAC Bureau has often been recognized as the innovator of A.I.D. credit programs dating back to the creation in the early 1960s of the Latin American Agribusiness Development Company (LAAD), several Development Finance Corporations (DFCs) and credit guaranty mechanisms. The LAC Bureau continues to be in the forefront of innovative credit and banking programs throughout the region:

o LAC missions have some 30 projects which have provided over $335 million in resources during the past four years to support intermediate credit institutions.

o Exporters, microenterprises, small businesses, and small farmers are the groups which generally benefit from these programs.

o Credit programs include technical assistance components for loan packaging, basic financial and accounting procedures, and production assistance for smaller borrowers.

U.S. MANUFACTURED IMPORTS FROM A.I.D. CBI COUNTRIES

(SITC CATEGORIES 5-8)

COUNTRY	1983	1984	1985	1986	Estimated* 1987	Average Growth Rate 1983-87
	($ MILLION)					
Belize	6.8	15.6	23.4	20.4	16.5	24.8%
Costa Rica	102.3	134.3	166.6	218.6	262.6	26.6%
El Salvador	94.7	121.5	90.6	57.3	76.7	-5.1%
Guatemala	14.6	27.7	28.4	38.7	65.3	45.5%
Honduras	37.4	39.4	45.8	55.5	69.2	16.6%
Panama	33.7	33.5	85.6	50.1	69.6	19.9%
TOTAL, CENT. AMERICA	289.5	372.0	440.4	440.6	559.9	17.9%
Dominican Republic	259.6	331.9	421.3	516.8	674.4	27.0%
Haiti	288.1	330.8	348.6	339.9	367.0	6.2%
Jamaica	19.8	34.2	78.8	129.6	211.2	80.7%
TOTAL, CARIBBEAN	567.5	696.9	848.7	986.3	1252.6	21.9%
Antigua	6.2	7.0	10.1	8.9	6.0	-0.8%
Dominica	0.2	0.1	8.5	8.8	6.0	134.0%
Grenada	0.0	0.1	0.8	2.1	2.0	n.m.
Monserrat	0.8	0.9	2.0	2.6	3.0	39.2%
St. Lucia	4.3	6.5	10.7	10.7	16.0	38.9%
St.Kitts	9.4	16.2	13.5	17.3	21.0	22.3%
St.Vincent	3.9	2.7	7.4	7.3	7.0	15.7%
TOTAL, EAST CARIBBEAN	24.8	33.5	53.0	57.7	61.0	25.2%
TOTAL, AID COUNTRIES	881.8	1102.4	1342.1	1484.6	1873.4	20.7%
Growth rate		25.0%	21.7%	10.6%	26.2%	

*1987 Estimates are based on January-November data, except for the Eastern Caribbean, which is based on January-August data.

The following are GAO's comments on the Agency for International Development's letter.

GAO Comments

1. Our use of nontraditional export statistics includes manufactured imports to the United States drawn from Department of Commerce statistics; we also include such imports by countries other than the United States. While statistics on the growth in total manufactured exports to the United States may be impressive, these exports utilize high levels of imported components, and thus their positive impact upon the exporting country is considerably less than the statistics would lead one to believe. As we have stated in chapter 2, the value of a country's total exports does not provide a complete picture of its impact on the economy, since it is the proportion produced in-country or domestic value-added that generates employment and net foreign exchange earnings. The value-added component is the difference between the value of a country's exports and the imported intermediate and capital goods (depreciated over time) used to produce those exports.

2. AID's statement is correct for any fixed level of debt. However, if the level of debt is not fixed, there is no direct relationship between the effective interest rate and the level of debt service. For example, if the outstanding debt increases, the debt service may increase even if the interest rate does not change. Since debt levels are not fixed for these countries (see col. 2, table 2.3), such a restrictive assumption contributes little to the analysis of a country's changing economic conditions. We are concerned with changing levels of debt and debt-service obligations. The effective interest rate may be used as a measure of these changing levels of debt and debt service.

Comments From the U.S. Trade Representative

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

Mr. Frank G. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, D.C. 20546

Dear Mr. Conahan:

Thank you for circulating your draft report, Caribbean Basin Initiative: Impact on Selected Countries (job code 472133), for our review and comment.

We are submitting this letter, reflecting joint comments by several of the U.S. Government agencies participating in the Caribbean Basin Initiative Task Force Subcommittee on Policy, co-chaired by the United States Trade Representative and the U.S. Department of State. Other agencies contributing to this report are the U.S. Department of Commerce, the U.S. Department of Agriculture, and the U.S. Agency for International Development. The latter agency submitted separate comments to you directly, since a large part of your report focuses on AID's specific activities in promoting the CBI.

We appreciate the report's breadth in reviewing both Congressionally-mandated and Administration actions which unfortunately have worked at cross-purposes with the objectives of the CBI. We agree that both the Congress and the Executive Branch should remain sensitive to the impact of potentially contradictory actions on the countries in the Caribbean Basin and, to the extent possible, should avoid taking actions which will be detrimental to their overall economic and trade interests.

Before turning to specific references in the text, we have several general comments which we would like to see included in the final version of the report. These broad issues have an effect on the overall operation and effectiveness of the CBI.

See p. 47.

First, we believe that the report does not give sufficient weight to the importance of the economic policies adopted by the CBI countries themselves. Discussion of this aspect is relegated to brief mentions in the final chapter on AID programs. We recommend, that this aspect receive much more prominent treatment in the report, including references in the Executive Summary and perhaps as part of the case studies.

2

The focus of the CBI is on a cooperative partnership between four "actors" -- the private sector in the United States, the private sector in the Caribbean Basin, the government of the United States, and the governments in the Caribbean Basin. The United States offers greater access to its market while the Caribbean Basin governments are to enact policies to encourage greater private sector initiative.

We believe that the policies adopted by the CBI beneficiaries themselves are of critical importance to an evaluation of the CBI's effectiveness. Such policies, in turn, also have direct implications for CBI beneficiaries' ability to generate employment, promote broad-based growth, and service debt. The CBI should be seen as one tool which may be used to accomplish these other objectives. Without adoption of rational economic policies by CBI beneficiaries, U.S. economic assistance and investment promotion activities will bear little fruit. The U.S. maintains an active policy dialogue with all of the CBI beneficiaries, often under the auspices of bilateral economic assistance programs administered by USAID.

Now on p. 33.

Second, the Executive Summary makes no mention of recent decreases in AID funding levels, although the point appears later in the body of the report (p. 50). The study gives good marks to the past development and implementation of AID programs in the region. However, without adequate funding in the future, such programs will, of necessity, be reduced in scope and, in some cases, jeopardized altogether.

In FY 88, for example, the Administration requested $92 million in Economic Support Funds (ESF) and $80.3 million in Development Assistance (DA) for Belize, the Dominican Republic, Haiti, and the Eastern Caribbean. In response, Congress allocated $68.2 million, all in DA, less than 40 percent of the amount requested. This resulted from reduced Congressional appropriations for all foreign assistance combined with Congress' earmarking of 94.7% of worldwide ESF. Since only the four Central American democracies were earmarked, the other traditional Latin American and Caribbean ESF recipients, with the exception of Bolivia, received no ESF in FY 88 because the unearmarked ESF residual of about $100 million was subject to sense of Congress restrictions that excluded this hemisphere. Because U.S. efforts to encourage economic reform and growth are linked to the amount of ESF we are able to provide, our interests and objectives in the hemisphere will suffer as will the countries affected.

See comment 1, p. 72.

Through the CBI, the Administration seeks to improve the climate in Caribbean Basin countries for all types of investment. The study curiously favors capital intensive investment (which is described as indicative of the investor's longer term commitment) over labor-intensive investment (described as being less secure and more volatile because the capital devoted to it is less). However, the CBI economies will benefit from <u>both</u> kinds of investment; therefore, it seems unnecessary to favor one over the other.

3

The study itself notes that the economies in the Caribbean Basin generally are characterized by relatively high rates of unemployment and low wages (compared with the United States). Therefore, it should not be surprising, nor should it be a cause for concern, that most investments in the Caribbean Basin are in relatively labor-intensive operations. Such investments, by creating more employment per dollar of investment, ultimately will be of greater value in contributing to economic development in labor-surplus economies.

The following comments are keyed to specific references in the draft report:

Chapter 1 -- Introduction

Now on p. 9.

p. 13 -- We suggest replacing Jamaica for Dominica in the explanatory sentence on Tax Information Exchange Agreements, since (as of this writing) Dominica has not yet implemented its TIEA. Barbados, Grenada, and Jamaica are at present the only CBI countries which have TIEAs in effect.

Now on p. 9.

p. 14 -- In the paragraph at the top of the page on the earlier GAO report on investments in the CBI, add the phrase ",with assistance from AID," after "The Department..." in the last sentence.

See p. 10.

p. 15 -- While we recognize that the selection of countries was worked out with the Senate Committee on Foreign Relations, we would also like to point out that the selection of the countries studied influences the findings in the report. By excluding other countries in Central America from the scope of the report and focusing on a group of countries which is not totally representative of the region as a whole, your assessment substantially understates the accomplishments of the CBI. The experiences of Dominica and Grenada in taking advantage of the CBI have not been the same as those of Costa Rica, Jamaica, or St. Lucia.

Now on p. 10.
See p. 14, table 2.1.

p. 16 -- The text cites Dominica and St. Vincent as being unable to "effectively compete in the international economic environment at this time." We believe that this statement is far too sweeping a generalization, since the report's own figures (page 21, Table 2.1) show annual export growth of 12 percent for Dominica and more than 18 percent for St. Vincent.

Now on pp. 10-11.
See p. 24.

pp. 16-17 -- While we find the use of domestic value-added in the study interesting, we believe that the concept is pushed beyond what can be supported by the underlying data. We would approach the analysis with a considerable degree of caution for the following reasons:

See pp. 24-25.

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- Securing accurate export and import figures, let alone accurate domestic value-added statistics, can be difficult. Where estimates are used, these should be treated more cautiously than the report seems to do.

- Of more serious concern is the confusion in the study between export values and volumes. For example, on page 28, the study calculates a loss of 1,200 jobs from each $1 million decline in sugar export earnings in the Dominican Republic, even if export volume is unchanged. If that were true, the marginal product of these 1,200 workers would have been zero. In fact, the decline in sugar export earnings in the Caribbean Basin occurred both because of lower sugar prices and lower export volume (brought about to some extent by lower U.S. quotas). The effects of lower export earnings are absorbed in a variety of ways, including reductions in real wage levels, reduced company earnings, cutbacks in production, and increased unemployment.

- The study fails to take into account secondary effects on countries' balances of payments of decreased sugar production. One could argue that the closure of an inefficient, money-losing (and resource-absorbing) sugar facility would actually benefit an economy overall, especially if it is replaced with a more efficient, higher-skilled operation producing non-traditional items, such as textiles and apparel, for export. Although some economic adjustments will be necessary to shift resources and workers from the production of sugar to production in other sectors, historical experience in many countries has shown that the longer term benefits from such structural adjustments are many. At the least, diversification of exports, by enabling countries to avoid excessive dependence on any one product or sector, results in less volatility in export earnings when external market conditions change abruptly.

- The study uses its estimates of increased real value-added to extrapolate the number of jobs created in the export sectors of the CBI countries. By making no distinction between different types of export activities, the study misses the potential for job creation. Under the study's present methodology, if a capital-intensive company producing $1 million in value-added closes, while a labor-intensive company producing the same amount of value-added opens for business, the study would conclude that net employment in the economy remains the same. This would be an incorrect assumption and misses the welfare benefits derived from employing formerly unemployed workers and for transferring new skills to the marketplace.

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Chapter 2 -- The CBI and Caribbean Debt, Employment and Economic Growth

Now on p. 13.
See p. 24.

p. 19 -- We disagree with the following assessment: "To date, benefits derived from the CBI have been limited, with only some lasting employment and broadly based economic growth being generated in the Dominican Republic."

It may be true that some investments in the region will be volatile and short-term. This is especially the case with contracting relationships, which are easier to establish but also easier to break. However, the study should differentiate between investments characterized by contracting operations and those involving fixed assets.

We are confident that the CBI investment survey being carried out by the Commerce Department, and to be ready for distribution by May 31, 1988, will document that benefits from the CBI have been widespread. Verification of the 700 surveys completed to date will include all of the CBI beneficiaries except Panama and Montserrat and will include information such as investment levels, sales volume, amount of employment generated, and sources of investment.

Now on p. 15.
See comment 2, p. 72.

p. 22 -- Table 2.2 would better illustrate the degree of export diversification taking place in the CBI countries if it reported, for example, the top five "new" exports as a share of total exports from the region. As it stands, the table shows that the CBI countries are exporting more types of products but gives no information about their relative importance to the economies as a whole.

Now on p. 15.

p. 23 -- While it is true that the CBI program allows cumulation of value-added from the various CBI beneficiaries toward the 35 percent rule of origin requirement, in practice we have not seen such intra-CBI trade taking place. It would be interesting to examine closer the reasons why such trade has not developed.

Now on p. 19.

p. 30 -- We assume that the last sentence on that page, in mentioning "growing remittances and increasing levels of assistance, neither of which relate to the CBI," refers to foreign assistance from countries other than the United States.

Now on p. 22.

p. 35 -- Qualify the last sentence in the first paragraph by revising it to read, "Some non-traditional exports and tourism ...."

We would also recommend adding to the "conclusions" sections a discussion of the CBI beneficiaries' economic policies and their effect on the ability to export and attract investment projects. The Administration, through the USAID policy dialogues and other ongoing contacts, has urged reform of such harmful economic policies throughout the region.

See pp. 46-47.

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One manifestation of this continuing effort is the U.S. Department of Commerce's project to conduct a series of "investment disincentive" studies in the region. In carrying out these studies, the Department will be working with the CBI beneficiaries to help identify domestic policies having adverse effects on the investment and business climates. In turn, we will use these studies as a basis for encouraging the countries to undertake reforms to remove existing impediments and lessen the effect of other policies which reduce their attractiveness as sites for investment and other business activity.

Now on p. 23.

p. 36 -- Revise the first sentence of the second paragraph to read, "The Dominican Republic has better economic potential than the other countries ...."

Chapter 3 -- Actions Working at Cross-Purposes to CBI Objectives

Now on p. 26.

p. 38 -- The introductory paragraph to this chapter indicates that U.S. import and health standard requirements remained unchanged under the CBI. This is accurate but the implication is that this situation works at cross-purposes with the CBI. The implication is corrected later in the chapter, where it is clear that such requirements remain necessary and exporters simply need to gain experience to deal with them. However, we suggest adding the following sentence after the second sentence in the first paragraph to avoid misinterpretation: "Some exporters have viewed these as barriers, but they should not be considered as such; exporting experience generally lessens this problem."

See p. 26.

We disagree with the use of fresh cut flowers from Costa Rica as an example of "inconsistent" rules and "arbitrary" change in administration of the CBI. The CBI provisions, as enacted in the Caribbean Basin Economic Recovery Act of 1983, were very clear in not exempting CBI exports from U.S. trade laws. The cut flower situation is an example where goods were exported using incentives which were found to be inconsistent with U.S. trade laws on countervailing duties and anti-dumping measures.

In addition, U.S. officials consulted with the Costa Rican Government during the time it was being designated for the CBI and warned them that its subsidies could be subject to U.S. countervailing duties. We encouraged Costa Rica to accede to the GATT at that time, to gain access to the "injury test" in countervailing duty investigations on duty-free products, and the Costa Rican officials we spoke with indicated that the government would consider taking that action. However, in the end they did not pursue GATT accession until later.

Now on p. 27.

p. 40 -- The report mentions in general terms various U.S. government programs which help Caribbean exporters learn the procedures and regulations required for product entry. It would

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be appropriate to clarify the type of assistance that the Office of International Cooperation and Development (OICD) of USDA provides. We suggest the following text be added after the reference to the OICD office: "For example, the OICD office works closely with export promotion associations of Caribbean Basin countries and organizes various technical workshops, seminars, individual export or team visits in which information is shared on USDA regulations, particularly phytosanitary requirements, quality issues such as grades and standards, and labelling and packaging techniques and practices."

In addition, the last sentence in the paragraph should read, "Also, Commerce and Agriculture help Caribbean exporters find U.S. partners who are familiar with product-entry and market requirements."

A new paragraph should be added to this section to describe the activities of the CBI Ombudsman: "Currently the Director General of the U.S. & Foreign Commercial Service at the Department of Commerce, the CBI Ombudsman facilitates contacts between officials and firms from CBI beneficiaries and appropriate U.S. agencies and departments. In particular, the Ombudsman assists individuals who have been unable to get responses from the U.S. Government regarding the feasibility of importing their products into the United States or have experienced difficulty in ascertaining whether their product qualifies for duty-free entry under the CBI."

Now on p. 29.

p. 42 -- We find it highly doubtful that the <u>net</u> value-added content in sugar production could ever approach anything close to 97 percent. Most of the CBI sugar-producing countries have to import substantial quantities of fertilizer, fuel and machinery, so that the domestic value-added content must be considerably lower than this comment implies. This also has implications for the earlier discussion on foreign exchange earnings and employment effects of the CBI based on domestic value-added ratios.

Now on p. 29.

p. 43 -- We would disagree with the characterization of the decrease in U.S. sugar quotas as being "abrupt." We recognize and agree that the decrease in access to the U.S. market for sugar has led to sometimes severe economic disruption in the region. At the same time, however, we believe that once the Food Security Act of 1985 was in place, the CBI beneficiaries could have foreseen that some reduction in U.S. sugar quotas would occur. Some unanticipated factors, such as the increasing popularity of substitute sweeteners in the U.S. market, have caused that reduction to be more severe and rapid than originally could have been predicted.

Also, the estimate attributed to officials in the Dominican Republic that the country has suffered $500 million in cumulative foreign exchange losses as a result of the imposition of U.S. sugar quotas is based on a set of implicit assumptions about

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sugar prices and external demand which are not spelled out in the report.

See pp. 29-30.

The discussion on "U.S. sugar policy" should be corrected to reflect the current situation on the so-called Inouye amendment. While there is a provision in this fiscal year's Continuing Resolution requiring the Secretary of Agriculture to issue regulations establishing a one-year, special quota increase for CBI beneficiaries, it is not being operated since the language in the Continuing Resolution failed to authorize USDA to use existing resources or to provide additional funding to carry out the program's operations. Under the provisions of the so-called Inouye Amendment, the ceiling for the program would in any case have been zero because of the Secretary of Agriculture's determination that no commodities would be made available under section 416 of the Agricultural Act of 1949 to the affected countries as compensation for the 1988 sugar quota year.

There are several other places in the report where the text assumes that the program is in place and operating; this needs to be corrected. Furthermore, we suggest that the text note that, even if put in operation, the Caribbean special export enhancement program does not address the root causes of the problem -- the deficiencies of the U.S. domestic sugar program. The Administration has put forward legislative proposals to address this basic issue, but to date the Congress has responded to them with little enthusiasm.

Now on pp. 30-31.

p. 44 -- We agree with the report that tourism represents a major and important area for potential economic development in the Caribbean Basin. Tourism is second only to agricultural exports as a source of foreign exchange in the region and is the mainstay for many of the Caribbean economies. It is the only industry in the region demonstrating steady growth since 1973.

Development of Caribbean tourism pays dividends in the form of greater numbers of visitors, creation of jobs, and increased construction activity throughout the Caribbean. The majority of development in tourism is by U.S. investors working in the following areas of activity: construction of roads, hotels and restaurants; furnishing of equipment for such activity; planning and building sewage and water treatment facilities; provision of utility services (electricity and fresh water); and provision of telecommunication services (both satellite and cable), airport construction and expansion, airline services, recreational equipment and services (boating, scuba, etc.).

Others are making efforts to diversify the region's tourism industry to include attractions of cultural and historical interest. Tourism in the region directly benefits the United States, as well, since a large part of every tourism dollar spent in the area (some say as much as 60-80 percent) comes back to the

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U.S. market for the purchase of food, equipment, and other supplies.

Tourism has the potential to exert a higher economic multiplier effect than many other industries because of its labor intensive character (especially if local procurement of goods and services can be increased). The advantages to developing tourism in the Caribbean include: increased employment opportunities; increased earnings of foreign exchange, which can reduce balance of payments difficulties, provided that local sources of goods and services are developed; positive multiplier effects or linkages to other sectors of the economy (particularly agricultural and manufacturing industries); increased government revenues; and greater diversification of the CBI beneficiaries' economies.

The Administration has created a CBI Policy Working Group on Tourism to identify administrative actions which the U.S. Government could take to enhance tourism development in the Eastern Caribbean countries, which typically have had more difficulty in attracting manufacturing projects. This group shortly will develop an "action plan," focusing on tourism needs in the Eastern Caribbean as a "pilot" effort. The "action plan" will focus on ways to bring existing resources together to support certain tourism-related activities.

Chapter 4 -- AID's CBI-related Assistance

We concur with USAID's comments on this and other parts of the report. There are a few areas in this section where we have additional comments.

See p. 34.

p. 51 -- In the last paragraph, we would add the following language, "AID continued to fund the Department of Commerce in fiscal year 1988 in the amount of $150,000 to support publication of promotional materials on the CBI as well as funds to support completion of the CBI investment surveys."

Now on p. 37.

p. 57 -- We suggest correcting the second paragraph to read, "When the U.S. Environmental Protection Agency (EPA) banned the use of the pesticide Ethylene Dibromide (EDB) to fumigate mangoes intended for the U.S. market, AID financed a project to develop a hot-water dip treatment method." Similarly, at the end of the paragraph, the words "fumigation method" should be replaced by "alternative treatment methods."

In the same paragraph, mention could be made of OICD's current work with the producer and export groups on coordinating similar research on treatment of mangoes in Guatemala in order to facilitate entry of mangoes into the U.S. market.

Now on p. 38.

p. 59 -- This is the first time in the report that a discussion of a CBI country's policy and its effects on business and investment

appears. However, we believe the report should not leave the impression, as this paragraph presently does, that the U.S. Government determines the policies which the CBI countries must follow. Clearly, we have a policy dialogue with the CBI beneficiaries which is collaborative in approach and seeks to encourage them to adopt policies which are conducive to building a strong private sector. We certainly do not dictate these policies.

Now on p. 42.

p. 66 -- Revise the last part of the first sentence under the Grenada section to read, "...political stability of the country and a marked improvement in the business environment."

Now on p. 46.
See p. 8.

p. 72 -- The text mentions in the first line of the conclusions that AID has no "specific legislative mandate" to implement the CBI. In fact, no U.S. department or agency has such a mandate. The National Security Council formed the CBI Task Force, chaired by the USTR, to implement the program. It is divided into two subcommittees, the CBI Policy Subcommittee and the CBI Operations Subcommittee. The Policy Subcommittee takes up questions of policy affecting the CBI program and is co-chaired by USTR and the State Department. The Operations Subcommittee discusses various issues affecting implementation of policy decisions already taken under the program and is co-chaired by the Department of Commerce and AID.

Now on p. 46.

p. 73 -- Strike the phrase, "Despite a one-time increase in the Dominican Republic's U.S. sugar quota for fiscal year 1988," and start the sentence with "Diversification ...."

Again, thank you for the opportunity to comment on your draft CBI report. Our offices and the other departments and agencies which are members of the CBI Task Force will be happy to work with your staff in preparing the final version of the report if additional questions arise.

Sincerely,

Jon Rosenbaum
Assistant U.S. Trade Representative for Latin America, Africa and North/South Affairs

Paul D. Taylor
Deputy Assistant Secretary of State for Inter-American Affairs

The following are GAO's comments on the U.S. Trade Representative's letter.

GAO Comments

1. We agree that both capital- and labor-intensive investment are important; we are not favoring either capital- or labor-intensive investment. Our analysis is meant to address the question of long-term employment generation, and the facts are that investment of capital (which cannot be packed up and removed overnight by the investor), rather than investment in leased space and second-hand sewing machines for a labor-intensive operation, is indicative of an investor's commitment to an investment thus leading to the creation of more permanent employment.

2. The intent of CBI is not just to promote "new" exports, but to promote those exports that the country can produce and market efficiently, whether they are bananas, coffee, baseballs or apparel. This report deals only with 6 countries in the region and thus does not address total exports from the Caribbean Basin region. The top 5 "new exports" from these countries are of insignificant importance, accounting in the aggregate for about one percent of their exports, and thus do not show any meaningful diversification in the countries' economies. For example, there are no new products among the leading 30 exports to the United States from Haiti and the Dominican Republic, and it would be misleading to suggest this fact translates into ineffectiveness on the part of CBI.

*U.S. G.P.O. 1988-201-040:80138

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