

## Regional exchanges of DFA: limiting factors and support

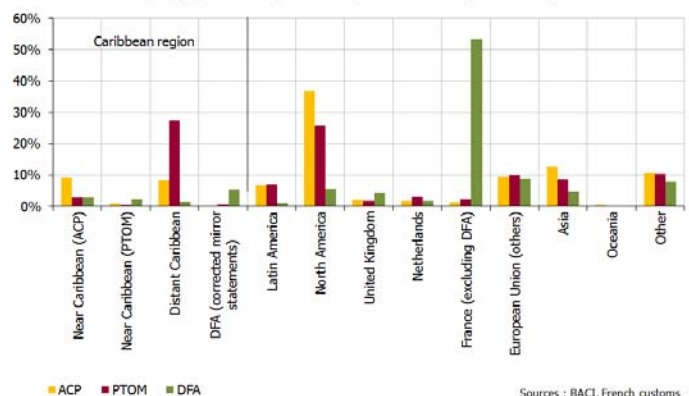
*This note, the 2<sup>nd</sup> strand of a research programme into regional exchanges of overseas territories and regions, presents a summary of a study published in the notes of the Institut d'émission<sup>1</sup>, which proposes modelling bilateral economic exchanges by French Departments of the Americas (DFA), as well as those of other Caribbean countries and territories with the help of a gravity model. The results obtained show the main determinants and enable the identification of factors which limit or, on the other hand, support, intra-regional exchanges.*

*The study shows that there is a certain amount of potential for intra-Caribbean exchanges, linked to the relatively small distances within the area, the level of economic development, which is quite high, and the relatively large size of certain countries. Nevertheless, the link with mainland France, whose effect is much more marked for DFA than for other non sovereign Caribbean territories and, to a lesser extent, the use of a minority language in the Caribbean area are significant structural factors limiting exchanges. The surplus of exchanges, measured for countries in the area participating in existing regional agreements, nevertheless augurs well for regional insertion of the DFA as the result of the signing of an economic partnership agreement at the end of 2008.*

### EXCHANGES WITH THE CARIBBEAN REGION STILL LIMITED

**Trade between the DFA and the Caribbean region is generally limited**, in 2007-2009 representing just 7% of all exchanges (excluding intra-DFA exchanges). Furthermore, they are concentrated in certain countries (depending on the sub zone considered, 1 to 5 countries are the focus of around 90% of trade) and relatively undiversified: energy products (especially with Trinidad and Tobago and Aruba), construction material (in particular cement from Venezuela) and, in terms of exports, products without the creation of local added value (reshipment of imported products). **The other countries and territories of the Caribbean "close" to the DFA** (African Caribbean Pacific [ACP] countries and Caribbean countries and overseas territories [PTOM]) **have more significant commercial links with their region**. Their intra-regional exchange of goods represented over 20% of the total of their exchanges in 2007-2009 (mainly outside the DFA). They are nevertheless relatively undiversified and dominated by energy products. Furthermore, while most supplies and sales of goods from DFA are with the European Union (EU), in particular with mainland France, North America, and the United States in particular, is the leading trade partner for the rest of the Caribbean.

Exchanges of goods from Caribbean countries and territories by geographic zone (% of all imports and exports, 2007-2009)



**The signing of an economic partnership agreement (APE) at the end of 2008 between fifteen Caribbean countries and territories and the EU is nevertheless a historic opportunity for the DFA to increase their regional insertion.** Thus, while the DFA are excluded from the main commercial and economic agreements of the zone (see text box 1), they are interested parties in the APE (due to their relationship with the EU as ultra-peripheral regions [RUP]). This agreement, which provides for the progressive liberalisation of exchanges between the two areas, has been agreed in a context where regional integration is being strongly encouraged on the French side. Perceived as a more endogenous economic development factor, it has been one of the main issues of the overseas States General.

<sup>1</sup> The 1<sup>st</sup> strand, relating to Pacific overseas regions (COM), was published in January 2011. It should also be noted that the work cited in this note is referenced in the associated Note from the Institut d'émission.

### Tex box 1: The Caribbean: a regional integration process underway

Within the Caribbean, numerous regional cooperation and integration agreements co-exist with differing levels of integration. First we can cite the **Organisation of Eastern Caribbean States (OECS)**, which may be considered as the most successful regional cooperation initiative, as its 7 member countries form a monetary union (Eastern Caribbean Currency Union [ECCU]). The **Caribbean Community and Common Market (CARICOM)**, which groups together 15 countries or territories in the Caribbean, also constitutes a relatively integrated organisation: in 2006 it saw the establishment of a common market and will see, by 2015, the establishment of a “single economy” (CARICOM Single Market and Economy or CSME). Finally, the **Association of Caribbean States (ACS)** is a broader regional cooperation platform (25 members and 3 associate members), but one which is also less formal (projects in the environmental field in particular). While the British PTOM are partially integrated into these agreements (for example Montserrat is a member of the OECS and CARICOM, Bermuda is an associate member of CARICOM), the Dutch PTOM (Dutch Antilles, Aruba) and DFA are excluded from them: they are only associate members of the ACS.

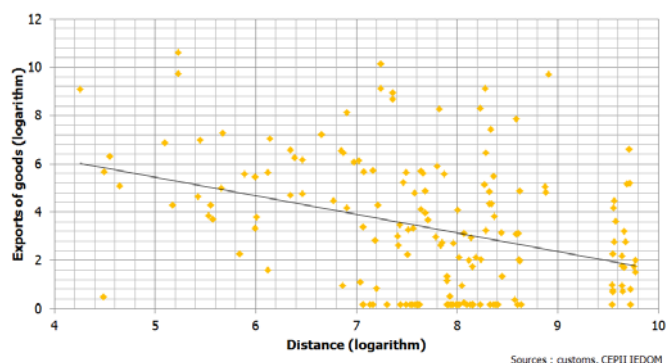
An additional boost to this regional integration was given at the end of 2008, with the signing of an economic partnership agreement with the European Union. This agreement provides for the progressive liberalisation (over 25 years) of exchanges between member countries of the CARIFORUM (Forum of Caribbean ACP States) and the EU in the fields of goods, services, capital and persons. Numerous specific provisions have nevertheless been made: sensitive products excluded from the agreement (numerous agricultural products, industrial and textile products, that is to say an average of 13% of products), sanitary and phytosanitary and food safety requirements for continued agricultural and agri-food exports, specific provisions for access to the DFA market (imports of bananas and sugar from members of the CARIFORUM excluded from the scope of the APE for at least 10 years, dock dues, special safeguard clause, applicable to all products, in the event of a competitive imbalance).

## RELATIVELY SIGNIFICANT STRUCTURAL SUPPORT FACTORS

**The main structural factor for the support of intra-regional exchanges: relatively small intra-Caribbean distances, despite transport infrastructures still being inadequate.** Unlike the Pacific “region”, intra-Caribbean distances appear quite small, close for the French West Indies to that separating mainland France from its European partners (of the order of 850 km). Furthermore, despite their insular nature and often modest size in global terms, the DFA, like other Caribbean countries and territories, show a sensitivity of their commercial exchanges to distance of the same scale as that normally estimated in literature

(around -1). This result contrasts with that obtained for New Caledonia, French Polynesia and the small Pacific island economies, where the elasticity of exchanges of goods over distances was found to be higher (from -1½ to -2). Consequently, the significant geographical distance of these territories, even between themselves, was considered to be a factor significantly complicating their exchanges. Nevertheless, this structural factor for the support of intra-Caribbean exchanges is not yet fully applicable, due to the insufficient development of internal transport infrastructures in both aviation and maritime fields (cf., in particular, the World Bank (2006), for which this infrastructure is often seen to be a competitive disadvantage). Even Guyane (French Guiana), geographically integrated into the South American continent, has poor connections with countries in the area: road access there is notably limited, even if construction of the Oyapock bridge could

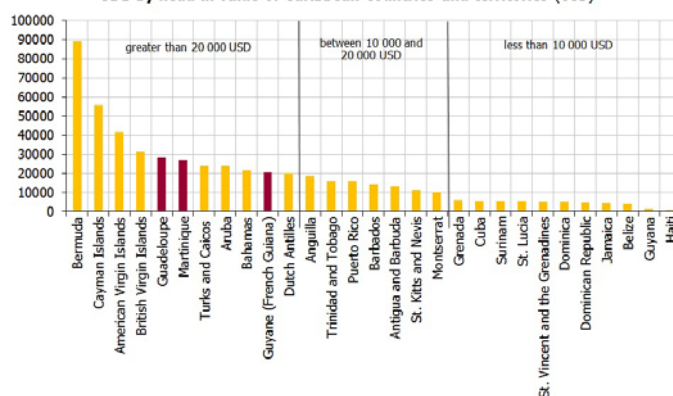
Exports of DFA goods (excluding EU) and distance (average 1998-2009)



improve exchanges with states in the north of Brazil.

**Another factor supporting intra-zone exchanges: the level of economic development and, for certain countries and territories, the relatively large size of the market, even if the “trade base” is often more modest.** The level of economic development in the Caribbean region is, overall, quite high (according to World Bank classification, it comprises 10 high income countries or territories and 10 mid-upper income countries), unlike that observed in the Pacific zone. Furthermore, the size in population terms of several Caribbean countries or territories is relatively significant, such that the combination of a high economic development level and a sufficient market size is more common than in the Pacific (Puerto Rico, Dominican Republic, Trinidad and Tobago in particular). However, estimates, unsurprisingly, show a positive link between commercial exchanges and GDP by head, as well as population (standard elasticity of around 1). Nevertheless, the high level of GDP does not necessarily translate into a significant productive capacity and exchange of goods: within the Caribbean, only one or two sectors often “drive” economic activity (non trading sector in the DFA, Montserrat and Cuba, the financial sector especially in the Cayman Islands, energy in Trinidad and Tobago, tourism, etc.).

GDB by head in value of Caribbean countries and territories (USD)



### Tex box 2: Data and methods used in the study

Data relating to bilateral exchanges of goods from the DFA (Guadeloupe, Martinique, Guyane) comes from the French customs authority, whereas that relating to commercial trade from Caribbean countries and territories comes from the Base for the Analysis of International Trade (BACI) from the CEPII, which has the advantage over other bases of presenting flows in a harmonised way. Data relating to GDP, population and exchange rates generally comes from the World Development Indicators base of the World Bank (sometimes supplemented by local sources). The variables of distance and certain indicators (language in particular) come from the CEPII Distance base. All of this data is available (at least) for the 1998-2009 period.

The bilateral exchanges of goods from the DFA like the rest of the Caribbean are modelled with the help of a **gravity model**, which is the international economic reference point when it comes to explaining this type of flow. It links exchanges between two countries (positively) with their respective size (measured by their GDP) and (negatively) to “transfer costs” (measured by distance). Beyond this “gravity standard”, other variables supply the model (relative distance, exchange rate, links with a mainland, trade agreements, common language, oil index, etc.).

## SIGNIFICANT AND ENDURING LIMITATIONS

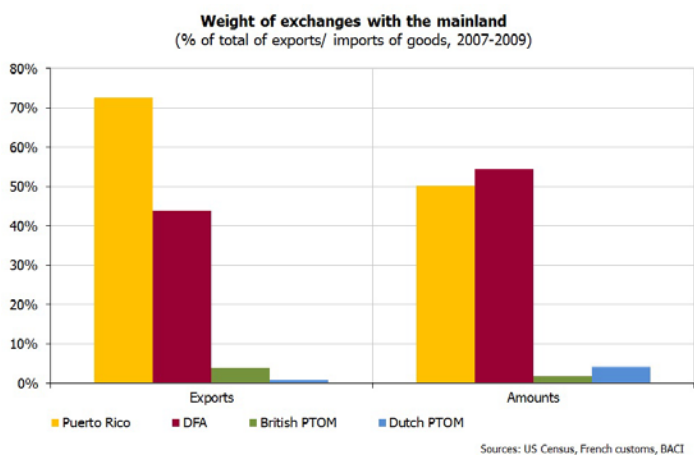
**A “colonial premium” much greater in the DFA than in other Caribbean territories linked with a mainland is measured, this covering aspects which could discourage intra-Caribbean exchanges.** The “colonial premium”, which corresponds to the surplus of exchanges linked to relations with the mainland (beyond the “gravity standard”), estimated for the DFA, is much higher (factor of 5 ½) than that measured for Dutch PTOM in the zone (factor of 3 ½) and, *a fortiori*, than that measured for British PTOM (Anguilla, Bermuda, Cayman Islands, Turks and Caicos, the British Virgin Islands, Montserrat; factor of

1), in this case due to the simple fact of a common language. The colonial premium measured for DFA also appears greater than that estimated for COM in the Pacific (factor of 3 ½). This result is the logical consequence of the extremely high level of integration of DFA into French domestic space (overseas departments, having, in particular, a common legislative and regulatory framework with mainland France), whereas the British PTOM and, to a lesser extent, Dutch ones, care notable for their much stronger institutional and economic autonomy compared with their respective mainlands (see text box 3). Thus, while the weighting of mainland France in DFA exchanges is over 50%, Montserrat and Aruba, which are the two largest territories of their former colonial rulers (respectively, the United Kingdom and the Netherlands) import barely 10% of their goods from them. Likewise, the British Virgin Islands and Montserrat, the areas which export the most to the United Kingdom, only export around 6 to 7% of

their products there. On the other hand, the close commercial relationship between DFA and mainland France appears more comparable to that between territories having links with the United States (Puerto Rico, American Virgin Islands), where autonomy is much more limited (nevertheless, in this case, geographic proximity can partially justify the high level of exchanges), even if no colonial premium could be measured for these territories as there are no detailed data on bilateral exchanges. However, the strong links between the French West Indies and Guyane and mainland France, although beneficial in terms of standard of living (cf. “the costs of sovereignty”, Poirine, 2007), has the potential to discourage intra-Caribbean exchanges (French and European standards, taxation, cost of work, etc.). These elements are also cited as significant brakes on trade by members of the CARIFORUM (Watson and Angelo, 2010).

**The absence of participation in the main economic and commercial agreements in the region until 2009, and the exclusion of sensitive products from the scope of the APE also constitute brakes on exchanges between the DFA and their region.** Estimates show a significant impact on the exchanges of goods from Caribbean countries and territories, linked to their membership, respectively, to the CARICOM (factor of 2½) and the ECCU (factor of 1½). The surplus of exchanges thus created by these agreements is notable (see also Egoumé-Bossogo and Mendis, 2002) bearing in mind the characteristics of the region (absence of land borders, relatively limited exchangeable base, strong attractiveness to North America)<sup>2</sup>. However, as we have seen, until the end of 2008, the DFA were excluded from Caribbean commercial and economic agreements. Furthermore, although these results bear witness to the expected favourable impact of the signing of the APE on DFA-CARIFORUM trade, this could be limited by the exclusion of sensitive products from the scope of this agreement (numerous agricultural products, industrial and textile products) as well as, for DFA, continued dock duties.

<sup>2</sup> For the small Pacific island economies, a significant positive effect was also shown for the main commercial agreements in force (South Pacific Regional Trade and Economic Cooperation Agreement [SPARTECA], Melanesian Spearhead Group [MSG]), but to a lesser extent than in the Caribbean.



**Tex box 3: What are the institutional links of PTOM and American Caribbean territories with their former colonial rulers?**

**British PTOM** benefit from a high level of autonomy from the United Kingdom. Institutional autonomy on the one hand: for some of them, only powers in the sector of defence, internal security and foreign affairs remain devolved to the United Kingdom (this is the case with Bermuda, the British Virgin Islands, the Cayman Islands). For others where British governance is stronger (in the financial sector, for example), a movement towards autonomy is underway (Anguilla, whose status should evolve towards a free association with the United Kingdom, Turks and Caicos Islands). Economic autonomy on the other hand: only Montserrat, an extremely small territory (less than 5,000 inhabitants), subject to volcanic eruptions, still benefits from significant British budgetary support. Other areas are almost self sufficient in budgetary terms. Furthermore, whereas French overseas territories and departments receive significant financing from the French development agency (AFD), the Department for International Development (DFID), the British counterpart of the AFD, finances only Montserrat.

The **Dutch PTOM** appear to some extent to be closely linked to the Netherlands. Thus they are an integral part of the Kingdom of the Netherlands. Nevertheless, while Bonaire, Sint Eustatius and Saba are municipalities (with special status) directly related to the Kingdom, Aruba (independent of the Dutch Antilles since 1986), Curacao and Sint Maarten have the status of “independent countries” (since 2010 the Dutch Antilles as such have been dissolved). While foreign affairs and defence remain devolved to the Netherlands, the management of internal affairs is incumbent on the local authorities. It should be noted that, within the framework of the institutional evolution of the Dutch Antilles since 2010, the Netherlands have nevertheless been required to intervene in the field of public finances, having regard to the significant budgetary problems encountered.

**Puerto Rico** and the **American Virgin Islands**, respectively a Free State associated with the United States and an organised territory not incorporated into the United States, seem for their part to benefit from much more limited autonomy. By way of example, in Puerto Rico, the US federal government has competence in fields as varied as trade, foreign affairs, customs policy, defence, security, communications, agriculture and social security.

**The use of a minority language (French) and currency (the Euro) within an area often considered to be a “United States lake” appear to be more moderate limitations on intra-Caribbean exchanges.** The use of French, a language little used in the Caribbean area (official or shared language only in Dominica and Haiti), compared with English and to a lesser extent Spanish, appears, according to our estimates, to be a factor limiting intra-regional exchanges by DFA. Nevertheless, the impact measured is less than the cost of opportunity deriving from the non participation in regional agreements or even links with mainland France. *A fortiori*, in estimates, it is not possible to isolate a significant positive impact of “shared currency” linked to the extremely widespread use of the Dollar (or currencies pegged to the Dollar) in the zone. In fact, even the few Caribbean economies whose money fluctuates against the US Dollar have significant trade with the US. This result is probably due to the weak exchange rate effect, which is observed in the study, on trade between the DFA and the rest of the Caribbean<sup>3</sup>. In fact, the products exchanged, mainly agricultural and agri-food products, are “limited” products (that is to say there is low price elasticity), and the share of products subject to “exchange rate risk” is limited.

|                              | 1998-2009 |           | 1999-2008   |             |
|------------------------------|-----------|-----------|-------------|-------------|
|                              | DFA       | Caribbean | Pacific COM | Pacific PEI |
| Distance (absolute)          | -1,1      | -1,0      | -1,4        | -2,1        |
| Population (partner country) | 1,1       | 1,0       | 1,1         | 1,0         |
| GDP/head (partner country)   | 1,0       | 1,1       | 1,3         | 0,9         |
| Exchange rate (nominal)      | -0,1      | -0,1      | -           | -           |
| Mainland (France)            | 5,9       | -         | 3,5         | -           |
| Mainland (Netherlands)       | -         | 3,5       | -           | -           |
| Mainland (United Kingdom)    | -         | 1,0       | -           | -           |
| RUP                          | 2,8       | -         | -           | -           |
| PTOM                         | -         | 2,1       | 1,0         | -           |
| ACP                          | -         | 1,4       | -           | 1,4         |
| DFA / COM                    | 2,3       | -         | 1,1         | -           |
| CARICOM (CSME)               | -         | 2,5       | -           | -           |
| ECCU                         | -         | 1,4       | -           | -           |
| SPARTECA                     | -         | -         | -           | 1,3         |
| MSG                          | -         | -         | -           | 0,7         |
| Common language              | 1,5       | 1,0       | -           | 1,4         |

Sources: customs, BACI, ONU, IEOM, IEDOM calculations

<sup>3</sup> For illustration, a 10% appreciation in the Euro would result in a reduction/increase in DFA exports/ imports of just 1%