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South-South and North-South Trade Agreements: The Pacific Islands Case

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Abstract

In the paper it is argued that given the economic characteristics of the PICs it was never realistic to expect that South-South FTAs such as PICTA and MSGTA could make a major contribution to addressing their trade needs. These FTAs are appropriately viewed as stepping stones to more ambitious steps toward integration with the global economy. Their effectiveness as stepping stones has been impaired by delays in their implementation. They have however provided PIC officials and politicians with valuable experience in the negotiation of modern trade agreements.

It is further argued that the EPA negotiations were driven by an external logic of little immediate relevance to the trade needs of PICs other than Fiji and Papua New Guinea. Efforts by the PICs to widen the scope of the EPA to deliver development-related benefits of greater consequence to themselves have so far been largely unsuccessful. In the meantime the EPA negotiations have absorbed an enormous proportion of the time and resources that the PICs are able to devote to trade issues.

Australia and New Zealand are in many respects natural partners with whom the PICs might consider deeper economic integration. Integration that is based solely on trade will not however deliver the development-related benefits that the PICs should be seeking in integration with these partners, and is unlikely to offer significant benefits beyond existing trade arrangements with them, while requiring significant adjustments on the part of most PICs. It remains to be seen whether the proposed PACER-Plus negotiations can be directed towards the establishment and implementation of an integration framework capable of delivering major development-related benefits to the PICs. Initial signs are not encouraging, but it is too early to be entirely pessimistic.

In the meantime their preoccupation with the EU and Australia and New Zealand appears to have prevented the PICs from paying attention to developments in the East Asian region, which would be the natural direction in which the PICs might look for additional trade and economic partnerships. The spread of FTAs in East Asia means that the PICs are facing progressively increasing discrimination in these markets. This issue will need to be addressed if the PIC retain ambitions of developing meaningful trade and economic partnerships in East Asia.

Introduction[1]

There are fourteen independent Pacific Island countries (PICs). Summary economic data and a brief discussion of the main economic characteristics of the PICs is provided in the next section. While the pre-independence colonial histories of these countries vary considerably, in terms of their current linkages with developed countries they can be divided into eleven countries whose principal economic and social linkages are with Australia and New Zealand, and three former US trust territories in Micronesia (Federated States of Micronesia, Marshall Islands and Palau), whose principal linkages are with the United States.

All fourteen PICs are members of the Pacific Islands Forum (PIF), which has a secretariat, the Pacific Islands Forum Secretariat (PIFS) that sits at the centre of a network of regional organizations that provide the institutional framework for regional cooperation across a range of economic, political and social concerns. The fact that Australia and New Zealand are also members of the PIF means that a certain tension exists between the role of the PIF and its associated network of regional organizations as a key vehicle for the promotion of regional solidarity and cooperation among the PICs, and their role as the peak vehicle for political and economic cooperation between the PICs and Australia and New Zealand. As the largest providers of finance for the operation of the PIF and its associated regional institutions, and the main economic partners and aid donors for the majority of the PICs, Australia and New Zealand could be regarded as the sub-regional hegemons. The fact that these hegemons are full members of the PIF and its associated agencies is somewhat unusual among regional institutions of this type. A range of other developed and developing countries have the status of "dialogue partners" of the PICs, and dialogues with these partners are routinely held after each Forum leaders' meeting.

For the PICs, engagement in South-South and North-South reciprocal FTAs is a very recent phenomenon that has developed only over the last decade. This is also the period in which the PICs have begun to consciously grapple with the need to become better integrated with the global economy. Three PICs (Papua New Guinea, Fiji and the Solomon Islands) have also been engaged as WTO members in the WTO's Doha Round from the beginning, while three others (Tonga, Samoa and Vanuatu) have been engaged in the WTO accession process, which was recently completed in Tonga's case. These developments imply a gradual but decisive break with the PICs' traditional approach to trade policy.

Traditionally the PICs typically relied on tariffs as an important source of revenue. Tariffs have also served and to varying degrees continue to serve a significant protective function in some PICs, most

[1] An earlier version of this paper was presented at a joint UNU-CRIS and UNU-WIDER international workshop on "South-South and North-South Trade Agreements: Compatibility Issues", held at the UNU-CRIS premises in Bruges on November 5-6, 2009.

notably in Fiji and Papua New Guinea. Export development has traditionally been heavily dependent on non-reciprocal preferences granted by major trading partners. The South Pacific Regional Trade and Cooperation Agreement (SPARTECA) and the Cotonou Agreement provide non-reciprocal preferential access to the markets respectively of Australia and New Zealand and the European Union. The US provides preferential access for its three former trust territories through Compacts of Free Association. While export industries developed in some PICs on the basis of these preferences, in some cases, notably in the case of the Fiji sugar industry, availability of these preferences was also associated with a lack of pressure to achieve and maintain international competitiveness, which not surprisingly tended to decline. PIC export industries that were dependent on preferences also became vulnerable to the erosion or loss of preferences.

In general the development of the national trade regimes of the PICs has hitherto been largely unconstrained by the terms of preferential agreements, and unconstrained also by obligations under multilateral agreements except in the case of the four PICs that are WTO members. The PICs exhibit wide variations in tariff structure, reflecting different approaches to revenue generation and the protection of existing or possible future industries. The services and investment regimes of the PICs are generally uncoordinated with each other.

As a prelude to a consideration of the PICs experience of South-South and North-South FTAs, the next section provides some background on relevant economic characteristics of the PICs.

Economic Characteristics of the Pacific Island Countries

Table 1

Table 1. Pacific Island Countries. Selected Economic Indicators (2007)

	Land area (sq. km)	Population Million	GDP per capita, current US$	GDP, current US$bn	GDP per capita PPP, current international $	GDP, PPP current international $bn	GDP growth annual %	Inflation CPI (annual %)
Pacific Island Countries:	**517,010**	**8.4**	**1,411**	**11.92**	**2,377**	**20.1**		
Cook Island	..	..	..	..	..	..		..
Micronesia, Fed. Sts.	700	0.1	2,126	0.24	2802	0.31	-3.2	..
Fiji	18,270	0.8	4,113	3.43	4304	3.59	-6.6	4.8
Kiribati	810	0.1	817	0.08	1295	0.12	1.7	..
Nauru	..	..	..	..	..	..		..
Niue	..	..	..	..	..	..		..
Palau	460	0.0	8,148	0.16	..	..	2.5	..
Papua New Guinea	452,860	6.3	990	6.26	2084	13.18	6.2	0.9
Marshall Islands	180	0.1	2,559	0.14	..	..	3.5	..
Samoa	2,830	0.2	2,894	0.52	4467	0.81	6.1	5.6
Solomon Islands	27,990	0.5	784	0.39	1725	0.85	10.2	7.7
Tonga	720	0.1	2,474	0.25	3748	0.38	-0.3	5.9
Tuvalu	..	..	..	..	..	..		..
Vanuatu	12,190	0.2	2,001	0.45	3666	0.83	5.0	4.0

Source: World Development Indicators

Table 1 provides some summary economic data for the fourteen independent Pacific Island countries (PICs).

The Pacific Island countries display a number of special economic characteristics that create challenges quite unlike those faced by any other region in the world economy.

Small Size

The Pacific Island countries include some of the world's smallest microstates.

- Eight of the fourteen PICs have populations of less than 100,000.
- Five PICs (Cook Islands, Nauru, Niue, Palau and Tuvalu) have populations of less than 20,000, with the smallest of these, Niue, having a population of less than 2,000.
- A further four PICs (Tonga, Kiribati, Federated States of Micronesia and Republic of the Marshall Islands) have populations between 20,000 and 120,000.
- The only PIC with a population over 1 million is Papua New Guinea, which accounts for 6.3 million of the PICs' total population of 8.4 million people.

Papua New Guinea has a land area of 463,000 square kilometres. The remaining thirteen PICs occupy hundreds of islands with a total land area of 65,000 square kilometres.

Geographic Dispersion

The fourteen PICs, with their 8.4 million people, occupy islands scattered across an area of ocean that measures 7,000 kilometres from east to west (from Palau at 135^{o}E to the eastern Cook Islands at 158^{o}W) and 4,000 kilometres from north to south (from northern Marshall Islands at 12^{o}N to southern Tonga at 21^{o}S).

Individual PICs are also spread over vast areas of ocean:

- The 24 inhabited islands of the Marshall Islands (total population 58,000) stretch 900 kilometres from north to south and 1,100 kilometres from east to west.
- The nine islands of Tuvalu (total population 10,000) stretch 550 kilometres from north to south and 400 kilometres from east to west.
- Kiribati (population 95,000) includes not only the former Gilbert Islands, stretching 700 kilometres from north to south and 500 kilometres from east to west), but also the three territories of Christmas Island, Phoenix Islands and Banaba (Ocean Island), located

respectively 3,200 kilometres, 1,800 kilometres and 450 kilometres from the capital on Tarawa.

- The Cook Islands (population 19,000) stretch 1,400 kilometres from north to south and 1,000 kilometres from east to west.
- Federated States of Micronesia (population 111,000) stretches 2,500 kilometres from Kosrae in the east to Yap in the west.
- Tonga (population 102,000) stretches 600 kilometres from north to south.
- Vanuatu (population 226,000) stretches 750 kilometres from north to south.
- Fiji's 835,000 people are spread across 322 islands, of which over 100 are inhabited

Isolation

In addition to separation from each other, vast distances also separate the PICs from the rest of the world, including the countries that are their main export markets and suppliers of imports.

Vulnerability to Natural Forces

Three PICs (Marshall Islands, Kiribati and Tuvalu) consist entirely of coral atolls with a maximum height of only a few metres above sea level, and are consequently at extreme risk from any rise in the ocean level. Several of the islands in the Cook Islands, Tonga, and Federated States of Micronesia are also coral atolls. All the PICs are unusually susceptible to tropical cyclones, and several have been devastated by cyclones in recent years. Tsunamis and volcanic eruptions have also inflicted substantial recent damage in some PICs.

Natural Resources

The land-based resources of the PICs are naturally very limited. This is most obvious in the case of the coral atolls, but in many of the "high islands" also agricultural possibilities are severely limited by the difficulty of the terrain. Only Papua-New Guinea, Fiji, Solomon Islands, Vanuatu and to a lesser extent Tonga and Samoa have been able to support significant commercial agricultural development. Commercially viable mineral and forestry resources are largely confined to Papua New Guinea, the Solomon Islands, and Fiji. Papua New Guinea is unique among the PICs in the richness of its mineral resource endowment.

On the other hand the PICs are richly endowed with marine resources. Their combined Exclusive Economic Zones (EEZs) comprise the world's largest tuna fishery, and perhaps the only tuna fishery in the world that is not currently being over-exploited.

The other important resource of the PICs is the beauty of their natural surroundings, which provides the basis for their tourism industries.

Obstacles to Market Development and Foreign Trade

With small populations spread across islands scattered through large expanses of ocean, development of domestic markets in the PICs has inevitably been severely constrained.

Even in Papua New Guinea, the largest PIC state, the domestic market is fragmented by the country's difficult geography, with the main island split in two by an almost impenetrable mountain range, extraordinarily difficult terrain in the highland region, and a large number of offshore islands. In addition to this Papua New Guinea's 6.3 million people speak over 700 different languages.

The combination of tiny domestic markets and vast distances, together with similarities in production possibilities, has also inhibited the development of a regional market. The range of products that could be traded regionally is unavoidably limited, and even when trade barriers between the PICs are removed, the high cost of transport between such small and scattered markets is an enormous obstacle to overcome. The isolation and small size of the PICs is also reflected in the high cost, irregularity and fragility of their transport links with the outside world, placing them at a further disadvantage.

Opportunities for manufacturing development have been particularly limited in such small economies. Where manufacturing has developed, primarily in Fiji, it has consisted entirely of light industry and has been heavily dependent on imported materials and components. Besides Fiji, only Papua New Guinea and Samoa among the FICs have significant manufacturing sectors.

A study by Winters and Martins (2004) concluded that prospects for the establishment of internationally competitive manufacturing enterprises in small remote island economies, a description that fits the majority of PICs, are generally bleak.

Primary commodities constitute the "natural" exports of the PICs, and the markets for these commodities lie mainly in resource-hungry industrial economies such as the EU, Japan and other industrial East Asian economies, and to some extent in South Asia. Transport difficulties are a significant competitive disadvantage for the PICs in these markets, as well as reducing the returns to PIC producers. High transport costs also raise the cost of imported goods, resulting in higher production costs for local producers.

Garments, principally from Fiji, have been the main manufactured export of the PICs, and their development has been based almost entirely on preferences. Fiji's garment exports to the USA, comprising about half of the total, suffered badly from the ending of quotas under the WTO's Agreement on Textiles and Clothing. Unlike Caribbean and African producers, Fiji had no tariff preferences in the US market that could compensate for the effect of the ending of quotas. Fiji's other major garment market, in Australia and New Zealand, is also under threat due to the erosion of preferences as those countries lower their MFN tariffs on garments and conclude new FTAs with a steadily widening range of partners. At their peak garment exports made up almost a quarter of Fiji's total exports, but today their share of total exports is below 10%.[2]

Fiji has also been uniquely vulnerable to developments that have reduced the value of its preferential access to the EU sugar market under the Sugar Protocol. Prior to these developments sugar constituted almost a quarter of Fiji's total exports, a higher share than for any other Sugar Protocol member, and two-thirds of Fiji's sugar exports were typically destined for the EU. Today the share of sugar in Fiji's total exports is around 16%.

The communications revolution offers potential for overcoming the handicaps of isolation. Even here however the PICs' small size and geographic dispersion places them at a relative disadvantage. Only Fiji has so far been able to gain access to a submarine cable link, although there are prospects that some other PICs may gain access to such a link in the future. Long-term contracts with monopoly suppliers add substantially to the cost of telecommunications in a number of PICs.

Diversity

In addition, and contrary to superficial appearances, the PICs are a very diverse group. There are many dimensions to this diversity:

- Size: while all PICs are "small", the differences in size among them in relative terms are very great. They range in size from Papua New Guinea and Fiji, through the "medium-sized" states (Solomon Islands, Vanuatu, Samoa, and Federated States of Micronesia) to the "microstates". The special needs of the "microstates" have been recognised in the establishment of a group within the PICs known as the "Small Island States" (SIS), currently comprising Cook Islands, Kiribati, Nauru, Niue, Republic of the Marshall Islands, and Tuvalu. There is an understanding that special and differential treatment be given to these SIS as well as to PIC LDCs in trade arrangements involving the PICs

- The ratio of highest to lowest per capita income among the PICs is over 10:1

[2] This figure, and the figure in the following paragraph, are both calculated from Comtrade data.

- Development Levels: Five of the fourteen PICs are least developed countries (LDCs).

- Resource Base:

The PICs vary enormously in land area and in the proportion of land suitable for agriculture. Papua New Guinea and Fiji have the most commercially advanced agricultural sectors. Papua New Guinea is also rich in minerals and commercially-exploitable forestry resources. These resources are available to a more limited extent in the Solomon Islands and Fiji, and are largely non-existent in other PICs.

While marine resources are important or potentially important to all PICs, there are substantial differences among them in their endowment of these resources. In particular, the majority of the tuna resource lies within the range of 10^{o}N to 10^{o}S. There are also big differences among the PICs in their approach to the exploitation of their fisheries resources. Some prefer to concentrate on negotiation of access fees from foreign fishing fleets, while others are determined that their resource should form the basis for development of a domestic fishing industry. In part these differences are linked in turn to differences in both market opportunities and availability of necessary resources, for example adequate water resources to support a fish cannery.

- Tourism: While tourism is important or potentially important to all PICs, the approach to tourism development varies widely. Fiji, Cook Islands and to a lesser extent Palau, Samoa, and Vanuatu have opted to develop “mass tourism”, exploiting favourable air connections with major tourist markets. At the other end of the scale a number of PICs have opted for a very “low key” approach to tourist development, either through force of circumstances (for example, human resource deficiencies or lack of suitable air services) or as a matter of preference (to avoid adverse effects on the local culture and environment). Other PICs such as Tonga take an approach mid-way between these extremes.

- Services: while services form a significant part of the economy in all PICs, the degree of readiness for significant services liberalisation varies widely, both between PICs and across different service sectors, in terms of factors such as:

  - The robustness or otherwise of the sectors concerned

  - The degree of sensitivity likely to be involved

  - Their experience of services trade liberalisation through the GATS (only four PICs are WTO members, with a further two at various stages of the accession process).

– The existence of a satisfactory regulatory framework (as a pre-requisite for liberalisation).

- Culture: The PIC region divides into three distinct cultural sub-regions: Melanesia (Papua New Guinea, Solomon Islands and Vanuatu), Polynesia (Samoa, Tonga, Niue, Cook Islands and Tuvalu), and Micronesia (Federated States of Micronesia, Kiribati, Nauru, Palau and Republic of the Marshall Islands). Fiji lies on the boundary between Melanesia and Polynesia, and is also distinctive in having a large non-indigenous population, mainly of Indian descent. The three-way cultural division plays a part, at times significant, in the trade politics of the region.

An inevitable consequence of this diversity is the complexity of the task of crafting any trade agreement that can satisfy the interests of all 14 PICs.

Engagement in South-South and North-South FTAs: Overview[3]

The beginning of the PICs' engagement in reciprocal preferential trade agreements stemmed from their collective recognition in the late 1990s of a need to become more closely integrated with the global economy. The Pacific Island Countries Trade Agreement (PICTA), a "South-South" agreement between the PICs concluded in 2001, was seen as a "stepping stone" towards progressively more complete integration with the global economy. It was always acknowledged that the economic benefits to the PICs from PICTA would be much smaller than from an FTA with major developed country partners such as Australia and New Zealand, or even more from unilateral MFN liberalisation[4], but the PICs considered a gradual approach was essential to ensure that the opening up of their economies proceeded at a pace commensurate with their adjustment capacities.

In establishing PICTA the PICs had to fight off pressure from Australia and New Zealand, who initially insisted that as full members of the Pacific Islands Forum they should also be entitled to membership of any trade agreement among Forum members. The PICs viewed a reciprocal FTA with Australia and New Zealand as premature at that stage of their opening up process. A compromise was reached whereby the PICs entered into the separate PACER (Pacific Agreement on Closer Economic Relations) with Australia and New Zealand. The PACER agreement is a framework agreement rather than being itself a preferential trade agreement, but it did oblige the PICs to offer to negotiate an FTA with Australia and New Zealand no later than 2011, or earlier in the event that they negotiated an FTA with another partner, such as the EU. The latter condition demonstrated the importance of market

[3] The issues highlighted in this section are discussed in greater detail in the subsequent sections.
[4] Quantitative estimates supporting these propositions are found in Scollay (1998), Stieckel et al. (1998) abd Scollay and Gilbert (1998)

access in the thinking of Australia and New Zealand toward a new trade agreement with the PICs. In exchange for their commitment the PICs secured an obligation from Australia and New Zealand to provide support for capacity-building in the area of trade facilitation, and this led to the establishment of the Regional Trade Facilitation Programme (RTFP).

A complication that has so far proved of relatively minor significance occurred when a sub-group of PICs decided to form an FTA of their own, the Melanesian Spearhead Group Trade Agreement (MSGTA), which thus emerged as a potential rival to the PICTA.

For the PICs, serious consideration and eventually negotiation of reciprocal North-South trade agreements began with the EPA negotiations with the EU. Under the terms of the Cotonou Agreement replacement of the existing non-reciprocal arrangement by a reciprocal FTA was required as a necessary condition for preservation of the preferential access to the EU market provided under the former arrangement. In these negotiations the PIC insistence of gradualism clashed with the EU imperative of concluding an Article XXIV-compatible agreement. However retention of preferential access to the EU was a compelling motivation for conclusion of an EPA only for Papua New Guinea and Fiji among the PICs, and these two are the only PICs to have so far signed the Interim EPA with the EU that constitutes the outcome of the negotiations to date.

Australia and New Zealand have now insisted on their right under the PACER to enter into negotiations with the PICs for a reciprocal FTA, and in mid-2009 it was announced that agreement had been reached to launch negotiations for such an agreement (currently referred to as "PACER Plus"). Compared to the EPA the PACER-Plus would involve a much greater acceleration of the PICs' opening up of their markets to international competition, and has tended to be viewed by the PICs with considerable apprehension.

Both the EU and Australia and New Zealand have been pressing for the inclusion of services trade in their proposed FTAs with the PICs. This has raised further concerns on the PICs' part regarding their readiness to embark on significant services trade liberalisation with developed country partners, given the underdeveloped state of regulatory frameworks for most of their service sectors, as well as uncertainty as to which of their service industries should be protected on grounds of social significance or long term potential.

Meantime there has been recognition that PICs are unlikely to benefit from trade liberalisation unless it is accompanied by wider economic and governance reforms, as well as substantial capacity-building. This recognition has been reflected in the Pacific Plan agreed in 2005 between the PICs and Australia and New Zealand, and also in moves to finally involve the PICs in the Aid for Trade programme originally mandated at the WTO's Hong Kong ministerial meeting in 2005.

Pressure to negotiate reciprocal FTAs with developed country partners has thrown into sharp relief the relatively small contribution to PIC development that can be expected from a conventional FTA in goods. This has led in turn to intensified efforts on the part of the PICs to identify additional dimensions with a greater potential development contribution that could included in these agreements. The resulting proposals made by the PICs to the EU, and likely to be made by them also to Australia and New Zealand, focus on labour mobility, certain product-specific derogations aimed at increasing the ability to the PICs to take advantage of the few natural resources with which they are abundantly endowed, and adjustment assistance.

These developments will now be described and discussed in greater detail.

South-South FTAs Among the PICs: PICTA and the MSGTA

PICTA

The Pacific Island Countries Trade Agreement (PICTA) was signed in 2001 and entered into force in 2003.[5] It provides for the gradual elimination of tariffs on all trade in goods between participating PICs, except trade in alcohol and tobacco products, in accordance with tariff elimination schedules set out in the agreement. These tariff elimination schedules are differentiated in two ways:

- separate schedules, with slightly longer phase-out periods were provided for PICs that are least developed countries (LDCs) or designated as Small Island States (SIS).
- each PICTA member is allowed a list of excepted products (referred to as the "negative list", for which tariff reductions begin and end later than for other goods. The negative list are generally short.

Under the original schedules tariff elimination was to begin on entry into force of the agreement (which occurred in 2003) and to be completed by 2010 by PICs other than LDCs and SIS, while tariff elimination by LDCs and SIS was to begin in 2004 and end in 2012. For all PICs, elimination of tariffs on excepted imports (the "negative lists" was to begin in 2007 and end in 2016.

Nine PICs are LDCs and/or SIS: Kiribati, Samoa, Solomon Islands, Tuvalu and Vanuatu (all LDCs, with Kiribati and Tuvalu doubling as SIS), and Cook Islands, Nauru, Niue and Republic of the Marshall Islands (all SIS). Thus only Fiji, Federated States of Micronesia (FSM), Palau, Papua New Guinea and Tonga do not have LDC or SIS status.

[5] As provided in the PICTA text the Agreement entered into force 30 days after the sixth deposit by an PIC of instruments of ratification at the Forum Secretariat. This occurred in 2003.

PICTA also prohibits any import or export prohibitions or restrictions on trade other than tariffs, customs duties or excise (Article 9). Quantitative restrictions are therefore banned.

The agreement was open for signature by PICs for a period of one year (until August 2002), with the exception that the period allowed for the three Micronesian "Compact" states to sign the agreement was up to three years after entry into force of the agreement. This was to allow these states sufficient time to seek and if possible to secure a waiver of the "MFN" provision in their Compact of Free Association with the United States, under which any tariff concessions by them to PICTA members would have to be immediately applied to imports from the United States. A waiver was granted to FSM and Marshall Islands as part of the renegotiation of their respective Compacts that was concluded in 2003. The waiver issue was also expected to be covered in the renegotiation of Palau's Compact, which expired in 2009.

In the event implementation of PICTA has proceeded much more slowly than originally envisaged. Recognising that the original schedules for tariff elimination could not be met, PIC trade ministers agreed in December 2006 on new tariff elimination schedules (the "2007 Amendments"). Under the new schedules for goods other than excepted imports, PICs other than LDCs and SIS were to begin tariff reductions in 2007, and complete them in 2015, while LDCs and SIS were to begin reductions in 2009 and complete them in 2017. For excepted imports the beginning and ending dates for tariff reductions are respectively 2012 and 2020 for PICs other than LDCs and SIS, and 2012 and 2021 for LDCs and SIS.

In 2007 PIC trade ministers took a further series of decisions aimed at accelerating PICTA. They also agreed to proceed with revision of the members' respective negative lists, as laid down in the Agreement (Article 8).

Confirmation by a PIC that it has completed the necessary arrangements to apply the amended tariff elimination schedules is followed by notification to the PIFS that it is "ready to trade".

To date eleven of the fourteen PICs have ratified PICTA: Cook Islands, Fiji, Kiribati, Nauru, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. Federated States of Micronesia has signed PICTA but not yet ratified it. Federated States of Micronesia indicates that it intends to complete a review of its trade policy and other related policies before deciding on PICTA ratification. Palau and Republic of the Marshall Islands have not yet signed PICTA. The implications for their relationship with the United States of entering into new trade agreement such as PICTA are a prominent consideration for the three "Compact" states in deciding whether to accede to PICTA.

Of the three PICTA Parties[6] to whom the tariff elimination schedule beginning in 2007 is applicable, by mid-2008 only Fiji had notified its "readiness to trade". Tonga was working through the legislative processes required to implement the amended tariff elimination schedules. Papua New Guinea had ratified the amended PICTA tariff elimination schedules but had not begun to incorporate the amended PICTA tariff rates into its tariff schedules.

Among the LDCs and SIS, Cook Islands, Niue, Samoa, Solomon Islands and Vanuatu have declared their "readiness to trade" under PICTA. According to the amended tariff elimination schedules these PICs were to commence their PICTA tariff reductions in 2009. This leaves Kiribati, Nauru and Tuvalu as the LDCs or SIS that have ratified PICTA but have not yet declared their "readiness to trade".

PICTA members began to consider the possible extension of PICTA to trade in services soon after PICTA entered into force in 2003, but proved hesitant to move ahead in this direction. Negotiations on PICTA Trade in Services (PICTA-TIS) finally began in 2008. These negotiations are making slow progress.

MSGTA

The Melanesian Spearhead Group Trade Agreement (MSGTA) was established in 1993 between Papua New Guinea, the Solomon Islands and Vanuatu. Fiji became a member in 1998. The Front de Liberation National de Kanak Socialist (FLNKS) in New Caledonia has observer status.

The MSGTA was originally a "positive list" agreement covering a very limited range of products. In its initial years it was very largely ineffective. Following the introduction of PICTA it was converted to a "negative list" agreement, in apparent effort to ensure that it would remain relevant. The latest revision of the MSGTA was agreed in 2007 and is often referred to as the 2007 MSG Trade Agreement (MSGTA 2007).

In the MSGTA 2007 each member is entitled to maintain a "negative list" of excepted imports (Article 9 paragraphs 1-3). Tariffs on these excepted imports from MSGTA members are to be phased out over periods ranging from 1 to 8 years, depending on the initial tariff rate (Article 9 paragraph 4). The maximum tariff rate on excepted imports is set at 30%, implying that higher tariffs on these excepted imports must be reduced to 30% at the beginning of the phase-out period. The years in which reductions are to commence and end are not stated. If it is assumed that Year 1 (the base year) is to be taken as 2007, this would mean that tariffs on the excepted imports are to be phased out from 2008 to 2015. As in the case of PICTA, alcoholic beverages and tobacco products are excluded from the excluded, as is cane sugar (Article 9 paragraph 5).

[6] According to the terms of PICTA, PICs become Parties to PICTA by ratifying the Agreement.

The text of the 2007 MSGTA does not contain provisions specifying how and when the tariffs will be reduced and eliminated on imports from member countries of products that are not listed as excepted imports. Regardless of this, the understanding between the Parties is said to be that tariffs on all imports other than Excepted Imports are to be reduced to zero immediately on entry into force of the agreement. Implementation of the MSGTA in relation to imports other than Excepted imports appears to be variable, with some members applying zero tariffs on imports from MSGTA partners while others still do not. As in the case of PICTA, Papua New Guinea was in 2009 still working on incorporating its MSGTA obligations into its tariff schedule.

The MSGTA and PICTA have different rules of origin. The PICTA rules are based on a 40% regional value content while the MSGTA rules are based on a change in tariff classification at the HS six-digit level. Private sector interests appear more satisfied with the MSGTA rules of origin than with those of the PICTA.

Assessment

PICTA has been quite ineffective in its intended role of serving as a “stepping stone” towards progressively more complete integration with the global economy. This ineffectiveness is due to the persistent and ongoing reluctance of the members to implement its provisions in accordance with agreed schedules. The delays can only partly be explained by unanticipated difficulties in translating PICTA commitments into domestic legislation. It appears also that a number of governments have been willing to give credence to concerns about the tariff revenue implications of PICTA and the fears promoted by NGOs of widespread social disruption resulting from PICTA, even though economic analysis clearly indicates that the trade effects of PICTA are likely to be minimal, so that it is difficult to understand how either the revenue or social implications could be credibly assessed as significant. It is possible also that MSGTA members have deliberately held back on the implementation of PICTA out of a desire not to see the importance of PICTA elevated above that of the MSGTA. On the other hand Papua New Guinea seems to have been equally dilatory in implementing both its PICTA and MSGTA commitments.

Intra-PIC Trade

Table 2 summarises the recent data available from Comtrade on intra-PIC trade. Data is given for three years, 2004, 2005, 2007, to ensure that each of the larger PICs appears as a reporter in at least one year (Papua New Guinea appears as a reporter only in 2004, and Vanuatu only in 2007). It should be noted that this trade cannot be attributed to PICTA or the MSGTA, given the delays in implementing those agreements, as outlined above.

Fiji accounts for by far the largest share of intra-PIC exports. In 2005 and 2007, the years in which Papua New Guinea data is not reported, Fiji accounted for 93% and 95% respectively of total recorded intra-PIC exports, and in 2004 its share was 73%, with a further 23% of intra-regional exports originating in Papua New Guinea. Fiji’s exports are principally directed toward its neighbours, especially Samoa, Tonga and Vanuatu, but also the smaller neighbouring states of Kiribati and Tuvalu. Papua New Guinea accounts for a relatively small share of Fiji’s exports, and its own exports are directly principally towards its near neighbour and MSG partner, the Solomon Islands, and to a lesser extent to Vanuatu, also an MSG partner. Vanuatu appears in the data as a reporter only in 2007, when it shows up as a minor source of intra-PIC exports. The figures for Vanuatu as a partner in the intra-PIC import data appear to confirm Vanuatu’s ranking as the third-largest source of intra-PIC exports, although in 2004 Vanuatu appears as the exporting partner for a higher percentage of intra-PIC imports than Papua New Guinea. The majority of Vanuatu’s exports to other PIC s are directed to Fiji.

Table 2: INTRA-FIC EXPORTERS BY REPORTING AND PARTNER COUNTRIES, 2004-5 AND 2007

Percentages of total intra-FIC Exports/Imports

Source: Comtrade

								2004							
Reporters								**Partners**							
	Solomon Is	**Cook Is**	**Fiji**	**Kiribati**	**Nauru**	**Vanuatu**	**Niue**	**FS Micronesia**	**Marshall Is**	**Papua New Guinea**	**Tonga**	**Tuvalu**	**Samoa**	**Palau**	**Total (Reporters)**
Imports															
Cook Is	0.0%		1.7%			0.0%	0.0%			0.4%			0.1%		**2.3%**
Fiji	0.1%	0.5%		0.0%		6.1%	0.0%		0.1%	5.5%	0.3%	0.0%	1.0%		**13.6%**
Papua New Guinea	0.5%	0.0%	5.3%			4.8%	0.0%				0.1%	0.1%	0.0%		**10.8%**
Tonga		0.0%	36.4%			0.0%				1.0%			0.2%		**37.7%**
Tuvalu	0.0%		5.5%			0.1%							0.0%		**5.6%**
Samoa	0.1%	0.0%	28.0%	0.6%						0.8%	0.4%				**29.9%**
Total (Partners)	**0.8%**	**0.5%**	**76.9%**	**0.7%**		**11.0%**	**0.0%**		**0.1%**	**7.8%**	**0.7%**	**0.1%**	**1.3%**		**100.0%**
Exports															
Cook Is			0.3%								0.0%		0.0%		**0.3%**
Fiji	4.4%	1.7%		12.8%		9.4%	0.0%	0.4%	0.7%	3.6%	14.1%	4.3%	21.7%		**73.0%**
Papua New Guinea	14.3%	0.1%	1.9%	0.6%		4.0%	0.0%	0.6%	0.0%		1.1%		0.5%		**23.1%**
Tonga			0.1%			0.0%				0.0%			0.2%		**0.3%**
Tuvalu			0.2%												**0.2%**
Samoa	0.0%	0.5%	1.8%							0.1%	0.6%				**3.0%**
Total (Partners)	**18.7%**	**2.3%**	**4.4%**	**13.3%**		**13.4%**	**0.0%**	**1.0%**	**0.7%**	**3.7%**	**15.9%**	**4.3%**	**22.3%**		**100.0%**

Table 2 (cont)

								2005							
Reporters	**Partners**														
	Solomon Is	**Cook Is**	**Fiji**	**Kiribati**	**Nauru**	**Vanuatu**	**Niue**	**FS Micronesia**	**Marshall Is**	**Papua New Guinea**	**Tonga**	**Tuvalu**	**Samoa**	**Palau**	**Total**
Imports															
Solomon Is			2.6%		0.0%	0.7%				14.5%			0.0%		**17.7%**
Cook Is			1.1%						0.0%	0.3%	0.0%		0.1%	0.0%	**1.4%**
Fiji	0.7%	0.0%		0.7%	0.0%	3.2%	0.0%			1.3%	0.2%	0.0%	0.6%		**6.7%**
Kiribati	0.1%		17.4%		0.0%	0.1%			0.1%	1.7%					**19.3%**
Tonga		0.0%	29.9%							1.3%			0.1%		**31.3%**
Tuvalu			2.9%			0.0%									**2.9%**
Samoa			19.9%			0.0%			0.0%	0.3%	0.4%				**20.6%**
Total (Partners)	**0.7%**	**0.0%**	**73.8%**	**0.7%**	**0.0%**	**4.1%**	**0.0%**		**0.1%**	**19.3%**	**0.6%**	**0.0%**	**0.7%**	**0.0%**	**100.0%**
Exports															
Solomon Is			1.1%	0.0%	0.0%	0.8%		0.0%		0.2%				0.0%	**2.2%**
Cook Is			0.1%				0.0%				0.0%		0.0%	0.0%	**0.1%**
Fiji	3.3%	1.5%		12.9%	0.3%	18.9%	0.0%	0.5%	0.2%	13.2%	16.6%	5.1%	22.1%	0.0%	**94.6%**
Kiribati	0.1%		0.9%									0.0%			**1.0%**
Tonga	0.0%	0.0%	0.2%				0.0%			0.1%			0.2%		**0.4%**
Tuvalu			0.1%												**0.1%**
Samoa	0.0%	0.3%	0.4%		0.0%	0.0%	0.0%	0.0%		0.0%	1.0%	0.0%			**1.7%**
Total (Partners)	**3.4%**	**1.8%**	**2.7%**	**13.0%**	**0.3%**	**19.7%**	**0.0%**	**0.5%**	**0.2%**	**13.4%**	**17.6%**	**5.1%**	**22.3%**	**0.0%**	**100.0%**

Table 2 (cont)

								2007							
	Solomon Is	**Cook Is**	**Fiji**	**Kiribati**	**Nauru**	**Vanuatu**	**Niue**	**FS Micronesia**	**Marshall Is**	**Papua New Guinea**	**Tonga**	**Tuvalu**	**Samoa**	**Palau**	**Total**
Imports															
Solomon Isds		0.0%	4.8%	0.0%		0.6%				18.0%			0.0%		**23.5%**
Cook Isds	0.0%		1.2%				0.0%						0.0%		**1.3%**
Fiji	1.5%	0.1%		0.4%	0.0%	3.8%	0.0%		0.0%	1.5%	0.4%	0.0%	0.2%		**7.8%**
Vanuatu	0.4%	0.0%	20.3%							4.5%	0.0%		0.0%		**25.2%**
Tonga	0.0%		14.3%	0.0%		0.0%				0.0%			0.1%		**14.5%**
Tuvalu															
Samoa		0.0%	27.0%			0.0%				0.2%	0.6%				**27.8%**
Total (Partners)	**1.9%**	**0.1%**	**67.6%**	**0.4%**	**0.0%**	**4.5%**	**0.0%**		**0.0%**	**24.2%**	**0.9%**	**0.0%**	**0.3%**		**100.0%**
Exports															
Solomon Isds		0.0%	1.2%	0.3%	0.0%	0.4%			0.0%	1.1%	0.0%				**3.1%**
Fiji	4.6%	2.7%		13.0%	0.3%	14.2%	0.1%	0.2%	0.4%	6.2%	23.5%	6.2%	21.6%	0.0%	**93.2%**
Vanuatu	0.2%	0.0%	2.2%	0.0%					0.0%	0.4%			0.0%		**2.9%**
Tonga			0.0%							0.0%			0.4%		**0.4%**
Tuvalu															
Samoa	0.0%	0.0%	0.2%				0.0%			0.0%	0.1%	0.0%			**0.4%**
Total (Partners)	**4.9%**	**2.8%**	**3.7%**	**13.4%**	**0.3%**	**14.6%**	**0.1%**	**0.2%**	**0.4%**	**7.7%**	**23.6%**	**6.3%**	**22.0%**	**0.0%**	**100.0%**

While Fiji dominates intra-PIC exports, it figures in only a minor way as a recipient of intra-FIC imports, accounting for 13.6%, 6.7% and 7.8% of total intra-PIC imports in 2004, 2005 and 2007, respectively. Vanuatu is the largest source of intra-PIC imports into Fiji, followed by Papua New Guinea. Unsurprisingly, Samoa, Tonga and Vanuatu, the principal recipient countries for Fiji's intra-PIC exports account for the largest shares of intra-PIC imports, with Kiribati and Tuvalu also accounting for not insignificant shares. Of these countries Samoa, Tonga, Kiribati and Tuvalu generally source well over 90% of their intra-PIC imports from Fiji, and Vanuatu in 2007 also sourced over three-quarters of its intra-PIC imports from Fiji in 2007. The Solomon Islands is the one PIC with a substantial share of intra-PIC imports (in 2005 and 2007) which sources the majority of those imports from Papua New Guinea. Papua New Guinea itself accounted for only 11% of intra-PIC imports in 2004, sourced mainly from Fiji and Vanuatu in close to equal proportions.

It is clear that Fiji is the major fulcrum for intra-PIC trade, with an overwhelming share of intra-PIC trade consisting of bilateral trade between Fiji and its neighbours, Samoa, Tonga, Vanuatu, Kiribati and Tuvalu. Fiji's trade with most of its PIC partners is largely of a one-way nature, consisting of Fiji exports to the partner, with very few exports flowing back from the partner to Fiji. Vanuatu is the only one of these partners with which Fiji may be said to have a genuinely two-way bilateral trade relationship. Papua New Guinea could be regarded as a secondary fulcrum for intra-PIC trade, although it accounts for a much smaller share of this trade, and well over half of its intra-PIC exports are directed to its immediate neighbour, the Solomon Islands.

EPA Negotiations with the European Union

From 2002 the PICs (known in this context as Pacific ACP States, or PACPs) were in discussions and/or negotiations with the European Union for establishment of an Economic Partnership Agreement (EPA) to replace the trade provisions of the Cotonou Agreement. An essential element of the EPA as proposed by the EU involved the replacement of a non-reciprocal preferential trade arrangement (the trade provisions of the Cotonou Agreement) with a fully reciprocal free trade agreement (FTA) in which the PICs/PACPs would be required to offer reciprocal tariff concessions to the EU.

This followed from the declaration by the EU that it would not seek an extension of the WTO waiver legitimising the Cotonou Agreement trade provisions, and that those provisions would therefore not be extended beyond their scheduled expiry at the end of 2007. This meant that only conclusion of a new trade agreement with the EU would allow the PICs/PACPs that are not least developed countries

(LDCs)[7] to maintain (or if possible, improve) their existing level of preferential access to the EU market. Given the developed country status of the EU, and the unwillingness of the EU to seek any further waiver, the new trade agreement would have to be a reciprocal FTA within the meaning of GATT Article XXIV and would have to conform to the provisions of GATT Article XXIV relating to such FTAs. This meant in turn that the EPA would have to include provisions establishing an Article XXIV-compatible FTA, whatever other provisions it might contain.[8]

In addition to a range of provisions relating to trade in goods, the EU sought the inclusion of a services trade component along with chapters on issues such as competition policy. On the PACP side, retention of preferential access to the EU market was of crucial importance only to Papua New Guinea and Fiji. This implied that additional provision of substantial benefits to the PACPs would be needed to induce other PACPs to participate in the EPA. Demands from the PACPs focused on temporary movement of natural persons, inclusion of a new agreement between the EU and the PACPs on management of fisheries resources, and the provision of substantial amounts of adjustment assistance, The prospect of improved rules of origin that would facilitate increased fish exports to the EU was also enticing to some PACPs.

Negotiations on trade provisions of the EPA began in earnest in 2007[9], although not all PACPs participated in these negotiations. It quickly became apparent that reaching agreement on the extent of product coverage of the EPA would be a significant sticking point. The requirements of Article XXIV regarding coverage of "substantially all the trade between the parties" and the period allowed for implementation of liberalisation provisions of the FTA proved particularly contentious in these negotiations. According to the view expressed by the EU during these negotiations the PACPs would need to offer to eliminate tariffs on their imports from the EU on 80% of tariff lines within 15 years in order to satisfy the "substantially all the trade" requirement of GATT Article XXIV. Most PACPs found this requirement very difficult to accept.

When it became apparent that agreement on a full Pacific EPA could not be reached before the end of 2007, the EU offered a temporary solution whereby "interim EPAs" could be signed between the EU and ACP states. These "interim EPAs" would be based on reciprocal tariff liberalisation commitments agreed between the EU and the ACP states as sufficient to satisfy the requirements of GATT Article XXIV, and underpinned by sufficiently detailed provisions on trade in goods to ensure that these commitments could be made operational. Negotiations for the remaining provisions required by the

[7] ACP states that are also LDCs enjoy duty-free access to the EU market under the EU's "Everything But Arms" (EBA) initiative, for almost all products until 2009, and for all products from 2009 onward.
[8] In regard to ACP states that are not LDCs, the terms of the Cotonou Agreement required that the EU examine "all alternative possibilities" for offering those ACP states "alternative frameworks for trade" that are "equivalent to their existing situation and in accordance with WTO rules" (Cotonou Agreement Article 37.6).
[9] It is fair to say that many PACPs were very hesitant to enter negotiations on the trade provisions of the EPA. One reason for this was concern over the implications for "triggering" relevant provisions of Article 6 of PACER (see below).

parties to form part of "complete" EPAs would continue through 2008, with the intention that the resulting agreements, once concluded, would replace the "interim EPAs".

As proposed by the EU, the purpose of the "interim EPAs" was to allow those ACP states prepared to initial them to benefit from the EPA preferences offered by the EU from 1 January 2008, following the expiry of the Cotonou Agreement preferences. For those ACP states unwilling to initial the "interim EPAs", the Cotonou preferences would be replaced by the EU's standard GSP preferences until such time as those states become parties to an EPA. In other words, from 1 January 2008 only those PACPs prepared to initial an "interim EPA" would continue to benefit from preferences equal to or better than those provided under the Cotonou Agreement.

In the event. Fiji and Papua New Guinea were the only PACPs willing to initial an "interim EPA". This Interim EPA incorporates the tariff concessions that they each agreed with the EU.

According to Fiji's offer to the EU, on entry into force of the Interim EPA tariffs on imports from the EU ranging from 3% to 27% remain in place on 91% of tariff lines. These figures reduce to 46% after 5 years, 32% after 10 years, and 19% after 15 years. In other words, at the end of 15 years tariffs on imports from the EU will have been eliminated on 81% of tariff lines, while 19% of tariff lines are excluded from the tariff liberalisation commitments.

In the case of PNG's offer to the EU, tariffs on imports from the EU for 83% of tariff lines will be zero on entry into force of the agreement. Since the MFN tariff on 73% of tariff lines is also zero[10], this involves preferential liberalisation of a further 10% of tariff lines in favour of the EU. At the same time 17% of tariff lines, with tariffs ranging from 15% to 70%, are excluded from the tariff liberalisation commitments.

In addition to reduction and elimination of tariffs according to the agreed schedules, the Interim EPA also bans import or export prohibitions or other restrictions on trade other than customs duties, taxes and fees or other charges, except where expressly provided in the Agreement.

The Interim Agreement with the EU also contains a provision requiring the signatory Pacific states to "accord to the EC Party any more favourable treatment applicable as a result of the Pacific states becoming party to a free trade agreement with any major trading economy[11]" in the future (Article 16: Non-Discrimination Clause, sometimes referred to as the "MFN Clause"). Thus any preferences provided to Australia and New Zealand in an FTA with those two countries, which went beyond the existing agreement with the EU, would then have to be provided to the EU as well.

[10] Calculated from information supplied by PIFS.

[11] A 'major trading economy' is defined as any developed country or any other country accounting for more than 1% of world merchandise exports in the relevant year. Thus it would include, for example, the United States, Japan, Australia, New Zealand, China, Korea and Taiwan.

After a hiatus, negotiations directed towards the inclusion of a permanent EPA resumed and then continued through 2009. Progress has been slow and it remains unclear which if any PACPs in addition to Papua New Guinea and Fiji will participate in the permanent EPA. The unwillingness of the EU to respond positively to key PACP demands on issues such as temporary movement of natural persons considerably reduces the incentive for them to do so. PACPs remain reluctant to agree to the inclusion of services trade in the EPA.

The EPA negotiations have absorbed enormous amounts of time and PACP negotiating resources, yet it remains uncertain as to whether a substantive outcome will emerge for PACPs beside Papua New Guinea and Fiji. Even in the case of Fiji the outlook has been clouded by the military coup in that country and the subsequent reaction of the EU.

FTA with Australia and New Zealand: "PACER-Plus"

The latter stages of the EPA negotiations were marked by ongoing debate between the PICs and Australia and New Zealand as to whether the PICs' obligation under PACER, to offer to negotiate an FTA with Australia and New Zealand, had been triggered. In 2007 Australia and New Zealand successfully secured agreement on a series of informal meetings as a preparation for the possible launch of negotiations for the FTA, currently referred to as "PACER-Plus". One outcome of these meetings was the development by the PICs in early 2009 of a "road map" for the future "PACER-Plus" negotiations. The "road map" envisaged a national "needs assessment" and national consultations in each PIC, on the basis of which the PICs would seek agreement with Australia and New Zealand on the scope of the negotiations and determine their own negotiating positions. However in 2009 the Forum leaders reached an agreement, seemingly at the instigation of Australia and New Zealand, to proceed immediately to formal negotiations, even though none of the national consultations and almost none of the "needs assessments" have yet been carried out.

A major complication for the proposed negotiations has been created by the decision of Forum leaders to suspend Fiji from the Forum and from all Forum activities, as a response to the military coup in Fiji and the refusal of the military government to agree to a timetable for restoration of democracy that was acceptable to other Forum members. Although it can be argued that Fiji continues to have a legal right under the terms of the PACER to participate in the PACER-Plus negotiations, the suspension has been interpreted by Forum leaders to mean that Fiji will not be permitted to participate. A procedure has been laid down whereby the outcome of each negotiating session will be conveyed to Fiji by a PIC representative, who will also convey any responses or views from Fiji to each subsequent negotiating session. This procedure is unlikely to be satisfactory. The absence of Fiji from the negotiating sessions means that the interests a country that is central to PIC trading relationships will not be adequately represented, and the PIC side of the negotiations will be deprived of the support of the most effective trade bureaucracy among the PICs.

Adjustment Implications of PACER-Plus for PICs

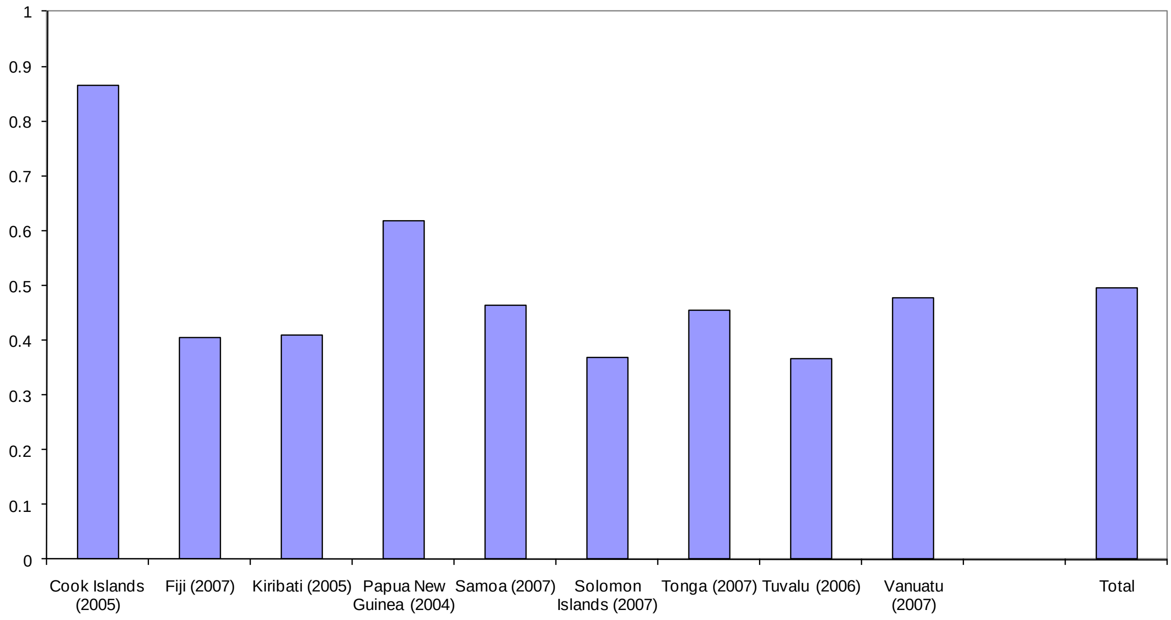
The potential adjustment implications of PACER-Plus for the PICs are much more significant than those of the EPA with the EU. This follows from the fact that Australia and New Zealand account for a much larger share of PIC imports than the EU. In fact Australia and New Zealand account for almost exactly half of all PIC imports. The shares of Australia and New Zealand in the imports of nine individual PICs is shown in Figure 1. The share is above 30% for all of the PICs shown, and is well above 50% for Papua New Guinea and the Cook Islands.

This implies significant adjustment to increased competition from Australia and New Zealand for domestic producers in the PICs, especially the manufacturing industries that have developed in Fiji and Papua New Guinea. These manufacturers will face intensified competition from Australia and New Zealand not only in their home markets but also in the markets they have begun to develop in other PICs. If PACER-Plus also includes services, as Australia and New Zealand clearly intend, PIC service providers will also face intensified competition both in their home markets and in other PIC markets.

The dominance of Australia and New Zealand as import sources also implies substantial revenue implications for the several PICs for whom tariff revenue continues to comprise an important share of government revenue. The impact will obviously be more severe, the greater the obstacles, whether political or administrative, to introducing alternative sources of revenue. In some PICs these obstacles are perceived to be severe. On the other hand, there are other PICs that have already drastically reduced their dependence on tariffs as a source of government revenue, and for whom this dimension of the adjustment to PACER-Plus is unlikely to pose serious difficulty. Papua New Guinea for example currently derives only around 2% of its total government revenue from import taxes.

Figure 1

Figure 1: Australia and New Zealand Share of ANZ Share of FIC Imports
Source: Comtrade



Benefits of PACER-Plus: Market Access

In contrast to the potentially substantial adjustment issues for the PICs, substantial market access gains for the PICs from PACER-Plus are much less easy to identify. In fact there is clearly a significant imbalance between the market access gains potentially available to the PICs on the one hand and Australia and New Zealand on the other.

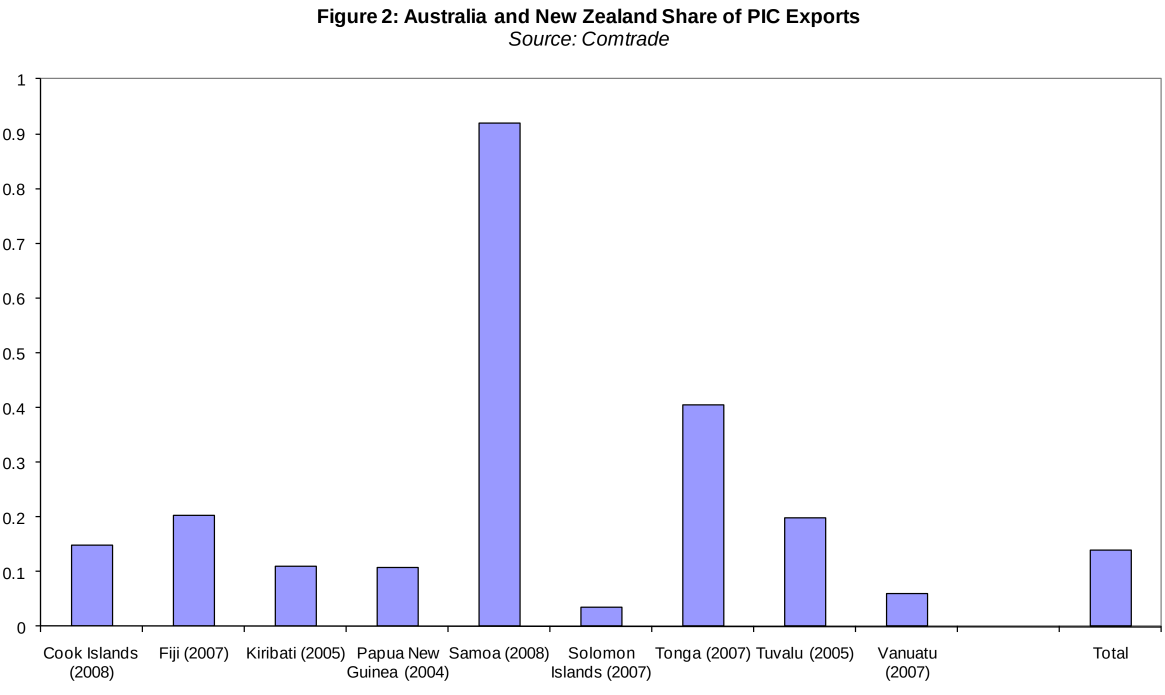
In terms of formal import barriers PACER-Plus will not improve on current access to the Australian and New Zealand markets for the PICs, since they already have duty-free quota-free access to those markets under SPARTECA and in formal terms that access is not under threat. The PACER provides (Article 5.3) that "with respect to any Forum Island Country, Australia and New Zealand shall maintain all existing arrangements relating to market access at the time this Agreement enters into force, until such time as that particular Forum Island Country has concluded new and/or improved trade arrangements providing equal or better access to their markets". At the same time the value of the existing market access is being steadily diminished by the erosion of the FICs' preferential position in the Australia and New Zealand markets as those two countries conclude FTAs with an ever-widening circle of partners, including especially the ten ASEAN countries and also China in the case of New Zealand and the United States in the case of Australia.[12] PACER-Plus will not change this situation. The main potential for improved access to the Australian and New Zealand markets for

[12] Australia is currently also in the process of negotiating FTAs with China, Japan, Korea and Malaysia, while New Zealand is in FTA negotiations with Korea, Hong Kong and Malaysia.

the PICs could come from improvements in rules of origin and more constructive approaches to SPS issues. These should not be discounted entirely, as both have been perceived as serious impediments to more effective exploitation of SPARTECA by the PICs.

On the other hand PACER-Plus potentially offers Australia and New Zealand new preferential access to the PIC markets. The PICs are by no means negligible as export markets for Australia and New Zealand, especially the latter. In 2007 and 2008 the PICs accounted for around 2% of total New Zealand exports and between 1% and 1.3% of total Australian exports. Furthermore, these shares are larger than or comparable with those of some significant export partners of both countries (Canada, Russia, India, Hong Kong, Singapore, Malaysia, Thailand, Philippines and Mexico in the case of New Zealand, and Canada, Russia, Philippines and Mexico in the case of Australia). Moreover, substantial sections of these PIC markets are protected by high tariffs, a factor that enhances the potential value of the preferential access that Australia and New Zealand will secure under PACER-Plus.

Figure 2



It is also the case that Australia and New Zealand are of much less overall importance to the PICs as export markets than as import sources. While Australia and New Zealand account for almost exactly half of the global imports of the nine FICs shown in Figure 1, they account for only 14% of the global exports of these same nine FICs. The generally low shares of Australia and New Zealand in the global exports of the individual PICs is shown in Figure 2. Samoa is a special case. Its exports to Australia and New Zealand are overwhelmingly dominated by automotive components assembled in Samoa by a Japanese-owned operation that supplies these components to the Australian automotive industry, taking advantage of the SPARTECA preferences and a derogation from the SPARTECA rules of origin. These exports face threats that are unlikely to be mitigated by PACER-Plus. The threats arise from the increased competitiveness relative to Samoa of other potential source countries that are increasingly securing their own preferential access to the Australian market through newly-negotiated FTAs, and structural changes in the Australian automotive industry itself that may occur in the future as a result of these developments. The other main example of a PIC industry that is heavily dependent on the Australian market is the Fijian garment industry. The exports of this industry to Australia rely heavily on bilateral understandings and arrangements as well as the SPARTECA preferences, and their position in the Australian market is again unlikely to be significantly improved by PACER-Plus.

Pursuing PIC Interests in PACER-Plus

Given the limited scope for the PICs to derive market access gains from PACER-Plus, it is clear that if PACER-Plus is to deliver substantial benefits to the PICs, and development-related benefits in particular, these benefits will have to provided in areas other than trade as conventionally defined. This point was expressed succinctly in the conclusions of a 2007 report by Nathan Associates, that sought to provide a preliminary assessment of the potential of PACER-Plus for the PICs:

- "PACER-Plus must be much more than a trade agreement if it is to succeed at providing a workable framework for deepening regional trade and economic cooperation.
- "The FICs (PICs) must find accommodations for three areas in which current capacity issues are significant:
  - (i) in the resources needed to secure their interests in international trade;
  - (ii) in the resources necessary to capture the benefits of regional markets; and
  - (iii) in their ability to mitigate the potential negative effects arising from regional trade liberalization."
- "Utilizing the Pacific's greatest resource – its people – would produce the greatest gain. Integrating free labor mobility into the Pacific region is….the most logical priority for the FICs.(PICs)"

Labour mobility looms as a potentially key element in likely proposals by the PICs for the provisions to be included in PACER-Plus. The PICs currently differ widely in the degree of access that their people currently enjoy to Australia and New Zealand. There are a number of long-standing arrangements in place, for example the people of Cook Islands and Niue have unrestricted access to New Zealand as New Zealand citizens. Samoa and Tonga each have annual migrant quotas for New Zealand, for example 1100 randomly selected individuals per year in the case of Samoa. Recent developments have been the introduction of the Registered Seasonal Employers (RSE) Scheme by New Zealand, providing for up to 5000 workers per season from Kiribati, Samoa, Tonga, Tuvalu, Vanuatu, and more recently also the Solomon Islands, and the Pacific Seasonal Workers (PSW) scheme by Australia, similarly providing for up to 2500 workers from Kiribati, Papua New Guinea, Tonga and Vanuatu. Fiji stands out as an FIC that has no participation in any of these access arrangements, along with Nauru and also the "Compact" countries in Micronesia who have separate access arrangements with the United States and arguably are not in need of access to Australia and New Zealand for their people. The varying levels of access that PICs enjoy under existing arrangements may translate into varying degrees of emphasis placed on the issue in PACER-Plus negotiations, but all PICs involved in these arrangements should have an interest in having the arrangements incorporated into PACER-Plus as international treaty obligations rather than remaining as unilateral offerings by Australia and New Zealand, as at present.

Additional proposals for elements capable of delivering development-related benefits to be included in PACER-Plus would be expected to emerge from the PICs' own national needs assessments and national consultations. In this connection it is of concern that Australia and New Zealand appear to have recently pushed for negotiations to commence, and the scope of the negotiations to be defined and agreed, before the national needs assessments and national consultations have been initiated, let alone completed. The negotiation process envisaged by Australia and New Zealand also appears designed, whether consciously or not, to minimise the opportunity for PICs to consult with each other for the purpose of developing united negotiating positions. PICs will need to find ways to resist pressures to move the negotiating process forward at a pace that allows them insufficient space to formulate and put forward proposals in their own interests.

The issue of negotiating resources is crucial to the PICs ability to adequately represent their own interests in the PACER-Plus negotiating process. The PICs have been accustomed in their trade negotiations to date to receive extensive technical support from the Pacific Islands Forum Secretariat (PIFS). In the PACER-Plus context however the apparent insistence by Australia and New Zealand that PIFS should not serve the interests of one group of Forum members against those of themselves as equal members seems to have implied that the PICs will be unable to receive technical support from PIFS as in the past. This led to the proposal for appointment of a Chief Trade Adviser (CTA) and establishment of an Office of the Chief Trade Adviser (OCTA), with the express purpose of providing the FICs with the type of technical support that they have been accustomed to receive from PIFS, on a basis fully independent from any influence by Australia and New Zealand. A decision to locate the OCTA in Vanuatu rather than in Suva (the location of PIFS) was intended to underline its independence from Australian and New Zealand influence.

The inability of the PICs to finance the OCTA themselves raises awkward questions for the OCTA's independence, especially if a substantial part of the necessary finance has to be provided by Australia and New Zealand. Doubts over whether the OCTA would be allowed to be genuinely independent were heightened when Australia and New Zealand attempted to participate in the writing of the terms of reference of the OCTA and sought a seat on its governing body, although both issues were subsequently resolved. Further doubts were raised by a decision, apparently encouraged by Australia and New Zealand, that the OCTA should initially be located within the PIFS rather than in Vanuatu as originally envisaged, especially given the recent appointment of an Australian as director of the PIFS division responsible for trade and investment advice. In the event this proposal too appears to have been circumvented, and it is understood that the OCTA will be established in Vanuatu during 2010. The decision to appoint as CTA a person with excellent credentials as a trade negotiator is another favourable sign. A key question now will be whether the OCTA is able to secure sufficient resources to effectively perform the functions envisaged for it.

In the meantime the MSG group has established its own secretariat, also in Vanuatu, and appears to envisage their secretariat as playing an important support role in the PACER-Plus negotiations. The MSG Secretariat however is also severely resource-constrained. The co-location of the MSG Secretariat and PIC OCTA in Vanuatu does offer some potential for cooperation and division of labour to obtain maximum value from the resources of both agencies.

Alternative FTA Partners?

Given the difficulties and limitations associated with the PICs FTA experiences with the EU and Australia and New Zealand, it is logical to ask whether there are other potential partners with whom the PICs could develop FTA relations either as complements or alternatives to their existing partnerships.

One obvious avenue would be to encourage the French and US Pacific territories to join PICTA. Although the populations of these territories are relatively small, their income levels are very high compared to the PICs. They thus represent an attractive potential market for the PICs, especially as the French territories in particular maintain high trade barriers against imports from non-EU sources, so that margins of preference over those sources potentially available to the PICs are also high. It is known that the French government has been supportive of closer integration of its territories with the independent PICs. Initial approaches were made by PIFS to the territories in the early years of PICTA, and some interest was displayed by New Caledonia in particular, but subsequent political developments appear to have mitigated against further progress.

The other obvious direction in which the PICs might look for additional partnerships is East Asia, which is both the world's most dynamically developing economic region and also the region beyond Australia and New Zealand that lies closest to the PICs. Development of closer trading links by the PICs with East Asia does however face formidable logistic obstacles. A further problem is that while the PICs have been pre-occupied with their negotiations with the EU and managing their economic relations with Australia and New Zealand, the spread of FTAs in East Asia has been steadily increasing discrimination against current and, perhaps more importantly, potential future FIC exports to those markets. The PICs have simply not had the resources to monitor and respond to these developments at the same time as they address their issues with the EU and Australia and New Zealand.

The United States, the world's largest economy, is of course located on the eastern rim of the Pacific, and would thus appear to be another logical FTA partner for the FICs. A flurry of interest in a possible FTA with the United States occurred in 2003-4 as date for the final phasing out of MFA quotas loomed, and was motivated primarily by desire for a mechanism that would allow Fiji garment exporters to maintain their position in the United States' market. The response from the United States was not encouraging, and the complexity of the task of mobilising political support for such an FTA within the United States appeared daunting to the PICs. Interest in pursuing an FTA with the United States quickly subsided, and has not been revived since. Full preferential access to the United States' market continues to be enjoyed by the three former U.S. trust territories, although little commercial use is made of this privilege in practice. Other PICs such as Samoa have been able to develop niche markets in the United States for products such as fish and noni fruit, on the basis of existing GSP preferences.

Conclusions

Given the economic characteristics of the PICs it was never realistic to expect that South-South FTAs such as PICTA and MSGTA could make a major contribution to addressing their trade needs. These FTAs are appropriately viewed as stepping stones to more ambitious steps toward integration with the global economy. Their effectiveness as stepping stones has been impaired by delays in their implementation. They have however provided PIC officials and politicians with valuable experience in the negotiation of modern trade agreements.

It is probable that the prospect of having to include services in both the EPA with the EU and PACER-Plus with Australia and New Zealand was a decisive factor in prompting the PICs to move forward on negotiations for the PICTA Trade in Services agreement (PICTA-TIS), after several years of delay.

The EPA negotiations were driven by an external logic of little immediate relevance to the trade needs of PICs other than Fiji and Papua New Guinea. Efforts by the PICs to widen the scope of the EPA to deliver development-related benefits of greater consequence to themselves have so far been largely unsuccessful. In the meantime the EPA negotiations have absorbed an enormous proportion of the time and resources that the PICs are able to devote to trade issues.

Australia and New Zealand are in many respects natural partners with whom the PICs might consider deeper economic integration. Integration that is based solely on trade as conventionally defined will not however deliver the development-related benefits that the PICs should be seeking in integration with these partners, and is unlikely to offer significant benefits beyond existing trade arrangements with them, while requiring significant adjustments on the part of most PICs. It remains to be seen whether the proposed PACER-Plus negotiations can be directed towards the establishment and implementation of an integration framework capable of delivering major development-related benefits to the PICs. Initial signs are not encouraging, but it is too early to be entirely pessimistic.

In the meantime their preoccupation with the EU and Australia and New Zealand appears to have prevented the PICs from paying attention to developments in the East Asian region, which would be the natural direction in which the PICs might look for additional trade and economic partnerships. The spread of FTAs in East Asia means that the PICs are facing progressively increasing discrimination in these markets. This issue will need to be addressed if the PIC retain ambitions of developing meaningful trade and economic partnerships in East Asia.

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