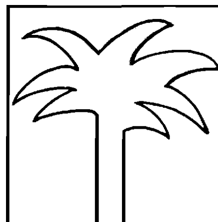

PICTA, PACER and EPAs: weaknesses in Pacific island countries' trade policies

Wadan Narsey

Most Pacific island countries have now signed the Pacific Island Countries Trade Agreement (PICTA) and the Pacific Islands Agreement on Closer Economic Relations (PACER) and are negotiating Economic Partnership Agreements (EPAs) with the European Union. These countries (their governments, companies, employees and the public) are not prepared for the economic adjustments that will be required under such trade agreements and there are likely to be defensive reactions to employment losses and significant losses of government revenues. PACER holds much greater prospects than EPAs for addressing problems of unemployment of unskilled labour and the broader development challenges of raising living standards in the Pacific island countries.

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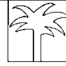
Most Pacific island countries are signatories to several overlapping regional and international agreements encompassing trade, aid and investment. These agreements are seen by Pacific island countries as instruments to accelerate their economic development, create employment, increase incomes and generally improve standards of living.

For the western Melanesian countries, there is the Melanesian Spearhead Group Trade Agreement (parties to this agreement are Papua New Guinea, Solomon Islands, Vanuatu and Fiji); for most of the southern Pacific island countries there is the special relationship with Australia and New Zealand in the form of SPARTECA; and the American trust territories have their special relationship with the United States in the form of the Compact of Free Association (between the United States and the Federated States of Micronesia, Republic of the Marshall Islands and the Republic of Palau).

However, interesting policy choices are posed by the interactions between the recently signed regional trade agreements among the Pacific island countries: the



Pacific Island Countries Trade Agreement (PICTA), the Pacific Agreement on Closer Economic Relations (PACER) (which includes Australia and New Zealand) and the Cotonou Agreement, the successor to the Lomé Agreement between the African, Caribbean and Pacific States (ACP). These agreements are in place against the backdrop provided by the imperatives of the World Trade Organization (WTO) to which Papua New Guinea, Fiji and Solomon Islands are signatory, while Vanuatu, Samoa and Tonga have applied to join.

PICTA and PACER are already binding on those countries that have signed and ratified, while the trade (and other) aspects of the Cotonou Agreement are in the process of being negotiated with the European Union in the form of Economic Partnership Agreements (EPAs)—expected to come into effect after 2007.

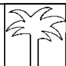
History suggests that trade agreements between small, relatively closed economies are an inferior option to unilateral trade liberalisation. The former generally results in rents being enjoyed as a result of trade diversion, rather than the countries reaping the benefits of trade creation. However, developing economies have found it difficult to adopt trade liberalisation unilaterally, usually because protected domestic producer groups have been politically more influential than domestic consumers and potential exporters who could benefit from the liberalisation. The Pacific island countries are no exception. This paper outlines the contradictory nature of the medium and long-term implications of PICTA and PACER, by examining the likely long-term impact on two sets of industries in the Pacific island countries—tobacco and alcohol products.

It is argued that the likely medium-term impact of PICTA will be at odds with the Pacific island countries' long-term development, with serious potential for wastage of national resources, given the likely long-term implications of PACER. It is suggested that regional trade is unlikely to increase significantly because of political lobbying by domestic producers. The impact of PICTA on employment will likely be a critical sticking point for the governments, with most not prepared for the long-term employment consequences of the trading agreements they have signed, despite the supposed overall net economic benefits.

The crucial importance of maximising the benefits from PACER is underlined by one of the critical negotiating issues for Pacific ACP states with the European Union over the EPAs—the fiscal impact of tariff reductions. The likely large tariff revenue costs for Pacific island governments from PACER suggest that Pacific island countries need to negotiate *quid pro quo* benefits in return for the likely tariff reductions. While the current EPA negotiations are focused on relationships with the European Union, the Pacific states should examine the possibilities of revamped relationships with Australia and New Zealand through the PACER, which has much greater long-term potential for sustainable economic growth and development in the Pacific.

PICTA and PACER

Following a 1999 Forum Trade Ministers' Meeting, a 1999 Forum Leaders' Meeting in Palau 'endorsed in principle a free trade area among Forum Members' (PICTA does not include Australia and New Zealand). In August 2001 nine Pacific island countries signed PICTA.[1] Together with Australia and New Zealand they also signed PACER, which is seen as an umbrella agreement for PICTA. PICTA is now in place, with nine countries having ratified, while five have not.[2] The Federated States of Micronesia, Republic of the Marshall Islands and Republic of Palau are allowed a grace period



of up to three years following entry into force of this Agreement, provided they make reasonable efforts to secure a waiver of their obligation to provide most-favoured nation treatment to the United States.

The PICTA signatories made a commitment to trade liberalisation, supposedly as a means of improving the living standards of all the peoples of the region. The Agreement states that its objectives are to strengthen, expand and diversify trade between the Parties

- through the elimination of tariff and non-tariff barriers to trade
- in a gradual manner, with a minimum of disruption, under clear rules for trade, and with conditions of fair competition
- leading to the eventual creation of a single regional market among the Pacific island economies, and
- while taking into account the differing economic potential and the special development problems of the least developed countries and small island states, the different development objectives, and the aspirations of indigenous peoples.

The Parties expect that PICTA should also

- contribute to the harmonious development and expansion of world trade in goods and services and to the progressive removal of barriers, and
- promote and facilitate commercial, industrial, agricultural and technical cooperation amongst themselves.

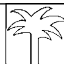
PICTA recognises each party's rights, obligations and undertakings to the WTO, or other multilateral, regional and bilateral agreements and arrangements to which they are party, including the Melanesian Spearhead Group, the ACP-EU Partnership (Cotonou Agreement), SPARTECA and the Compacts of Free Association.

Fundamentally, PICTA requires that all tariffs on 'originating goods' traded between them be reduced and eliminated in accordance with the timetables set out in Annex II (PICTA Article 7, paras 4, 5 and 6)—essentially falling to zero within ten to 12 years after ratification. Those Pacific island countries classified as less developed countries and small island states are given a parallel but longer time schedule for reducing import duties than the larger Pacific island countries (Papua New Guinea and Fiji).

For the protection of 'sensitive industries' from full competition, and to give them a longer time frame for adjustment, PICTA allows each country to provide an 'excepted imports' list with a slower timetable for reduction of tariffs (Annex IV). Again, less developed countries and small island states are allowed slightly longer time schedules for reducing import duties.

The rationale for PICTA

PICTA may be attributed to internal and external forces, both economic and political. The internal economic imperative supposedly derives from the recognition by Pacific island countries that they need to become internationally competitive, especially as they see their preferential markets in industrial economy partners eroded by challenges through the World Trade Organization.[3] As well, there is an increasing realisation on the part of developed countries that their preferential agreements constitute bad aid and trade policies by perpetuating developing country dependence on trade distortions that hamper internal economic efficiency and must in any case ultimately be eliminated. The logic articulated by the Agreements has been that, rather than jumping off the deep-end into free trade agreements with the industrial economies, Pacific island countries may have



an easier time if they first develop a free trade agreement or regional trade agreement amongst themselves as a 'stepping stone' to free trade agreements with the rest of the world.

The mechanisms whereby the Agreements expect free trade agreements to encourage improvements in competitiveness are

- enlargement of market size will encourage economies of scale, competition[4] and new investment earlier thought unprofitable
- competition and adjustment would be brought in gradually so that sudden destabilising economic disruptions are minimised, and
- PICTA would provide a 'training ground' for further (and presumably harsher) economic integration with the wider globalised world order: for businesses and for governments that will need to implement fiscal reforms (such as in tax systems) and enabling legislation (regarding product standards, phytosanitory measures, quarantine requirements, customs procedures and so on).

While these advantages have generally been internationally recognised in regional trade agreements elsewhere, their application in the Pacific island context is questioned in this paper.

There are also seen to be political advantages to the PICTA

- being able to speak with one voice in international fora, enabling the Pacific island countries to have a greater influence than they would individually
- being part of a regional free trade agreement (with all the necessary structural and fiscal reforms) will 'lock in' economic policies and thereby discourage backsliding by governments responding to political imperatives and lobby groups, and
- financial and technical aid incentives provided by the donor countries (specifically Australia and New Zealand) for being committed to the agreed policy agenda.

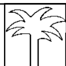
These latter advantages, while plausible, are also debatable in the light of the results so far (it may even be difficult to obtain a united front on the EPAs with the European Union).

There has also been a powerful external impetus to form PICTA. It has been argued that the post-Cotonou EPAs to be negotiated with the European Union will be facilitated if the Pacific island countries are bound by a free trade agreement, which then would facilitate the WTO compatibility of the EPAs. But the Cotonou Agreement also states that economic and trade cooperation between the European Union and the ACP states shall build on the regional integration initiatives of the ACP states, 'bearing in mind that regional integration is a key instrument for the integration of the ACP countries into the world economy'.

This last assumption is debatable for all Pacific island countries, but especially for at least two groups amongst these countries with special relationships to metropolitan or industrial economies—the United States and New Zealand.[5] Nevertheless, the current reality is that even those Pacific island countries not previously part of the Lomé Convention have joined the post-Cotonou development partnerships with the European Union (these are Cook Islands, Federated States of Micronesia, Marshall Islands, Nauru, Niue and Palau). There are, no doubt, long-term strategic advantages for the European Union, *vis-á-vis* other superpowers, in having most of the Pacific island countries bound to it through EPAs.

The PACER

The PACER, which has been signed and ratified by all the Pacific island countries, is



seen as an umbrella framework setting out possibilities for trade relations among all Forum members, that is, inclusive of Australia and New Zealand. However, PACER was not a proactive agreement for fostering free (or freer) trade between the Pacific island countries and Australia and New Zealand. It was a reactive and essentially defensive agreement protecting Australian and New Zealand trading interests in the Pacific country markets against other developed countries or groups of countries. Article 6 advises that if any Pacific island country 'commences formal negotiations for free trade arrangements' with any other developed country or grouping, they should also commence similar negotiations with Australia and New Zealand.[6] Hence, PACER essentially attempts to assure Australia and New Zealand that they will not be disadvantaged relative to other trading partners in their trade relations with the Pacific island countries.

PACER also requires negotiations with Australia and New Zealand to commence eight years after the PICTA comes into force, if it is not triggered before that through the actions of the Pacific island countries described above. However, in both cases Pacific island countries would become parties to free trade arrangements only if the negotiations are successful.

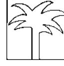
PACER also contains requirements for the provision by Australia and New Zealand of financial and technical assistance for the development and implementation of the trade facilitation programs. This assistance is to give special attention to the needs of small island states and less developed countries, both in the design of the programs and funding levels. However, the extent to which the financial and technical assistance provided to Pacific island countries will be additional to existing levels of assistance is unclear.

In one important aspect, PACER is not a symmetrical agreement between Australia and New Zealand on the one hand and the Pacific island countries on the other. While PACER provides the Pacific island countries with the right to consultation with Australia and New Zealand if either Australia or New Zealand were to enter into negotiations for a free trade agreement with a non-Forum country, the benefits to be negotiated would only be for 'improved market access' for Pacific island countries—not the equivalent of the free trade agreement being negotiated with the non-Forum country (as would have been the case had the agreement been symmetrical).[7]

There are two views explaining the signing of PACER. There is the view that Pacific island countries only agreed to PACER after they succeeded in rejecting Australia and New Zealand's belated attempt to join PICTA. An alternative interpretation is that PACER is a symptom of the Pacific island countries' recognition that, for the foreseeable future, Australia and New Zealand will be their most important developed country partners and donors, and that Pacific island country relationships with other developed countries or groups of countries should not place Australia and New Zealand at a disadvantage. But this explanation makes the PACER a reactive agreement, not proactive as would have been the case had there been political substance to the interpretation.

The EPAs under the Cotonou Agreement

The Cotonou Agreement[8] was signed as an 'equal' development partnership between the European Union and the ACP states.[9] What cannot be lost sight of is that while the central objective of the Cotonou Agreement partnership is stated to be to 'promote and expedite the economic, cultural and social development of the ACP States' (Article 1), a new trading regime is explicitly held by the



European Union to be at least as important an objective.[10] Thus, while the Cotonou Agreement expects the ACP development strategies to be centered on the objective of reducing and eradicating poverty, the provisions state this objective has to be consistent with the objectives of 'sustainable development and the gradual integration of the ACP countries into the world economy'. The Cotonou Agreement commits that 'regional and sub-regional integration processes which foster the integration of the ACP countries into the world economy in terms of trade and private investment shall be encouraged and supported'.

Under the Cotonou Agreement, the Lomé IV trade arrangements are to continue until 2007, while the development aid arrangements will continue for 20 years. The trade arrangements to apply after 2007 are to be renegotiated[11] and these will take the form of economic partnership agreements, or alternative trading arrangements with ACP countries that are not willing to conclude EPAs. Article 37.6 of the Cotonou Agreement states that the alternative trading arrangements will provide these countries with a 'new framework for trade which is *equivalent to their existing situation and in conformity with WTO rules*' (italics added).[12]

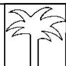
Article 36 of the Cotonou Agreement states that the ACP states and the European Union 'agree to conclude new WTO-compatible trading arrangements'. Of relevance is GATT Article XXIV, which covers preferential trading arrangements between developed WTO countries and all subsets of developing countries. The non-reciprocal Lomé Arrangements were covered by a waiver from the WTO. It is now understood that WTO regulations will not allow discrimination between different groups of less developed countries that have partnership arrangements with the European Union and that reciprocity will be required of the ACP states after 2007.

Pacific island country import duties on EU products are likely to be reduced or eliminated. Of critical importance will be the definition of 'substantially all the trade' on which duties will be eliminated. While there is no consensus on how 'substantially all the trade' will be defined, Pacific ACP states need to prepare for the worst case scenario that import duty will have to be eliminated on 90 per cent of all imports (by value) from the European Union.[13]

Where the European Union's commercial interests are concerned, it is unlikely that they will be placed subservient to ACP development interests. For instance, the recent kava debacle must throw grave doubt on the importance placed by the European Community (EC) on Pacific island country development based on their genuine comparative advantages. Over the past year, EC pharmaceutical companies, whose sales were threatened by the increasing popularity of kava products, had little difficulty in obtaining bans against Pacific island kava exports to Europe. The aid relationship underlying the Cotonou Agreement is that the European Community sees itself as a development 'bigger brother' to the under-developed Pacific island economies. Yet the 'bigger brother' stood by while an industry in which the Pacific ACP countries have comparative advantage was decimated by EC multinationals.

Are expected regional trade agreement benefits likely to be realised?

While some of the political benefits of regional integration movements are obvious in the short term, there is considerable debate about their economic usefulness in the long term. Bhagwati (1991) quite legitimately asked whether regional trade agreements were 'building blocks or stumbling blocks'



for developing economies. The question is very pertinent in the Pacific island country context, with their relatively tiny markets.

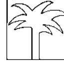
The early studies which preceded the formation of PICTA (Filmer and Lawson 1999, Scollay, Gilbert and Collins 1998) concluded that the largest gains from regional integration would arise from a free trade agreement including Australia and New Zealand, while a free trade agreement encompassing only the Pacific island countries could not be expected to provide significant benefits. These regional conclusions are consistent with the international studies. Vamvakidis (1999) examined the impact of five regional trade agreements negotiated in the 1970s and 1980s and found that none led to faster growth, largely because 'most of these agreements were among small, closed and developing economies'. His findings for the island nations of the Caribbean (part of CARICOM), showed a massive decline of growth rates from an average of 4.5 per cent to only around 1 per cent. In a time-series study spanning 43 years, Vamvakidis (1999) compared the growth performance of countries that had liberalised broadly and those that joined a regional trade agreement. It was found that the former grew faster in both the short and long term, but slower after participation in a regional trade agreement.

There has also been serious concern about the unequal sharing of economic benefits in a regional trade agreement. Venables (2003) concluded that regional trade agreements between low income countries tended to lead to divergence of member country incomes, and that developing countries are more likely to be better served by 'north-south' than by 'south-south' agreements. The larger, more industrially advanced countries in the free trade agreement tend to enjoy the bulk of the production benefits. Thus, Caribbean island country experience has been that the major beneficiary has been Trinidad. These conclusions are likely to be stronger for the small island economies of the Pacific, given their relatively small populations, low incomes per capita, lack of regular communication links (especially for the transport of goods), lack of developed infrastructure, and the similarity of their resource endowments (mostly scarce).

Simply reducing tariffs is unlikely to encourage greater competition amongst Pacific producers. It would be necessary to develop a host of complementary measures and practical assistance to the currently small Pacific producers to encourage them to attack other markets: for example, cost-effective production of quality goods; regular and cost-efficient transport and freight charges; and coping with customs regulations, product standards, and quarantine requirements. Prasad, Reddy and Naidu (2003) discuss some of the conditions under which Pacific island countries may be able to benefit from a free trade agreement and the inherent limitations of their production bases.

However, it could be argued that if the entire PICTA market is able to be supplied by one (monopoly) firm utilising economies of scale (as is quite likely in a number of industries), effective competition may neither be feasible nor desirable, especially if smaller scale and inefficient operations are encouraged by protection or subsidies. On the other hand, having a monopoly operating throughout the PICTA region may also lead to the undesirable result that most of the benefits of trade diversion would be captured by the producer rather than by the consumers.[14]

The investment benefits may also not eventuate as expected. Where PICTA encourages new foreign investment to operate behind high tariff barriers, there is the danger that Pacific island countries will compete with each other through tax



incentives for investors (foreign or local) to locate within their geographical boundary. In most cases, the higher the incentives, the lower the retention of national benefits. The latter in any case may also be small, or even negative, if the costs of domestic production are significantly higher than the cost of imports. The empirical evidence in Balasubramanyam, Sapsford and Griffiths (2002) suggests that it is not the presence of regional trade agreements that determines the size and direction of foreign direct investment, but the economic characteristics of the investing and host country. Thus the smaller Pacific island countries are unlikely to see any significant increases in investment, either domestic or foreign.

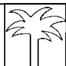
It has also been argued that by diverting trade from developed countries (with their larger knowledge base arising out of their greater stock of research and development) to the less developed PICTA countries, the Pacific island countries may also reduce their learning opportunities—in addition to the welfare loss due to the encouragement of trade diversion from a more efficient supplier, rather than trade creation (World Bank 2002:15). It might also be argued in the Pacific island context that there may be greater learning opportunities to be derived from investment and production opportunities associated with import replacement, even though the regional trade agreement continues to impose taxes on producers.

However, Pacific island countries ratifying PICTA may need to come to terms with a thorny fundamental issue: the assumption that a regional trade agreement such as PICTA is a 'stepping stone' towards full integration with the world economy. Enlarging the regional market through PICTA may enable some firms to increase their scale of operations, by and large by replacing domestic producers and/or imports from non-PICTA countries, assisted by protective tariffs for the PICTA area.

For many, this will require investment in plant, increases in employment, and expansion of distribution and marketing networks. While these firms will no doubt significantly improve their economic efficiency, it is also quite likely that they will still be small relative to the competing metropolitan multinational companies. When the extra-PICTA margins of preference decline (as eventually they must) it is quite likely that the majority of the expanded Pacific island country firms will still find themselves unable to compete with the metropolitan giants and inevitably have to close.

This will certainly be the case if PACER comes into full effect. The majority of manufacturing firms in Pacific island countries survive on the basis of high tariff protection, with effective rates of protection much higher than the nominal rates.[15] The annual production runs for most firms could be covered by a few days' production in the metropolitan countries. In all likelihood, most metropolitan producers would simply export the finished products to the Pacific island countries if tariff protection were removed from the domestic producers. Rare exceptions may include those cases where the orders from PICTA clients are too small for the metropolitan companies to bother with; hence a Pacific-based subsidiary may be left to mop up the small demand.[16]

This point raises three important issues for PICTA governments. First, should Pacific island governments be encouraging the expansion of firms (with the associated resource costs) into the enlarged but still protected PICTA market, knowing that within the medium term (some eight years at the outset) these firms will still not be able to survive in a globalised competitive market? In other words, if PICTA succeeds, it would paradoxically be creating an even thornier problem than currently exists, by strengthening industries that may be even



more difficult to dismantle because of their increased size and contribution to domestic employment and income generation—and political influence.

The importance of individual companies in Pacific island politics and public policy cannot be underestimated. The Fijian economy, for instance, is characterised by government-granted and protected monopolies operating in a wide range of key industries, such as telecommunications, cement, television and milk, to name just a few. Government refuses to dismantle the monopolies (for a variety of reasons), despite protracted public protests over many years.

Second, the regional free trade agreement will only lead to expansion of production if the short-term benefits justify doing so. Clearly, firms will invest capital and increase production only if they are able to sufficiently exploit market power (at the expense of consumers) in order to rapidly return the capital invested before further liberalisation occurs.

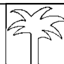
Third, and probably most importantly, given the likely long-term adjustments that will be required by PACER and the World Trade Organization, is the lack of preparedness of Pacific island countries, their industries, and their governments. This point relates especially to the significant changes in employment, the demise of local entrepreneurs, and fiscal policy measures that will be required by the implementation of the EPAs and PACER.

These points raise serious questions about the strategies being followed by Pacific island governments in relation to their major trading partners. It is suggested here that Pacific island countries are not pursuing the mix of strategies that would offer the greatest promise of future economic benefits. Reference is made to the Melanesian Spearhead Group Agreement, a case study of the regional trade agreement implications for the Pacific alcohol and tobacco industries, and the negotiating weaknesses of Pacific ACP countries over the EPAs with the European Union. The suggestion is made for a proactive triggering of PACER negotiations and a more urgent approach to closer economic integration with Australia and New Zealand, towards the eventual formation of a South Pacific Economic Community.

The Pacific island country integration reality: reversals of liberalisation

There seems to have been insufficient acknowledgement amongst the PICTA signatories that, for economies of scale to be enjoyed by some PICTA producers, simultaneously requires producers in other Pacific island countries to reduce their market share, and even for some to close down. It must be expected in such circumstances that owners and workers in threatened industries will lobby their respective governments against the imports from the other PICTA countries, presenting the old arguments about protecting local jobs, incomes and taxes. The domestic consumers who would enjoy the benefits of free trade (usually greater than the costs) typically do not form a counter lobby group. Most Pacific island governments, mindful of the reactions of disgruntled voters at the next elections, have indeed reacted to protect the local lobby groups.

Such reactions are obvious from recent developments in the Melanesian Spearhead Group (MSG). At recent meetings of the grouping, the smaller islands have expressed concern about the survival of their industries. In August 2002[17], Solomon Islands' officials referred to their government's 'balance of payments' problems and 'SOS' calls from some of their industries. Vanuatu expressed concern about soap and canned meat imports



from Papua New Guinea and ice cream imports from Fiji that were placing their domestic industries under stress. This meeting noted that the MSG Agreement allowed temporary relief in the form of tariffs (usually 12 or 15 per cent) to be phased out after three years. The meeting agreed that bilateral arrangements on a product-by-product basis were needed.

In a later meeting of the MSG Customs Working Group[18], the Solomon Islands representatives proposed a three-year 'temporary' suspension of duty-free MSG trade. Vanuatu, referring to their declining exports and worsening balance of trade with Papua New Guinea and Fiji, proposed to impose an 'injury tariff' of 40 per cent on corned beef, chicken, pork, fruit juices, ice cream, sawn timber, furniture and toilet paper—the very few items in which MSG trade had begun. Solomon Islands proposed to apply injury tariff rates to 37 items over the next 36 months.[19]

The 2004 Fiji Budget saw the government reducing tariffs on imports of an essential consumer item—exercise books. In a matter of weeks, the government reversed its decision because of strong public lobbying by a major domestic 'producer'.[20] There has been a recent expansion of flour mills in Fiji. All can operate profitably only because of the high protection afforded the 'industry', while the current industry leader acknowledges that a metropolitan plant would satisfy the entire annual Fiji output in a few days. The Fiji kava industry recently took umbrage at imports of cheaper and apparently more potent Vanuatu kava, with little reaction from the Fiji Government, which had only recently come out in support of the MSG Agreement (*The Fiji Times*, 1 August 2004).

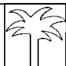
It is clear from the reluctance to reduce import duty protection on clearly inefficient industries that reversals of free trade policies will take place if and when PICTA-induced trade begins to take place, should there be threats to domestic producers.

Opposition to regional trade

For free trade agreements to produce the expected benefits requires that Pacific island governments understand the economics (costs and benefits) of their affected industries and firms. They have to come to clear conclusions about the long-term viability of these industries and firms before making decisions to foster or perpetuate a protectionist environment. They also need to clarify whether Pacific island countries would benefit more (in consumption and production) by complete unilateral trade deregulation for some industries, rather than the limited deregulation presented by the regional trade agreements. There is little indication that Pacific island countries have moved far in this direction, although all have signed PICTA and PACER.[21]

It seems that while many Pacific island companies are in a position to move into other Pacific markets within the ambit of PICTA, few are actually contemplating doing so. Some have been operating behind protectionist barriers in 'comfort zones' for so long that it is virtually a foreign culture to think of competing regionally or internationally. Some companies simply do not have the expertise to take advantage of PICTA. For some companies, metropolitan multinational control with conflicting interests in the Pacific island markets may also inhibit regional and international aggression by the company. Thus, some firms that have the capacity to export to other Pacific island countries, nevertheless follow company policy not to target markets being supplied by the metropolitan company.

A recent study (Narsey 2003) on the integration of alcohol and tobacco products into PICTA throws up a number of contentious issues, which may be examined



with respect to PICTA in general. While alcohol and tobacco products are currently excluded from PICTA,[22] there were serious concerns that some Pacific island breweries, distilleries and cigarette manufacturers might not be able to compete in a Pacific-wide free trade agreement. It would seem that Pacific island governments have not decided between the trade-offs promised by the free trade agreements (including cheaper consumer prices and a wider range of goods) and government revenues, short-term loss of domestic employment and incomes, and the demise of relatively inefficient domestic firms. The kinds of difficult decisions that some governments will be required to make about the extent to which they should keep protecting their alcohol and tobacco industries are exactly the kinds of decisions that they will be required to make with respect to many industries threatened by the operations of PICTA and the eventual impact of PACER.

Pacific island governments have not prepared for the possibility that when PICTA-induced exports begin to succeed in other Pacific island country markets, there will be opposition from vested interests currently entrenched in those markets. A critical sticking point for the integration movement will be resort to PICTA 'rules of origin' regulations to deny access to competing PICTA products. Yet few Pacific island governments have examined their existing industries to see whether their products would qualify under the rules of origin.

Unpreparedness for 'rules of origin' issues

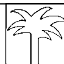
According to PICTA, each Party must establish a mechanism to provide, on request, a binding ruling on the originating status of goods to be imported, available at least six months in advance of shipment of such goods, and valid for a period of at least six months after the arrival of the first shipment. To this end, the Parties are required to establish a Rules of Origin Committee (serviced by the Forum Secretariat), which shall consist of representatives, whether from the public or private sector, from the first five Parties to ratify the Agreement, including at least one representative from a least developed country or small island state. Derogation from the rules of origin would only be permitted where it is established, on the basis of objective evidence, that the goods concerned have undergone 'substantial transformation' in the territory of the exporting Party;[23] or are temporarily unable to qualify as originating goods due to 'exceptional circumstances'.

Such a Committee has yet to be established, yet almost certainly any PICTA-induced trade that threatens domestic industries will give rise to rules of origin challenges. Most Pacific country alcohol and tobacco products are extremely unlikely to qualify under the current PICTA rules of origin, while some are borderline.

Trade in tobacco products

The four tobacco product manufacturers operating in Papua New Guinea, Solomon Islands, Fiji and Samoa are all owned by British American Tobacco. They manufacture cigarettes, 'roll your own' products, and also local varieties of 'stick' cigarettes that are cruder versions of cigarettes, sometimes using print newspaper as the wrapping for the tobacco (as in Papua New Guinea).

Employment in these firms is significant in the Pacific island context, given their extremely poor record of job creation. The PNG factory employs 255 persons, Fiji 132, Solomon Islands 161 and Samoa 46. Roughly one-fifth of the employees are women. Some 197 persons are also employed



on the Fiji farms, most on a part-time basis. British American Tobacco operates in most Pacific island countries as virtual monopolies (due to the high protection against imported brands), although there is some indirect 'competition' from the informal sector products.[24]

A salient fact for discussing likely outcomes of PICTA trade in tobacco products is that the British American Tobacco factories in Papua New Guinea, Samoa and Solomon Islands all use imported tobacco and other inputs. British American Tobacco (Fiji) is the only subsidiary using domestically grown and processed tobacco: some 73 per cent of the tobacco used by British American Tobacco for manufacture of cigarettes in Fiji is grown locally, by small farmers.[25]

British American Tobacco (Papua New Guinea) is by far the largest factory of the four and would normally have been one of the two prime candidates (other than Fiji) for the location of 'the one' factory which British American Tobacco would probably prefer to supply the entire PICTA market. However, not using domestically grown tobacco would prevent it from supplying the other Pacific island country markets under PICTA. Based on the author's study, only cigarettes made from locally grown tobacco (in Fiji) are likely to satisfy the rules of origin. Hence it may be surmised that Fiji cigarettes, if exported to the other Pacific island countries under PICTA, would tend to drive the local producers (Papua New Guinea, Samoa and Tonga) out of their domestic markets. Production, employment and incomes would grow in Fiji, and decline in the other three countries.

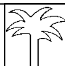
Yet none of the latter countries currently envisage the demise of their tobacco 'industries' despite the reality that their products would not be able to satisfy the PICTA rules of origin; they have minimal domestic value added; they are not genuine 'infant industries' as such; and the consumers are paying extremely high prices essentially to subsidise the profits of the company. The sole factor underlying the reluctance of these countries to see competition from other Pacific island countries is the employment currently provided by their cigarette factories.

It is also patently clear, that were PACER to come into effect, British American Tobacco would prefer to supply the entire Pacific market[26] from one of its metropolitan factories and close all the factories in the Pacific islands. Whatever increases in production, employment and incomes are enjoyed by Pacific island industries through PICTA (namely the Fiji industry, in this case) would eventually have to be sacrificed for the wider and greater economic benefits derived from the integration through PACER. There is little indication that any of the Pacific island countries are preparing their manufacturers and employees for this inevitable eventuality.

Trade in beer products

The beer industries in the Pacific island countries are represented by two large breweries (Papua New Guinea and Fiji), two of moderate size (Samoa and Solomon Islands), and five micro-breweries (two in Fiji, and one each in Tonga, Cook Islands and Palau). All the breweries use imported material inputs of hops, barley, malt and yeasts, with the exception of the sugar used by the Fiji and PNG breweries.

Most of the breweries make a variety of products—bitters, lagers, and stout-type beers. Most of the Pacific island breweries have experimented with the composition of their beers to please the local palate, which is usually different from the metropolitan tastes originally geared to by the beer manufacturer.[27] Some have successfully turned their breweries around because of astute changes to their beer formulae.



The large and moderate sized breweries employ significant numbers of workers—in Fiji some 150, Samoa 120, Solomon Islands 99, Tonga 40 and Vanuatu 35.[28] The micro-breweries in Fiji, Palau, and Cook Islands employ only a handful of staff. Fijian and PNG breweries are the largest and would be considered to be the most efficient.

Throughout the Pacific island countries, there is diversity of the extent to which imported beers are allowed to compete with domestically produced beer, via the structure of import and excise duties. Fiji, Samoa and PNG producers virtually supply their entire markets while Tonga has around 85 per cent of its own market. The major Vanuatu brewery supplies only half of the domestic beer market, for a number of reasons.[29] The micro-breweries in Palau and Cook Islands have a minor share of the domestic market for beer (around 5 per cent), reflecting the relatively low duties charged on imported beer and their problems in maintaining quality.

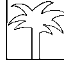
In the brewery industry, the universal free market trend has been for economies of scale to prevail and small regional breweries and micro-breweries to succumb to the large multinationals, with the minor (in terms of market share) exception of 'boutique' breweries. Were there to be completely free trade in beer products amongst the PICTA countries, it is quite likely that the beers from Fiji, Papua New Guinea, Solomon Islands, and to a lesser extent Samoa, would tend to displace the beers from the smaller breweries in Vanuatu, Tonga, Palau and Cook Islands. Were the Pacific island countries to maintain significant import duty protection against imported beers from non-PICTA countries—and this cannot be taken for granted as several Pacific island governments may wish to preserve consumer choice—then in a number of non-beer-producing countries (such as Kiribati), there is likely to be replacement of Australian and New Zealand beer products by exports from Papua New Guinea, Fiji and Samoa.

However, the outcome in terms of brands may be different, given that an Australian company has controlling interest in the Fiji brewery, and through it, of the Samoan brewery. Fiji beers are not aggressively marketed in Kiribati, and Samoan beers are not aggressively marketed in Cook Islands, despite demand. Part of the explanation is the controlling interest of the Australian Fosters group in Carlton Brewery Fiji Limited (and Samoa Brewery Limited).

Amongst the Fosters Group's four divisions are Carlton and United Breweries (CUB) and Fosters Brewing International (which manages Fosters Lager and the breweries in Fiji and Samoa). The Fosters Group and CUB exports Australian beers (mainly the Fosters and VB brands) to the Pacific island countries, and derives all the profits from these sales. Owning only part of the shares of Carlton Brewery Fiji Limited and Samoa Brewery Limited, the sale of Pacific island beers is unlikely to generate the same level of profit per litre of beer sold in these markets for the Fosters group (although the relatively lower labour costs and the higher rates of protection would tend to increase the profitability of Pacific island breweries).[30]

Nevertheless, if PICTA did give protection to PICTA producers, one counter-strategy for Australian beer exporters will be to produce the Australian brands under franchise within the regional trade agreement—probably using Carlton Brewery Fiji Limited (in Fiji) and/or Samoa Brewery Limited (in Samoa) (such as Fosters and VB). The end result would still be that PICTA trade would lead to an increase in output and employment in the Pacific island beer industries in the short to medium term.

However, if PACER were to lead to the removal of duties against Australian and New Zealand exports, it is unlikely that the metropolitan owners of Carlton Brewery Fiji



Limited and Samoa Brewery Limited would wish these factories or unique local brands to continue. Fosters generates around US$5 billion in total annual sales (with sales growing by more than 40 per cent in the past five years) and has brewing operations in Australia, Vietnam, India and China.[31] The Fiji and Samoa breweries are therefore of relatively minor consequence in Fosters' global operations (on the Fosters' website, there is no mention of the Fiji Bitter or Vailima brands). Most of the Pacific island beers would be replaced by the metropolitan beers from Australia and New Zealand, and the Pacific island breweries would close down.[32] There would be a corresponding loss of employment, larger even than the level of employment existing before the PICTA-induced trade.[33]

From the Pacific island governments' revenue point of view, the PACER developments may even pose financial advantages. Given the lower unit costs of metropolitan alcohol products, Pacific island governments may well be able to raise higher fiscal and import duty revenues than would be possible from the domestic production. However, given the importance of employment for Pacific island governments, the job losses would strongly mitigate against the implementation of PACER, despite the wider national benefits promised. Rather than being a 'stepping stone', PICTA may be characterised as yet another stumbling block to full international trade deregulation.

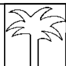
The 'rum' case of Fiji Bounty Rum

Another product in which paradoxical situations may be thrown up by PICTA and the dominance of Pacific island markets by a multinational is rum. For developing economies attempting to export manufactured items, it is extremely difficult at the best of times to find a product that is internationally competitive in price and quality. This is certainly not the case with one of Fiji's spirit products, rum,[34] produced by South Pacific Distillery Limited. The majority shareholder of South Pacific Distillery Limited is Carlton Brewery Fiji Limited, which is controlled by CUB (Australia)/Fosters International.

South Pacific Distillery Limited has been exporting rum (to the Pacific island countries and Australia and New Zealand), but an increasingly large proportion is exported as bulk rum, not bottled brand-name rums. The relative lack of success of alcohol exports to the Pacific island countries is an interesting and complex issue involving a range of possible factors.

The unit cost issue has to be an important factor. The metropolitan products generally tend to have lower unit costs (because of economies of scale). South Pacific Distillery Limited would also face double costs in the transport of bottles. Empty bottles have to be imported from New Zealand, bottled with Fiji spirits, and then re-exported. There is currently no recycling of bottles. However, the financial interests of the parent company, Fosters/CUB, would also seem to be relevant, given that South Pacific Distillery Limited has produced international award-winning rums which can clearly be marketed at the upper end of the rum market.

South Pacific Distillery Limited's Bounty Rum compares favourably with other international rum brands such as Coruba. Its Bounty Dark Rum won gold medals in 1983 and 1995 in the International Wine and Spirits Competition. In 1997, it won a gold medal in the Monde Selection organised by the International Institute for Quality Selection, in Brussels. In the same competition in 1999, South Pacific Distillery Limited's Bounty Millennium Black Label Rum was awarded the Grand Gold Medal. Again, in 2002, its White Rum won a silver medal. The number of medals won by South



Pacific Distillery Limited rum products is only limited by the number of times it has entered competitions and, strangely enough, it has not entered very often.[35] The cost of entering a product would seem to be low (South Pacific Distillery Limited management gave a rough figure of F$1,000 per product), compared to the considerable marketing benefits to be obtained if a product wins medals.

Indeed, it would seem that a private Australian company last year imported bulk Bounty Rum from Fiji, entered the Fiji product in international competitions under its own brand name,[36] and won 20 per cent of all the rum prizes (including 2 golds and 3 silvers) in the International Wine and Spirits Competition in London, as well as the Grand Trophy for the Best Rum in the competition.

South Pacific Distillery Limited's Bounty Rum does not receive enthusiastic support from Fosters/CUB. First, a CUB subsidiary (The Continental Spirits Company) imports, bottles and sells Jamaican rum under its own brands (for example, 'Captain Morgan'). Second, CUB has interests in other brands, such as Bundaberg Rum, which may be more profitable to market and sell than Bounty Rum. Third, with Carlton Brewery Fiji Limited marketing policies effectively under the control of Fosters/CUB, it is possible that the superior profitability for Fosters/CUB in selling Australian products to Pacific island countries, may be an equally relevant factor in the reluctance to push Fiji spirit products in the Pacific island markets. Carlton Brewery Fiji Limited handles the marketing of its Australian parent products in the Pacific, although there is not a pro-rata sharing of the resulting profits. Fiji rum also faces an Australian customs barrier in that it cannot be exported to Australia unless it is more than two years old. Some Australian rums are sold in Australia well short of this minimum maturity period.[37]

While South Pacific Distillery Limited is not necessarily internationally competitive as a producer of pure alcohol[38], it would seem that it has ample scope to expand production of its unique quality rum products. The rum products are clearly of international quality and competitiveness, and there does not seem to be any limitation on the supply of the major input (molasses), which it obtains at a reasonable cost.[39] The major weakness seems to be the failure of the dominant shareholder to encourage South Pacific Distillery Limited to engage in aggressive marketing and to increase production accordingly.

While reference has been made to alcohol and tobacco industries, similar arguments may be made to virtually all the domestic manufacturing products capable of being encouraged through PICTA.

Weaknesses in ACP negotiation strategy over EPAs and trade policy

The weakness in the overall trade policy of the Pacific ACP states may be seen in a specific weakness in the EPA negotiation strategy: that relating to additional resources requested from the European Union because of the likely losses in Pacific ACP governments' revenue resulting from the likely significant reduction in tariffs. While the fiscal costs are certainly likely to be borne by the Pacific ACP countries, the benefits of the tariff reductions will be enjoyed not by the European Union but by their major trading partners, Australia and New Zealand.

For some of the Pacific island countries, trade liberalisation and integration into the global economy has been a stated government policy, as a desirable development policy on its own merits. However, all Pacific countries are concerned that trade liberalisation through the EPAs

with the European Union may require Pacific island countries to grant reciprocity in tariff reductions, which, through the triggering of PACER, may have significant negative impacts on their fiscal positions. This raises one of the more interesting questions regarding the international trade strategy of the Pacific island countries.

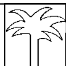
Table 1 indicates that very little of Pacific island country duty revenues will be directly at risk because of reduction of duties on imports from the European Union. The share of the European Union in Pacific island imports is small. It has also been argued that the European Union's share will remain small, despite the reduction in duties. Scollay (2002) suggests that where a trading partner has a large share of the Pacific ACP country's market, this is an indicator of that country's competitiveness in that market, and also an indicator of its ability to increase its market share if it were granted preferential access via a regional trade agreement. The opposite would apply to countries with currently small shares. While this argument is applicable in situations where there is sharp competition between supplying countries, a more relevant issue is transport costs from Europe to the Pacific.

Thus while the EPAs with the Pacific ACP countries will not pose any great danger to fiscal revenues, their triggering of PACER will have important consequences. Duties on Australian and New Zealand imports comprise the largest share for most Pacific island countries (and the United States for the Compact countries). If PACER is triggered and Pacific island countries are required to eliminate duty on 90 per cent of imports from Australia and New Zealand, there would be dramatic reductions of import duty revenues for Pacific island countries.[40] Based on 2003

Table 1 **Share of trading partners in PACP import duty revenues, 2002–03** (per cent)

	Percentage of total import duty revenues collected					
	Fiji	Kiribati	Marshall Islands	Niue	Samoa	Vanuatu
Australian and New Zealand	51	69	8	98	53	60
Australia	42	63	7	-	14	44
New Zealand	9	5	1	98	39	15
European Union	1	-	n.a.	n.a.	5	4
PICTA						
Fiji	n.a.	13	n.a.	n.a.	9	9
Papua New Guinea	n.a.	n.a.	n.a.	n.a.	n.a.	2
United States	1	n.a.	53	n.a.	12	n.a.
Others	47	18	39	2	22	25
All	100	100	100	100	100	100

Note: Figures subject to rounding errors. The data is given on shares of import duty rather than shares of imports by value, as the two can be significantly different for most Pacific island countries.
Source: Narsey, W., 2004. *Trade liberalisation and fiscal reform: towards a negotiating framework for Economic Partnership Agreements with the European Union*, Report for the Forum Secretariat and the Pacific ACP Trade Experts Advisory Group meeting, Suva.



data, total import duty lost would be 75 per cent for Samoa, Vanuatu (50 per cent), Marshall Islands (50 per cent), Kiribati (45 per cent), Niue (43 per cent) and Fiji (38 per cent).

If the Pacific island countries with substantial fisheries resources choose to negotiate separate EPAs with the European Union, the other Pacific ACPs will have very few 'bargaining chips' with which they can leverage additional financial resources from the European Union. The removal or reduction of import tariffs by Pacific island countries will generate few economic benefits for the European Union and there is little incentive for the European Union to increase aid resources to the Pacific for this reason.

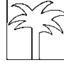
One possible argument for proceeding first with the EPAs is that the Pacific ACP states will be able to win from the European Union major concessions which can be used later as precedents for winning similar concessions from Australia and New Zealand. Thus it is hoped that there will be an asymmetrical liberalisation of tariffs, a generous interpretation of the quantification of 'substantially all trade', and major concessions on Mode 4 (movement of persons) from which Pacific ACP states will pose little threat to EU labour markets, because of distance.

But there are two weaknesses in this argument. First, the European Union is not likely to give the major trading concessions that the Pacific ACP states are looking for—especially since they run the risk of weakening the European Union's bargaining hand with the far more important (for them) larger ACP states and the larger developing economies in general. Second, there is currently little economic incentive for Australia and New Zealand to adopt similar concessionary approaches to the Pacific island countries, given the paramountcy of their trading interests. However, the triggering of PACER could offer the possibility of wider economic *quid pro quo* benefits for Pacific island countries from Australia and New Zealand.

Need for proactive triggering of PACER?

The current advice being offered to Pacific island countries is that in their EPA negotiations with the European Union, they should be careful not to use terminology that may trigger PACER. Thus they should insist on non-reciprocal market access and tariff concessions, while making no reference to free trade agreements or customs unions. This approach is certainly possible. The EPAs are unlikely to take the form of a customs union and may be far from becoming a free trade agreement type of arrangement, especially if the European Union grants the ACP states non-reciprocity. Hence, Article 6 of PACER may not be triggered. Moreover, even if full reciprocity has to be granted and even if Article 6 does trigger negotiations with Australia and New Zealand, there is no time limit to the consultations required, nor any requirement that an agreement must be concluded. So theoretically, Pacific island countries may postpone the activation of any FTA created by PACER, even while negotiating fully reciprocal EPAs with the European Union.

But there is a fundamental flaw in this approach. Should the duty-free access granted to the European Union trigger similar access to Australia and New Zealand through the PACER, the Pacific island countries (other than the Compact territories) will see a severe reduction in their fiscal revenues and there will be a significant expansion of imports from Australia and New Zealand. And yet, while Australia and New Zealand can be expected to enjoy the



lion's share of the benefits of deregulated Pacific island markets, negotiations with them for *quid pro quo* concessions are not on the agenda. Of course, once the EPAs are negotiated the Pacific island countries could negotiate with Australia and New Zealand on trade liberalisation. But by then the Pacific island countries have weakened their negotiating position, given that WTO regulations require that developed countries (the European Union and Australia/New Zealand) not be treated differentially by the developing countries.

It makes more sense, therefore, for Pacific ACPs to negotiate simultaneously with Australia and New Zealand for reciprocal benefits to be derived from the deregulation of Pacific ACP markets. An understanding of the extent of benefits that may be received by the Pacific island countries from Australia and New Zealand and of the extent to which the Pacific island countries can grant tariff concessions to the exports of Australia and New Zealand can then logically feed into the EPA negotiations with the European Union.

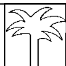
The economic reality is that the Australian and New Zealand economies will, in the long term, be the most important trading partners for the Pacific island countries—in terms of foreign investment, markets for exports of goods and services (such as tourism), suppliers of goods and services, donor assistance, and possibilities for the absorption of skilled and unskilled Pacific island labour. In terms of geopolitical developments, it could be argued that, in the long term, Australia and New Zealand should be the leaders of a 'South Pacific Community' akin to the European Union. Even if Australia and New Zealand have for the time being given up the initiative, it makes sense for PACER to be triggered proactively by the Pacific island countries, as a logical geo-political development that is in the long-term interests of the citizens of the Pacific island countries.

It should be noted that this does not require Pacific island countries to choose between closer relations with Australia and New Zealand on the one hand and the European Union on the other. A closer economic and political relationship with the European Union, as a global super-power, has much to commend it. Not only are there indications that the European Union could rival the United States as a global economic powerhouse within the next two decades, but economic and political relationships with the European Union do not have some of the negatives associated with a close relationship with the United States. For those Pacific island countries whose economies must depend heavily on tourism, close association with the United States could make them targets of terrorist attacks, posing grave threat to their economies.

The PACER provides for annual reviews of the operation of the Agreement and all aspects of trade and economic cooperation among the parties. General reviews of the PACER are to be held at three-yearly intervals. The first such opportunity should be taken by the Pacific island countries to begin negotiations towards a free trade agreement, in return for tangible and more advantageous benefits than are currently being offered under SPARTECA and the bilateral aid programs.

What future economic relationship with Australia and New Zealand?

Discussions on the economic and political integration of the Pacific island countries with Australia and New Zealand have tended to be 'all or nothing' affairs, focusing on the use of a common currency (the Australian dollar) as a necessary condition. Thus de Brouwer (2000) concluded that the independent Pacific states would benefit significantly by



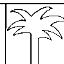
stabilising their economies and policy structures, through the adoption of the Australian dollar. Duncan (2002) reiterated his earlier call that Papua New Guinea, Solomon Islands and all other Pacific countries would benefit from adopting the Australian dollar, thereby removing the key policy instrument which was encouraging undisciplined governments from engaging in deficit financing. Most recently, an Australian Senate Committee Report revived the idea that a Pacific Economic and Political Community would be of benefit to both the Pacific island countries and Australia, while fostering peace and stability in the Pacific.

Chand (2003), on the other hand, while also focusing his discussion on currency integration, acknowledges that currency unification was neither a necessary nor sufficient condition for accelerating Pacific island country development. Without specifying further, he saw 'freer movement in goods, capital, services and labour' accompanied by unification of codes and standards, as ensuring deeper economic integration.

But the discussion on closer economic relations does not need to focus on formal economic and political integration, if the objectives are to foster economic development for Pacific island peoples. It is open to Pacific island countries to use the PACER as a channel for considering new trading relationships (including the reduction of tariffs on Australian and New Zealand exports to the Pacific island countries corresponding to the EPA tariff reductions), which could be reciprocated by Australia and New Zealand in comparable benefits. The new trading arrangements cannot be considered separately from the aid arrangements, nor from the wider economic relationships which can be of benefit to the Pacific island countries, for their sustainable long-term development. Much of what the Pacific island countries could look forward to on the development agenda from the EPAs is equally applicable to what is desired from Australia and New Zealand.

Australia and New Zealand already have sizeable aid programs with the Pacific island countries, although the effectiveness of Australian aid to the Pacific is being called into question. It has been claimed that decades of Australian aid to the Pacific island countries has not resulted in levels of investment and rates of growth that were expected as a result of the aid programs, and that most Pacific island countries are not viable states. There is, of course, interesting and robust debate about these claims applied in a blanket fashion to all the Pacific island countries, without any concrete attempt to examine the track record of Australian and New Zealand aid programs in the Pacific island countries.

What cannot be disputed is that while Australian and New Zealand aid has focused on human resource development in the Pacific, much of the resultant skills have not been retained in their home countries. A study more than a decade ago documented the high proportions of tertiary graduates lost by Fiji, Samoa and Tonga within five years of graduation (Narsey and Morris 1992). Several Pacific island countries (notably Fiji, Samoa, Tonga, Cook Islands and Niue) have contributed substantial portions of their skilled and professional human resources to the economies of Australia and New Zealand through emigration. A low estimate[41] of the monetary value of this annual outflow of human capital, estimated by one study to be F$60 million annually (Reddy, Mohanty and Naidu 2004), outweighs the monetary value of Australian and New Zealand aid to the Pacific (excluding Papua New Guinea). The severe shortage of engineers, doctors, nurses, teachers and skilled administrators



drastically reduces the standard of living in the Pacific island countries, further encouraging internationally marketable persons to emigrate.

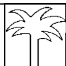
The irony is that the very skills that have been needed to make 'development work' in the Pacific island countries have been sucked out to Australia and New Zealand via their points system of granting permanent resident status. The emigration of these scarce skills is a primary cause of the current backwardness of their home countries. Indeed, many Australian and New Zealand aid programs attempt to fill the gaps with costly technical assistance programs using their own citizens,[42] or foster programs of human development which, given the high rates of emigration, eventually amount to pushing fingers into the perpetually created holes in the dike. It is surprising that recent critics of Australian aid to the Pacific have not dwelled on the role of Australian and New Zealand immigration policy in retarding development in the Pacific island countries.

It is also abundantly clear that where substantial numbers of educated people have been retained in the Pacific island countries, there have not been enough in terms of critical mass, nor trained to become the entrepreneurs who might have been the source of sustained economic growth. The decades of Australian and New Zealand aid have not succeeded in fostering investment and economic growth in the areas of comparative advantage that are perceived by economists to hold the greatest hope for sustainable economic growth—in tourism, fisheries, forestry and minerals.

It is vital therefore that the Pacific island countries examine whether they should be entering into dialogue not only with the European Union over the EPAs but also with Australia and New Zealand on the programs of development cooperation that will result in enhanced levels of investment (both domestic and foreign), higher rates of sustainable economic growth, the retention of skilled persons in the Pacific island countries, and the regulated access of unskilled labour from the Pacific islands to the labour markets of Australia and New Zealand. This does not have to take the form of formal economic and political union. There could be progress on a limited number of key fronts, whose logical consequence in a decade or so would in all probability be the formal union that has been theorised.

Dual citizenship or residence for skilled persons

It is abundantly clear that as long as Pacific island countries continue to suffer serious outflows of skilled and professional people, they will not be able to attain sustainable economic growth, nor provide decent public services to their populations. An enlightened response by Australia and New Zealand to the emigration from the Pacific island countries is the explicit recognition that their Permanent Residence status may be satisfied by residence and work in the Pacific island countries. Many qualified Pacific island citizens may choose to remain working in the Pacific island countries, as long as they have a guaranteed outlet to Australia and New Zealand should political or economic circumstances in the Pacific island countries prove unacceptable. Indeed, the future of children is often the primary driving factor for emigration. A significant number of young Pacific island citizens may be tempted to remain in Pacific island countries while they are single or have young children, but may choose to pursue educational and other long-term interests for their children by movement to Australia and New Zealand in later years. For Australia and New Zealand, this may well prove more economical than providing the more expensive technical assistance using their citizens.



Access of unskilled labour to Australia and New Zealand

The access of unskilled labour from the Pacific islands to the Australian and New Zealand labour markets arouses strange reactions from different quarters. Thus Bedford (2003), noting that successive Australian governments have been very reluctant to allow migration of unskilled and semi-skilled labour from the Pacific, quotes Ware (2003) to the effect that 'now is not the moment' to consider some form of guest-worker scheme for Pacific islanders. He also quotes Helen Hughes as arguing that special exemptions for unskilled (perhaps temporary) Pacific island workers is paternalistic in the extreme. Bedford concluded that 'sustainable development in Melanesia in the twenty-first century, as in Australia and New Zealand, will depend heavily on opportunities for young people to travel overseas for training and employment' (2003:37). It is the latter, however, that Pacific island countries must argue for, not completely freeing up, but in some regulated fashion.

Indeed, a regulated supply of unskilled labour from Pacific island countries to Australia and New Zealand can become a win-win situation. There are many occupations in both countries where the local citizens are reluctant in seeking employment, and Pacific island citizens can and wish to fill the gaps. Given the small sizes of the Pacific island populations, this ensures natural limitations on the numbers of unskilled labour entering the Australian and New Zealand markets. There certainly would not be the uncontrollable 'flood' that one may expect should a similar scheme be instigated with Indonesia, India or Vietnam.

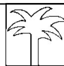
The Pacific island citizens would be all too glad of gainful employment, at wages that are several times those of their home countries. Their home countries would directly benefit through remittances. It may be noted that both the Samoan and Tongan economies are buoyed by significant flows of remittances from their citizens employed abroad. These flows of funds are more significant than the flows of aid, and probably far more productively employed.

There would also be numerous indirect benefits: with the large numbers of currently unemployed youth being able to engage in gainful employment, the Pacific island countries should see reduced social pressure, leading to reduced levels of crime and general lawlessness that currently plague some of the Pacific island countries, thereby improving the investment climate in the Pacific island countries themselves. It should be noted that Cook Islands and Niue, whose citizens are allowed free access to New Zealand, do not have significant incidence of unemployment or crime. They have the enviable problem of trying to repopulate their homeland.

Trade liberalisation in rugby?

Discussions of Pacific comparative advantage in trade seldom focus on one area, which, in the Pacific island countries is not generally considered an economic activity; yet it is 'big business' by any definition in the global world order. I refer here to sporting links with Australia and New Zealand, specifically in Super Twelve rugby.

There is no doubt that Pacific islanders (particularly Fijians, Samoans and Tongans) have great comparative advantage in rugby. The Pacific island stars have taken the Super Twelve competition by storm. Australian and New Zealand talent scouts now annually scour the secondary schools competitions in the Pacific island countries to identify potential stars who could assist their teams to sporting success, and the high financial rewards that go with it. The paradox is that while individual Pacific island players can



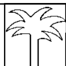
play for the Super Twelve teams, Pacific island teams cannot. Fiji, Samoa and Tonga have for several years expressed the wish to become part of the competition but have been denied entry.

It is ironic that Australia and New Zealand hold themselves up as regional leaders in the liberalisation of their economies. Yet, in their countries there is no free entry and exit, no 'free market' or 'level playing field', in rugby. One of the essential mechanisms of a free market is that unsuccessful firms go out of business, to be replaced by successful ones. This is practised in the English premier football league, for instance, with a significant impact on motivation. At the end of each season, the bottom five teams of the premier league are relegated and the top five of the lower division promoted. By the end of the season, teams in danger of relegation and those with the possibility of promotion achieve pinnacles of competitive effort that do much to give energy and vigour to the league competitions, not to mention the profitability of the clubs, and the pay-packets of the players concerned.

It is unfortunate that it is not difficult to draw comparisons between what is happening currently and the colonial and neo-colonial trade practices by which the developed economies have traditionally discriminated against the exports of developing countries. Historically, raw materials from developing economies were allowed duty-free entry to industrial economy markets. But the moment the developing economies attempted to add value to their raw materials by transforming them into more valuable products (and thereby create more jobs and higher incomes in the colony), higher duties were slapped on them, or a whole range of non-tariff barriers were used to prevent entry. The result was that developing economies ended up largely exporting raw materials (and jobs and incomes) to industrial economies. Currently, to qualify for preferential entry to industrial economy markets (such as under SPARTECA), developing economies have to satisfy stringent minimum value added content criteria via rules of origin (usually requiring 50 per cent of the value-added to originate domestically or in the partner country), which, interestingly, many industrial economy products themselves would never have been able to satisfy.[43]

Compare this with the current international rugby environment faced by Pacific island countries. Australia and New Zealand will admit 'raw materials' (individual players) to their home markets (the Super Twelve competition), but not the value-added products (Pacific island rugby teams). Pacific island rugby unions have struggled for years to enter the Super Twelve competition, and to be given a fair share from the Rugby World Cups, but to no avail.[44] On the contrary, Pacific island countries have not been able to even overcome international club restrictions on their citizens from representing them in the latest rugby World Cup.[45]

Yet entry of even a combined Pacific team to the Super Twelve has great potential for generating employment and incomes in the Pacific island countries. For instance, if the 'home games' were rotated between Fiji, Samoa and Tonga, the events could result in a significant boost for tourism activity for these three countries, both through fans (local and foreign) visiting, as well as appropriate television advertisement and exposure for the domestic tourism industries. Tourism is one of the few industries identified as focused on the comparative advantages of these small, vulnerable island economies, with genuine prospects of lifting the Pacific island countries from their current economic stagnation and poverty. Yet the Pacific island countries do not receive any encouragement in this regard.



Facilitating appropriate investment

The Australian and New Zealand aid programs have focused on creating an enabling environment to encourage and sustain economic growth, and thereby alleviate poverty. Over recent decades, there has been a corresponding focus on improving health and education, and more recently, on improving governance. These are constructive efforts, necessary conditions for economic growth to occur. However, they have proven not to be sufficient conditions for economic growth. The uncomfortable bottom line is that even in the countries with reasonably good education and health systems, and reasonable governance, there has not been a satisfactory record of investment (especially by the private sector), and consequently, the long-term record of economic growth and development has been extremely poor. Only some of this lack of investment may be attributed to political instability in countries such as Fiji and Solomon Islands.

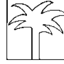
A recent statement by the Australian Minister for Foreign Affairs (Downer 2003) reiterated that their trade policies, in addition to aid policies, were critical in their efforts to assist the economic development of Pacific island countries. However, while both Australia and New Zealand have massive trade surpluses with the Pacific island countries, they have not mounted coordinated efforts at boosting direct investment in the Pacific island countries, either as independent private investment or as joint ventures (with the private sector) in Pacific island areas of comparative advantage. Unfortunately, to compound the problem, Pacific island countries have been ambivalent about foreign investment.

Yet only a dramatic increase in investment in areas of comparative advantage has any prospect of raising the Pacific island countries out of their current economic stagnation. Such investment could address problems such as unsustainable logging in Melanesia, which both Australia and New Zealand have frowned upon. For instance, investment in downstream timber processing and value adding in the Solomon Islands, would not only create long-term jobs and incomes that are WTO-compatible but also serve to slow down rates of harvesting of forests. Without economic growth and internally generated incomes and taxes, there are few alternatives for Pacific island countries such as Solomon Islands to cover their fiscal deficits (which are also complained about by donor countries and international multilateral institutions). Yet there is no mention of encouraging investment in timber processing in the various donor programs that are currently assisting in the economic recovery of Solomon Islands, nor in the other areas of comparative advantage.

The 'Jekyll and Hyde' relationship between Pacific island countries and Australia and New Zealand

Pacific island countries should re-orient their attitudes towards Australia and New Zealand, away from the 'Jekyll and Hyde' relationship that currently exists. While many Pacific island countries and Pacific island regional organisations[46] are almost totally dependent for their recurrent budgets on aid from Australia and New Zealand, there is national resentment when the latter attempt to influence policies in the Pacific island countries.[47] Thus, while national budgets talk of encouraging foreign investment for economic growth, political leaders often condemn foreign investors as economic exploiters, while foreign investment is discouraged in many areas of the domestic economies.

To some extent there are genuine Pacific island country concerns about the loss of national 'sovereignty' and cultural identity.



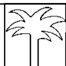
But there are also issues in which the interests of Pacific island leaders and élites do not harmonise with the interests of the ordinary citizens. For instance, a complete economic and political union between the Pacific island countries and Australia and New Zealand is understandably not high on the agenda of Pacific island political leaders—they stand to lose a considerable amount of ministerial discretionary powers (and status) in their economies and societies. On the other hand, the vast majority of ordinary citizens would, if they were asked in a referendum, undoubtedly vote for political and economic union, if that gave them free access to Australia and New Zealand for education, employment and residence. It is unfortunate that Pacific island country stances are largely determined by the élites, not the ordinary people. Even Pacific academic leaders of opinions are critical of integration and globalisation.

Australia and New Zealand likewise should examine whether their foreign policy can move towards creating a genuine Pacific economic and political community, in which the Pacific island countries can see their large neighbours as genuine 'big brothers', and not as 'Big Brother'. To a large extent, the reactive nature of PACER is an indication of a significant weakness in the ability of Australia and New Zealand to manage proactively and sensitively the evolution of economic and political relationships with the Pacific island countries. Australia and New Zealand may wish to examine a perception amongst trade experts, for instance, that whatever may be the logic of Australian and New Zealand aid to the Pacific island countries, when it comes to trading relationships 'no quarters will be given', no concessions made, unless they result in a net economic gain for Australia and New Zealand.[48]

The current EPA negotiations are an interesting manifestation of the importance that the European Union places on strengthening its trade, investment and aid links with the score or so of small Pacific ACP states. Yet the Pacific island countries' immediate neighbouring super-powers do not see as a priority the inherent international political and economic advantages of having the Pacific island countries under their wings in some kind of a Pacific Economic and Political Community, in which the Pacific island countries could be encouraged to accept through the right mix of incentives. Were such an arrangement a reality, Australia and New Zealand might be able to engage in international fora claiming to speak for 20 or so Pacific island nations whose territories and exclusive economic zones cover a quarter of the world's surface. Currently, Australia and New Zealand seem to have lost the high ground to the European Union.

Conclusions

The regional and international trading agreements that Pacific island countries have signed and are in the process of negotiating present somewhat paradoxical situations. A major trade and aid agreement (Cotonou) encourages the prior establishment of a free trade area amongst the Pacific island countries (PICTA). This free trade agreement presents only limited benefits to the Pacific island countries. In their EPA negotiations with the European Union, the Pacific island countries are arguing for resources additional to those provided by the Cotonou Agreement because of the likely fiscal impacts of the reciprocity in tariff reductions that the EPAs will require. However, the European Union is unlikely to benefit significantly from reductions of duties on their exports. On the other hand, reciprocity granted to the European Union will, if PACER is triggered and taken to its logical conclusion, have to be granted to Australia and New Zealand,



who will thereby be the primary beneficiaries of tariff reductions under the EPAs.

The irony is that any increase in trade, production and employment arising from PICTA may have to be reversed should PACER be implemented. The costs to the Pacific island countries will be substantial, as the bulk of their domestic manufacturing plants will face closure. It makes more sense, therefore, for the Pacific island countries to use the prospect of reducing tariffs to European Union trade not only to leverage development benefits from the European Union but also to negotiate simultaneously with Australia and New Zealand for development benefits, in return for freer trade. PACER ought to be a priority area for Pacific island country trade policy agendas. It is not currently.

Notes

1 While these countries signed the agreement, it did not become binding until they had ratified it.

2 Fiji, Papua New Guinea, Solomon Islands, Tonga, Samoa, Cook Islands, Niue, Nauru and Kiribati have ratified. Vanuatu and Tuvalu have not signed yet, while the three Compact countries have been given a grace period.

3 A case in point is the recent successful World Trade Organization challenge by Australia, Brazil and Thailand of the European Union's preferential price for ACP sugar.

4 If all the signing countries ratify PICTA, it is expected to create a market of some seven million consumers.

5 Some countries have a special relationship with New Zealand (such as Cook Islands and Niue) while others have special links to the United States (the compact states of Palau, Marshall Islands and Federated States of Micronesia).

6 Free trade arrangements are taken to mean 'free trade areas' or customs unions (as defined by GATT Article 24.8).

7 As Pacific island countries currently enjoy duty free (but qualified) entry under SPARTECA, the improvements in access may be through measures such as more lenient rules of origin criteria, assistance with marketing initiatives, and assistance with quarantine obligations.

8 The Cotonou Agreement, successor to the Lomé Convention, was signed in Cotonou (Benin) on 23 June 2000.

9 The extent of disagreement over the modality of proceeding further with the EPA negotiations suggests that the Pacific ACP states are not being treated as genuinely equal partners.

10 The extent of balance achieved in the new arrangements between these two sets of objectives will be an interesting reflection of the degree of 'equality' between the two sets of partners.

11 The negotiations are to take place between September 2002 and December 2007, in two phases.

12 It is quite unclear how the new framework can be simultaneously equivalent to the existing situation and, at the same time, in conformity with WTO rules.

13 Other definitions being suggested are 90 per cent of product lines, or an optimistic hope for an asymmetric liberalisation, with 90 per cent being the average.

14 The World Bank (2002) argues that the PICTA member countries should reduce their external tariffs in order to reduce the costs of trade diversion. However, doing so would also reduce the incentives for domestic PICTA producers to benefit from the enlarged free trade agreement market.

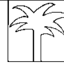
15 The effective rate of protection measures, at world prices, the value added that is protected by the nominal duty.

16 For example, the requirements of building projects for roofing iron or structural steel may be better served by manufacturing plant in the Pacific island countries that are able to respond quickly to specific needs.

17 Informal MSG Trade and Economic Officials Meeting, Forum Secretariat, 5 August 2002.

18 The 11th MSG Trade and Economic Officials Meeting (Port Moresby, 25 October 2002).

19 The minutes of the Meeting concluded that '[t]he above two (2) resolutions were adopted at the 11th MSG Trade and Economic Officials Meeting, subject to the acceptance of the



above resolutions by each respective MSG Member Country'.

[20] With almost all the material inputs necessary for the manufacture of the exercise books being imported, there would be miniscule domestic value adding; thus, the effective rate of protection would be extremely high, with the costs all imposed on the hapless consumers.

[21] The Samoan Government and its Ministry of Trade seem to be an exception in this area.

[22] There were fears that reduction of duties might have a severe negative impact on some governments' excise and custom revenues.

[23] The Agreement also states that the Rules of Origin Committee should ensure that 'if appropriate, they [the rules] conform to the guidelines produced by bodies such as the World Customs Organisation and the World Trade Organization'.

[24] In some countries, such as Fiji, there is a significant informal tobacco industry, consisting of subsistence farmers growing tobacco, drying and forming into 'twist' tobacco—known locally as *sukhi*.

[25] Papua New Guinea has used locally grown tobacco in the past.

[26] Roughly about 1.6 billion sticks of cigarettes in 2002.

[27] Some of the original products manufactured had German, Dutch, Australian and New Zealand origins.

[28] As an indication of its concern over the impact of PICTA, the PNG brewery declined to give details, even of their employment.

[29] Not only is there a strong importer lobby, but there is increasing competition from domestically 'produced' (largely unregulated) spirits and mixed drinks.

[30] The lower unit costs of the metropolitan beer may generate higher profits per litre of beer sold.

[31] In 2003 Fosters claimed to be ranked the number two selling brand in the United Kingdom; number one in London; number seven across Europe; sixth largest imported beer brand in the United States; and the number two beer brand in the Middle East (Fosters Group website).

[32] For a product like beer, which has associations with local tourism industries, it would not be nationally desirable for the domestic beers to become extinct. This would be one of the very few industries that Pacific island countries can protect with some legitimacy, even if the industry may not be as efficient as metropolitan industries.

[33] The lower labour costs of breweries in the Pacific island countries would not be enough to compensate for the economies of scale advantages of the metropolitan breweries.

[34] The arguments below refer only to rum products, not other spirits such as whisky and gin.

[35] A company official strangely responded that they did not need to win medals every year. Wine producers know only too well the boost given to the market value of their products if they win medals at international competitions.

[36] The brand 'Inner Circle' originally used by a CSR subsidiary, is well known in Australia.

[37] Bundaberg Rum is a continuous distillery product saleable within a year.

[38] New Zealand manufactures pure alcohol at less than half the cost of SPDL, as a by-product of the dairy industry.

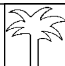
[39] SPDL currently uses less than 5 per cent of the molasses available from Fiji Sugar Corporation.

[40] It is ironic that several studies have argued that it would be to the advantage of Pacific island countries to reduce import duties inilaterally. Unilaterally, few Pacific island governments are convinced of that position.

[41] The calculation by these authors of the value of the human capital being lost uses domestic prices and values for costs of education and health, and Fiji's GDP per capita (as a proxy for output lost through emigration). Even using the same methodology, from the recipient countries' points of view their valuations would be several times these estimates.

[42] One such example was AusAID's Institutional Strengthening Project at the Fiji Bureau of Statistics. A number of key personnel from the Fiji Bureau of Statistics have emigrated to fill important positions in the Australian Bureau of Statistics.

[43] Many industrial economy products are simple transformations and combinations of developing economy inputs.



[44] A minor concession given recently is the playing of a limited number of matches against a combined Pacific islander side.

[45] While the large countries are able to draw on their best players, the small Pacific island countries have their best players embargoed by the clubs they play for.

[46] The one exception is the University of the South Pacific, whose recurrent budget is almost completely funded by the member governments.

[47] A recent case in point was the furore over the appointment of the Secretary General of the Forum Secretariat.

[48] This was the response given to the author when he suggested to a Forum Trade Experts Advisory Group meeting (including experts from Australia, New Zealand and the Commonwealth) that the Pacific island countries should open a negotiating front with Australia and New Zealand simultaneously with the EPA negotiating front with the European Union.

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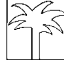

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Acknowledgment

This paper was prepared with the support of the EU-funded Human Resources Development Programme (Project No. 8 ACP RPA 009).