Pacific Institute
of Public Policy

Beyond fish and coconuts: Trade agreements in the Pacific islands

Key messages:

- Special relations with former colonial powers encouraged dependence on a limited range of commodities and a select few export destinations.
- Tariffs protected Pacific producers from foreign competition and generated significant proportions of government revenue. They also delayed the reality of inefficient and uncompetitive local industries.
- Big trading partners like Europe, Australia and New Zealand are expecting the fledgling economies of the Pacific to quickly liberalise.
- Pacific island countries have little to sell each other, and intra-regional trade is low due to major economic, historical and geographic factors.
- PACER is arguably the most controversial trade agreement facing the region, partly because of the potential for significant revenue losses Pacific island countries face by opening up to Australia and New Zealand.
- Doing nothing is not an option: the region cannot continue to rely on past arrangements and high tariffs.

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Globalisation is coming to the Pacific. But are the islands heading for a free-trade paradise; are they forever lumbered with their colonial inheritance; or is there a middle way - a Pacific way? This paper attempts to untangle the numerous trade agreements with the aim of focussing discussions to address such fundamental questions as: What will the islands export in order to benefit from trade deals? Are there enough points of different for countries to specialise and trade competitively? What are the benefits of deals with Canberra and Wellington? Can multilateralism bolster commerce with the wider world?

Slaves to style the islands are not. Yet lately Pacific island countries have been a reluctant follower of the global fashion for freer trade. Intra-regional pacts aim to boost trade between island nations. Talks are scheduled with Australia and New Zealand. Europe is trying to strike a deal. And two Pacific island countries plan to join the World Trade Organisation.

The region won political independence later than most colonies. The new island states rightly wanted to avoid moving from political and social subservience, to economic subordination. The latter was a realistic prospect given the lack of maturity of most Pacific economies, and the threat of cheaper and better quality foreign imports.

Imposing tariffs had the impact of protecting Pacific producers from foreign competition. It also had the advantage of raising significant income for governments. For 12 of the 14 island states of the Pacific Islands Forum[1] (Pacific island countries), import duties comprised an average of one third of total tax revenues. But tariffs also delayed recognition of the reality of inefficient and expensive local industries.

When European powers left the region in the 1970s, they bequeathed a legacy of preferential market access arrangements and subsides. The Lomé conventions defined Europe's economic relations with its former colonies until 2001, and provided duty-free access for Pacific imports to Europe. Special *Stabex*[2] funding was also provided, which helped with the establishment and operation of commodities marketing boards, and subsequently reinforced their monopsonist[3] positions.

1. The Pacific Islands Forum member states are: Australia, Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, New Zealand, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Associate member territories are New Caledonia and French Polynesia.

2. Stabex (from French *Système de Stabilisation des Recettes d'Exportation*) is the acronym for the compensatory finance scheme to stabilise export earnings of the ACP countries. It was first introduced in the first Lomé Convention in 1975 and abolished by Cotonou Agreement in 2000.

3. The market condition that exists when only one buyer will purchase the products of a number of sellers.

For a long time after independence, additional aid, particularly in Melanesia, went into established commodities such as copra, coffee, palm oil and cocoa. These arrangements helped perpetuate traditional trading patterns, while the smallness and fragmentation of the islands further restricted export diversification. There was little incentive for Pacific governments to expand product ranges or look for new markets, as the subsides encouraged the export of traditional commodities duty-free and at above world market prices. The result was trade policy operating by default, rather than according to any active strategy. In Fiji and Papua New Guinea the focus was on sugar exports to Europe; in Vanuatu and the Solomon Islands it was the copra trade.

Today, Pacific island governments can rely less on special treatments for exports to traditional destinations. Economic separation is less feasible. Big trading partners like Europe, Australia and New Zealand are expecting the fledgling economies of the Pacific to liberalise, and quickly. With limited commercial experience, it should be no surprise that Pacific governments can appear intransigent.

Intra-regional trade agreements[4]

The aim of regional trade agreements is to reduce barriers so that countries can trade more easily among themselves. A bigger market provides domestic businesses with wider opportunity for export, and is more attractive to foreign investors from outside the region. Consumers can benefit from lower prices and more choice. Regional trade agreements also forge political integration between member countries, which can have big flow-on effects for a region's standing and influence in global affairs.

The best-known example of a regional economic alliance is the European Union (EU). A range of challenges, including lack of economies of scale, small markets and weak infrastructure prohibit such a union in the Pacific. For a start, the islands are more spread out than European countries. For example, Apia and Port Moresby are 4,350 kilometres apart, about the distance from London to Baghdad. Why would Samoa and Papua New Guinea trade across such an expanse rather than with bigger and closer neighbours? And unlike Britain and Iraq, Pacific island countries have very little to sell to one another. In the words of an official of the Pacific Islands Forum Secretariat: "The islands are hardly going to sell a lot of coconuts and fish to each other." Yet opportunities exist for increased intra-regional trade, particularly in services, and especially among the geographically clustered and more diversified economies of Melanesia.

Melanesian Spearhead Group Free Trade Agreement (MSG-FTA)[5]

The Melanesian Spearhead Group (MSG) was formed in 1986 to foster cultural and political co-operation between Papua New Guinea, the Solomon Islands and Vanuatu. While political co-operation evolved over time to encompass issues of immigration, customs and security, it is trade and the MSG-FTA that is arguably the best known and most visible instrument of the Melanesian alliance.

The MSG-FTA was agreed in 1993; Fiji signed up in 1998; a revised agreement was signed in 2005; and all duties have now been eliminated among the four members except for a small number of 'negative list' products, which will decline to a zero tariff by 2015. Despite the concessions of reduced tariffs, the MSG-FTA has failed to significantly increase trade flows between the Melanesian countries. There have been some problems with enforcement of tariff reduction commitments, instances of trade diversion[6] have occurred, and there have been issues over rules of origin[7].

The main advantage of the MSG-FTA has been the strengthening of the bloc's political solidarity. A new permanent secretariat has been established in Port Vila, pointing to the prospect of greater Melanesian co-operation in the future, and the potential for MSG to act independently from other regional organisations, such as the Pacific Islands Forum.

New Caledonia's pro-independence *Kanak Socialist National Liberation Front* (FLNKS) has observer status in the MSG. The potential contribution of New Caledonia and the French Pacific territories to regional economic growth is often underestimated. The GDP of New Caledonia and French Polynesia is roughly the same as the 14 Pacific islands countries combined. Both French territories are heavily protected and do most of their trade with France. Whilst openness appears a long way off, leaders have expressed interest in regional integration. A small amount of trade liberalisation would make a big difference to the region, especially the Melanesian countries.

Pacific Island Countries Trade Agreement (PICTA)

PICTA is a free trade agreement among the Pacific island states (excluding Australia and New Zealand), signed in 2003. Under the agreement, goods imported from Pacific island countries that have minimum 40 per cent local content will have zero tariffs by 2021. Tariff reductions under PICTA began in 2007. There is a negative list of sensitive industries (including those items on the MSG-FTA negative list) that are exempt from tariff reductions.

Intra-regional trade is low, due to the major economic, historical and geographic differences across the region. The compact states of the Federated States of Micronesia, Palau and the Marshall islands have always had close economic relations with the US for political and military reasons. The territories of New Caledonia, Wallis

4. The paper does not cover bilateral trade agreements.

5. The MSG-FTA is discussed in detail in the PiPP briefing paper, *'MSG: trading on political capital and Melanesian solidarity'* (July, 2008).

6. Trade diversion is a term that applies when trade is diverted from a more efficient exporter towards a less efficient one , usually because a free trade agreement makes the less efficient producer cheaper in the importing market.

7. Rules of origin are used to determine the origin of a product for purposes of applying tariff concessions.

and Futuna and French Polynesia have strong ties with France. Polynesian states such as Samoa, Tonga, the Cook islands and Tuvalu have close trade and family links with New Zealand and Australia.

Because intra-regional trade is low, not much government revenue is forgone under PICTA. In Melanesia, goods traded under PICTA are mostly covered by the MSG-FTA (outlined above), so any trade effects due to PICTA itself are also minimal.

Trade with Australia and New Zealand

Australia and New Zealand have long sought integration with Pacific island economies. If the islands were to trade freely with each other under PICTA, it was argued that eventually they would also have to open up to their bigger neighbours. Indeed, opening up to Australia and New Zealand was billed as a sign of maturity after two-decades of one-way access.

South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA)

SPARTECA entered into force in 1981, providing duty and quota-free access to Australia and New Zealand for the 14 Pacific island countries; subject to rules of origin requirements, which are due for review in 2008.

Pacific island countries have taken advantage of SPARTECA with varying success. The proportion of goods exported to Australia and New Zealand ranges from 98 per cent in Niue, to over a half in Samoa, to around a quarter for Fiji and Papua New Guinea. Vanuatu and Kiribati send less than a tenth of exports to Australian and New Zealand markets.

Marketing assistance to Pacific island producers is available, but meeting quality, consistency and sanitary and phytosanitary standards has been a challenge. This is partly a result of the small size of the island countries, infrequent transport and the lack of experience with developed-country standards. Susceptibility to natural disasters adds to the volatility of exports.

Pacific Agreement on Closer Economic Relations (PACER)

PACER is arguably the most controversial of the trade agreements facing the region. Potentially, it means the Pacific island countries will enter into a free-trade arrangement with Australia and New Zealand. If such an agreement results from PACER negotiations, it will supersede existing SPARTECA market-access arrangements. Most Pacific island countries depend heavily on import tariffs for government revenue. Opening up to Australia and New Zealand, where most imports originate, could endanger this revenue - in some cases up to 30 per cent of total recurrent revenue.

Pacific island governments also harbour fears about an inability to protect domestic industries. Infant-industry policies have been ineffective in some countries, with manufacturing output declining despite over two decades of protection. But the solution here is not to abandon industrial policy entirely (defined in its broadest sense as the strategic development of favoured goods and services). Pacific island countries should be supported to develop competitive industries, such as tourism, food processing, fisheries and agricultural products. Abolishing tariffs and subsides may strip away the ability to tailor trade and industrial policies to suit the peculiar requirements of Pacific island countries.

Cambridge economist Ha-Joon Chang (2007) argues, the international playing field should not be level, rather tilted in favour of developing countries. As both development and trading partners, Australia and New Zealand can support the development of Pacific island economies by ensuring PACER negotiations do not centre on blanket liberalisation and securing reciprocal market access. At a minimum, Australia and New Zealand should pledge not to go beyond current World Trade Organisation commitments, particularly on goods, services, investments and government procurement, and lay out lengthy transitional arrangements.

A free trade agreement under PACER is not inevitable. All that is mandated is the necessity to enter into negotiations. A fairly negotiated outcome beneficial to all parties is of course desirable, but Pacific island states are rightly wary about the level of the playing field.

Trade with the European Union

Under the Cotonou Agreement, which replaced the Lomé IV Convention, the African, Caribbean and Pacific (ACP) group of countries were to have negotiated a series of separate trade agreements with the European Union by the end of 2007. The deal was to be reciprocal, meaning that Europe would, for the first time, expect the same market access abroad as it was to allow at home.

Economic Partnership Agreements (EPAs)[8]

By mid 2008, the only Pacific nations to sign EPAs were Fiji and Papua New Guinea, and that was to keep preferential access for sugar and tuna exporters. These agreements now set a precedent for other Pacific countries should they wish to enter into EPAs in the future. Imports from Europe are small and diminishing, so direct tariff revenue losses and trade effects from the EPA are likely to be minimal. But, as already discussed, this is not the case with larger trading partners including Australia and New Zealand.

For the Pacific, the main issue is the precedent that the EPA sets given the 'most favoured nation' (MFN) clause, which requires countries to extend conditions 'no less favourable' than that provided to others. So the EPA would effectively prevent Pacific island countries from doing different deals with other trading partners. Further, MFN provisions impact on other agreements, including PICTA, MSG-FTA and potentially PACER, as any concessions made to the EU must be provided to all signatories.

8. The EPA is discussed in detail in the PiPP briefing paper, '*Pacific lessons from the EPA*' (June, 2008).

World Trade Organisation (WTO)

Papua New Guinea, Solomon Islands, Fiji and Tonga are members of the WTO. Vanuatu and Samoa are in the process of acceding.

Vanuatu nearly completed its accession negotiations in 2001. At the time it would have been the first 'Least Developed Country' (LDC) to join the WTO, but baulked when asked for more liberal commitments for goods and services than existing members, including Australia, European countries and the United States. The WTO General Council has since agreed to provide more flexibility on the accession of LDCs. It remains to be seen if Samoa and Vanuatu (set to re-start accession discussions in 2008) will benefit from this special treatment. In the case of Tonga, which joined in 2005, it appears not. Tonga liberalised services extensively, was required to abandon prohibited industrial subsidies and bound its tariffs at the very low average rate of under 20 per cent.

Graduation from LDC status has further implications. Samoa is on course to graduate in 2010 and Vanuatu in 2013; potentially affecting the privileges and preferences that they currently enjoy in the WTO and other forums. The prospect of losing these advantages makes it all the more important to promote export development and to improve international competitiveness.

The way forward

The Pacific is confronting the challenges of globalisation. From protectionism and dependence on a narrow range of commodities and export destinations, the region now faces a more liberal trading environment. The EPAs and PACER are unlikely to be the end of the story. An increasing proportion of trade is being done with Asia, which may herald new agreements. In a climate of change, doing nothing is not an option. The region cannot continue to rely on existing arrangements and high tariffs.

Clearly, the Pacific island countries have little bargaining power. Negotiating capacity remains a key challenge. The islands are simply too small and have insufficient resources to be able to negotiate on equal terms with bigger partners. Even with technical assistance and capacity-building, it is unlikely that individual countries can negotiate effectively at regional and international levels. Regional representation remains essential. Despite the shortcomings of PICTA and the MSG-FTA, they at least provide a platform upon which Pacific island governments can formulate their demands.

Pacific island countries can move beyond fish and coconuts, but only if export-oriented trade policy is developed for each country. This is a key issue: most have no trade policy, and no analysis or evidence to develop one.

It is not possible to stem the tide of global economic integration. But rather than despair, there is a need to actively engage in trade talks. Many forms of integration are possible. It is up to Pacific island governments to decide the kind they want.

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This briefing paper is based on extensive research and interviews with key Pacific stakeholders, and has been subject to peer review. A more detailed background paper on this topic is also available.

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