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PACER Plus and its Alternatives: **Which way for trade and development in the Pacific?**



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132 Leicester Street, Carlton, Victoria 3053 Australia
Phone: +61 3 9289 9444 **Fax:** + 61 3 9347 1983
Email: enquire@oxfam.org.au **Website:** www.oxfam.org.au
ABN: 18 055 208 636/CC29173



Level 1, 14 West Street, Newton, Auckland 1145 New Zealand
Phone: +64 9 355 6500 **Fax:** +64 9 355 6505
Email: oxfam@oxfam.org.nz **Website:** www.oxfam.org.nz

PACER Plus and its Alternatives: Which way for trade and development in the Pacific?

Lead author: Nick Braxton

Contributors: Barry Coates, Kelly Dent, May Miller-Dawkins, Jo Pride

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Executive Summary

Negotiations for a new agreement on economic cooperation under the Pacific Agreement on Closer Economic Relations (PACER) between the Pacific Island Countries and Australia and New Zealand are likely to be launched in August 2009. If framed in the right way the outcome could support the Pacific to build on its assets, strengthen its resilience during global economic recession, and accelerate progress towards the Millennium Development Goals. Framed in the wrong way, it could exacerbate the problems of poor economic performance, growing economic hardship and conflict.

Much of the debate around the launch of the negotiations has focused on support or criticism for a standard free trade agreement that is World Trade Organisation compliant. This paper outlines the potential risks, and concludes that the adoption of a standard free trade agreement would entail high costs and generate little benefit for the Pacific. Risks include lost government revenue and consequent reduction in essential government services, regressive measures that harm the poor, a failure to harness the potential benefits from utilising the Pacific's resources, and loss of the Pacific's productive capacities and damage to the welfare of its people.

Both Australia and New Zealand have usefully clarified that they are seeking a different type of agreement, and have undertaken to put development at the core. Against a backdrop of acrimonious Pacific trade negotiations with Europe and an enormous Pacific trade imbalance with Australia and New Zealand, it is clear that a new approach is needed.

This paper analyses some of the alternative trade arrangements and reveals that there are many options available to negotiators. It is entirely possible to construct an economic cooperation agreement that would improve the Pacific's trade prospects while avoiding many of the risks.

One option is to improve on the current non-reciprocal arrangement (the South Pacific Regional Trade and Economic Cooperation Agreement – SPARTECA), to create a '*SPARTECA Plus*' framework. Such a scheme could remove the existing technical barriers to Pacific exports, while retaining the flexibility for Pacific governments to adopt targeted policies to add value to their natural resources, boost exports and better supply their domestic markets. This option would provide the greatest flexibility for each Pacific Island Country to pursue its economic and social objectives. In the case of any challenge under the rules of the World Trade Organisation (which is extremely unlikely), similar terms could be offered through an enhanced Generalised System of Preference (GSP) agreement.

Another option is to overcome some the worst problems associated with a standard free trade agreement by exploiting flexibilities in trade rules to arrive at a '*PACER-lite*' agreement. This option could leave Pacific governments with a greater range of development options if all the flexibilities inherent in the World Trade Organisation's rules on goods trade are utilised and if areas such as services trade and intellectual property rights are not included.

Getting the trade rules right, however, is not even half the battle. The Pacific already has relatively open access to Australian and New Zealand markets. It is the lack of viable supply that is the main constraint that an economic cooperation agreement must address. Therefore, the Pacific must have greatly enhanced productive capacity to be able to add value to its natural resources, boost exports and displace imports. This needs to be the core of any agreement that has development as a primary aim.

Achieving improved productive capacity will, however, require a substantial programme of resources for the Pacific and a realistic timescale. To avoid diverting resources away from current aid priorities, additional funding should be made available to the Pacific, in excess of existing aid commitments. It is crucial that this development component is not regarded as an add-on to a trade agreement. It should be at the core of an economic cooperation agreement.

Designing a developmentally-oriented economic cooperation agreement that includes trade provisions is not an easy task, and there are few, if any, examples that governments can draw on. Nevertheless, there are three crucial elements that are required if these negotiations are to deliver on the stated aim that they will enhance the Pacific's development:

1. Discussions must be broad in scope, including topics that are more obviously trade-related, such as trade facilitation, but going well beyond these to strengthen the Pacific's productive capacity. The starting point should be the identification of strengths and constraints to understand how an agreement can be designed to benefit priority sectors identified by Pacific countries such as small business, agriculture, fisheries, tourism and cultural sectors. Such a new framework will take time to develop and will require capacity at the national and regional levels for the Pacific Islands.
2. Trade officials are not necessarily best placed to understand the full range of issues that are required for a developmentally-oriented economic cooperation agreement. It will need an integrated approach, requiring strong cooperation across government departments. While Australia and New Zealand's decision to assign Pacific Division staff from their Foreign Affairs and Trade ministries to lead the negotiations is a good start, if development is to be the priority, those who know about development should be in the lead. In addition, there is a need for extensive consultation with parliamentarians, traditional leaders, civil society, the private sector and others. Otherwise, the tendency will be to revert to familiar structures, such as a standard free trade agreement, which would risk undermining economic development rather than enhancing it.
3. Since this is primarily not a standard free trade agreement, it will require a different approach. It will be difficult for negotiators who have been schooled in the language and mindset of adversarial trade negotiations to respond to this challenge. Lessons need to be learned from the failure of the Economic Partnership Agreement (EPA) negotiations. Serious consideration should be given to assembling the most appropriate range of skills for negotiating teams within all governments, including Australia and New Zealand. The past adversarial framework for preparatory negotiations must be replaced by a co-operative model of seeking to identify those policies that would realistically enhance the Pacific's development. A continuation of the strong push for an earlier start to negotiations, a short duration, with little regional support and standard trade negotiations approaches will lead to bitterness, poor relationships and an abject failure to meet the worthy aims for an economic cooperation agreement.

There are choices to be made about the future of economic cooperation between the Pacific Island Countries and Australia and New Zealand. Now is the time for fresh thinking and a forward-looking framework.

Introduction

The Pacific Island Countries (PICs) are experiencing difficult economic times. Those countries with high levels of remittances are vulnerable as unemployment increases in the developed world; tourism is being hit by a combination of recession and swine flu; demand for exports is falling; and international credit is tight and expensive. Pacific countries are also contending with stubbornly high food prices in the wake of sharp price rises last year and the growing costs of climate change, which is impacting agriculture and the safety of vulnerable communities. Economic development is a priority for the Pacific and an essential foundation for progressing towards the targets embodied in the Millennium Development Goals. As close neighbours, donors and major trading partners, Australia and New Zealand have a crucial role to play.

Forum Trade Ministers have agreed to recommend to Leaders that negotiations should commence on an economic cooperation agreement between the PICs and Australia and New Zealand. Such an agreement would present the Pacific with difficult choices. All countries have, to various degrees, opened up their economies to world trade and investment, either unilaterally, or as a result of engagement with regional and global liberalisation processes. However, negotiations with Australia and New Zealand could result in a document that eclipses all previous initiatives in terms of its scope and impact, as the two countries are by far the most important trading partners for the majority of the PICs. Many of the previous moves to liberalise trade that have been undertaken by the Pacific are non-binding and reversible, whereas any agreement with Australia and New Zealand is likely to be binding and enforceable. Decisions made in the course of the coming negotiations will affect generations to come.

The choice facing the PICs is not a black or white one between opening their economies fully to Australia and New Zealand as a step towards “engaging in the global economy”, or retreating from the challenge that the global economy represents. Rather, the PICs have a wide range of options open to them, both on the technical level of trade rules and on the strategic level of how those rules can be used in the pursuit of each PIC’s economic and social goals.

Key to an outcome that will be of genuine benefit to the PICs will be the extent to which PIC development goals are reflected in any final agreement, rather than subordinated to it. Trading arrangements should enable the Pacific to make the most of the region’s strengths, and avoid closing down development options that the Pacific is likely to need in order to build strong and viable economies for future generations.

This paper starts with a description of current trade arrangements, showing the complexity arising from multiple overlapping agreements and ongoing negotiations. The second section provides an overview of the Pacific’s trading patterns, highlighting the massive imbalance in trade flows between the Pacific and Australia and New Zealand. The third section then looks at the likely impacts of a standard free trade agreement (FTA), demonstrating that the Pacific has little to gain beyond the current duty-free access to Australian and New Zealand markets that they already enjoy. However, the PICs face serious risks from an FTA, both in terms of short term transition costs and long-term constraints on their development options.

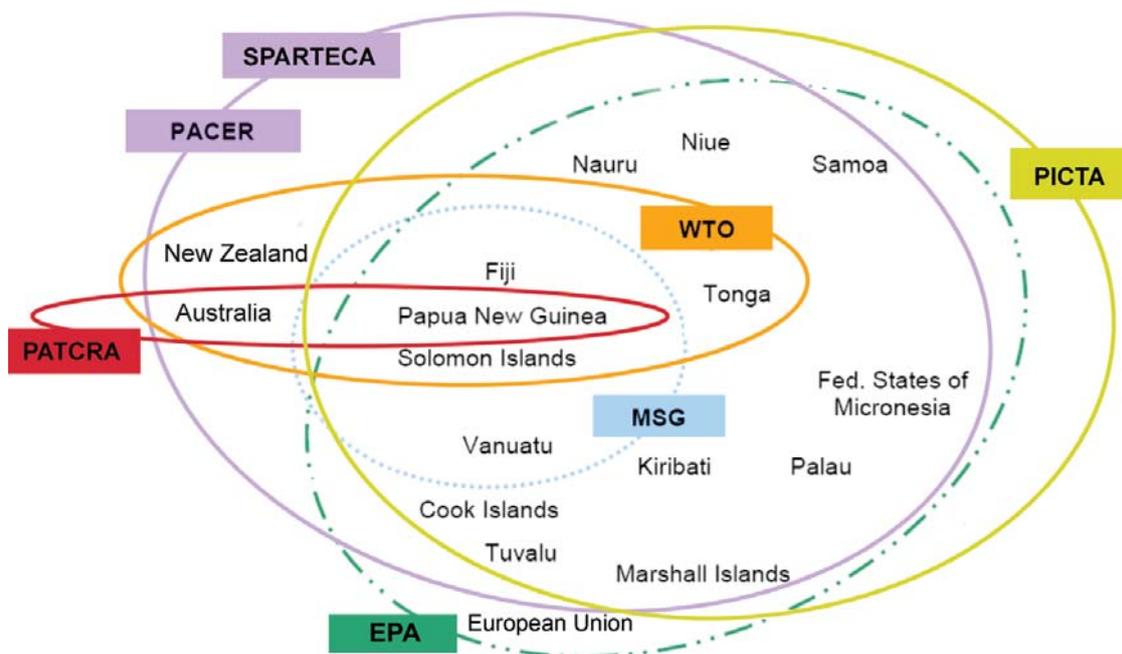
Section four is the heart of the paper. It outlines the alternative forms that this economic cooperation agreement could take. It notes the statements, made by both the New Zealand and Australian governments, that the aim is not a standard FTA, but an economic cooperation agreement that prioritises the Pacific’s development. It reveals that there are a wide range of potential forms for trading arrangements, and scope for the inclusion of a strong development component that would enable the Pacific to address the real challenges for enhanced economic development – building its capabilities to significantly increase its production for the export and domestic markets.

The paper concludes that a developmentally-oriented economic cooperation agreement is both feasible and could contribute to the Pacific’s development. However, it would represent a radical departure from the standard FTA. Therefore, it is essential that the PICs are provided with the time and the capacity, both nationally and regionally, to be able to consult widely, to analyse the real constraints to economic development and decide how an agreement with Australia and New Zealand could help overcome them.

1. Current trading arrangements

As can be seen from the graphic below, PICs are already involved in a significant array of overlapping formal trading agreements, from membership of the World Trade Organisation (WTO), to a regional trade agreement involving only the PICs, to negotiations for an agreement with the European Union (EU).

Trade agreements involving PICs - current and under negotiation



- PICTA:** Pacific Island Countries Trade Agreement (in force since 2003)
- PACER:** Pacific Agreement on Closer Economic Relations (2001)
- EPA:** Economic Partnership Agreement (under negotiation)
- SPARTECA:** South Pacific Regional Trade and Economic Cooperation Agreement (1981)
- PATCRA:** Papua New Guinea-Australia Trade and Commercial Relations Agreement (1976, revised 1992)
- MSG:** Melanesian Spearhead Group (1994, Fiji joined 1998)
- WTO:** World Trade Organisation (Australia, NZ 1995; Fiji, PNG, Solomons 1996; Tonga 2007; Samoa and Vanuatu negotiating entry)

The status quo - SPARTECA

Trade between the PICs and Australia and New Zealand is currently regulated by SPARTECA. Signed in 1981, SPARTECA allows most Pacific exports duty-free access to the Australian and New Zealand markets, and does not require the same treatment for Australian and New Zealand products in return. As noted in the preamble to the agreement, it was framed "Taking into account the limited industrial potential of Forum Island countries vis-a-vis other developing countries" and "Mindful of the differing economic potential of Forum Island countries and the special development problems of the Smaller Forum Island countries".¹ In other words, Australia and

¹ SPARTECA, preamble.

New Zealand recognised the special circumstances of the newly independent PICs, including their size, distance from markets and environmental vulnerability, and aimed to provide favourable terms for their exports.

Trade between the Islands - PICTA

From the mid- to late-1980s Australia and New Zealand have energetically pursued a policy of trade liberalisation, and have increasingly argued that the PICs should follow their lead. Mindful of the enormous differences between the circumstances of the PICs and their wealthier neighbours, Pacific governments have been generally reluctant to rush into wholesale liberalisation. Rather than embark on liberalising trade with Australia and New Zealand, in 2001 the PICs agreed to work on liberalising inter-island trade through PICTA, in force since 2003. The agreement mandates a reduction in PIC tariffs to zero over a period of eight years for developing countries and ten years for least developed countries and small island states, with each country also submitting a list of “sensitive” products on which tariffs would not be fully phased out for 14 years. The timeline for reductions in tariffs subsequently slipped, with initial reductions not beginning until 2007. The agreement includes only the Island members of the Pacific Islands Forum, not Australia and New Zealand. In 2008 negotiations began on including trade in services in the PICTA agreement.

There is also a sub-regional agreement between the Melanesian members called the Melanesian Spearhead Group (MSG) that covers a limited range of trade in goods.²

Including Australia and New Zealand - PACER

Although PICTA does not include Australia and New Zealand, PACER, signed at the same time, sets out the conditions under which “the Parties will enter into negotiations with a view to establishing reciprocal free trade arrangements between the Forum Island Countries and Australia and New Zealand.”³ The PICTA agreement is thus often referred to as a “stepping-stone” agreement to reducing tariffs to developed-country trading partners, especially Australia and New Zealand. The PACER agreement is not a trade agreement in itself, but contains a “trigger” clause that requires the PICs to consult with Australia and New Zealand with a view to negotiating a free trade agreement should they commence “formal negotiations for free trade arrangements which would include one or more developed non-Forum country”, or if formal negotiations fail, by 2011 at the latest. The PACER agreement also includes a commitment from Australia and New Zealand to assist the PICs with improving trade facilitation, for instance by helping to improve customs procedures.

In addition, Australia and Papua New Guinea already have a trade agreement covering goods trade (PATCRA) that provides largely duty-free access for Papua New Guinean goods but is not fully reciprocal.⁴

Since 2008 there have been a series of “informal” consultations under PACER, leading to the region’s trade ministers announcing in June 2009 that they would recommend to their leaders that formal negotiations under PACER should commence after the 2009 Leaders’ Forum in August.

² Members are Fiji, Papua New Guinea, Solomon Islands and Vanuatu

³ PACER article 5.

⁴ The original PATCRA was signed in 1976, shortly after Papua New Guinea’s declaration of independence. The current agreement (PATCRA II) was signed in 1991.

Outside the Region – the EPA

The PACER Agreement was framed in the knowledge that the PICs were about to undertake negotiations with the European Union for a free trade agreement. Like Australia and New Zealand, Europe had historically provided largely duty-free access for Pacific exports, on a non-reciprocal basis, along with exports from the other members of the Africa, Caribbean and Pacific (ACP) group. However, this access (enshrined in the Lomé conventions) had been challenged as being incompatible with WTO rules because it unfairly discriminated against developing countries not included in the group, such as Asian and Latin American countries. The European Union agreed to scrap the historical duty-free access by December 2007 and negotiate *reciprocal* free trade agreements that adhered to WTO rules – the EPAs. This commitment was included in the Lomé convention's successor, the Cotonou Agreement.

The EPAs were billed as true partnerships that would be consistent with the Cotonou Agreement's aim of "reducing and eventually eradicating poverty consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy."⁵ Europe's negotiators consistently argued that the EPAs would "establish a new type of trading relationship between the EU and the ACP countries based on a partnership for development" and that Europe had "no offensive interests".⁶ It is worth noting that the Commissioner for Trade, rather than for Development, led the negotiations.

Lead negotiator for the Pacific, Hans-Joachim Keil of Samoa, argued that Europe's tactics in the talks amounted to the repetition of "rigid red lines and inflexible positions that do not reflect any genuine willingness to think creatively and arrive at a mutually acceptable solution that addresses the unique needs and circumstances" of the Pacific region.⁷ The acrimonious negotiations resulted in Fiji and Papua New Guinea breaking from the rest of the region and initialling "interim" EPAs covering goods only, to ensure that their exports, particularly sugar and canned fish, would not be hit with industry-destroying European import tariffs. Negotiations for a region-wide EPA are ongoing. A similar story occurred in the four African regions also negotiating with the EU, with only the Caribbean grouping signing a full regional EPA (with the exception of Haiti).

The Pacific EPA negotiations form an important part of the context for PACER Plus. Australia's Parliamentary Secretary for Pacific Island Affairs, Duncan Kerr, has said that the aim is to "secure greater regional economic integration in a way that promotes the sustainable economic development of Pacific Island countries and aids their gradual and progressive integration into the international economy."⁸ It should be remembered, however, that the PACER agreement was also framed to protect Australian and New Zealand interests, as evidenced by statements on PACER from (then) New Zealand Trade Minister Phil Goff in 2007:

This [PACER] ensures that New Zealand, which already allows tariff-free entry to goods produced in the Pacific Islands, is not disadvantaged by preferential access to Pacific markets being given to European countries.⁹

The sentiment was echoed by (then) Australian Trade Minister Warren Truss:

It's obviously in Australia and New Zealand's interest that any new deal that the South Pacific countries may do with the European Union doesn't disadvantage Australian exporters into those countries.¹⁰

⁵ The Cotonou Agreement, Article 34.1.

⁶ Michel, Louis, European Commissioner for Development and Humanitarian Aid, *Economic Partnership Agreements: Drivers of Development*, European Commission, undated, pp.14, 19. Available at http://ec.europa.eu/development/icenter/repository/EPA_louis_michel_en.pdf accessed 09/06/2009.

⁷ Keil, Hans-Joachim cited in David Cronin, "Trade: Poor Face up to EU Arm-twisting," *Terraviva Europe: The European Edition of the IPS Daily Journal*, March 2007. 14/03/2007, <http://www.ipsterraviva.net/Europe/article.aspx?id=4509>, accessed 09/06/2009.

⁸ Kerr, Duncan, "Address to the European Australian Business Council Policy Forum", Sydney, 6 April 2009). Available at http://www.foreignminister.gov.au/parlsec/speeches/2009/090406_eabc.html accessed 09/06/2009

⁹ Goff, Hon Phil "Preliminary Discussions on Pacific Trade Agreement", Press Release, 12 June 2007.

¹⁰ Radio Australia, "Australia seeks equal trade rights in South Pacific," 13 June 2007.

The incoming New Zealand government has indicated in a cabinet paper that it wishes to take a different approach from the “increasingly ‘purist’ trade policy agenda [that] has emerged over recent years”.¹¹ This apparent willingness to extend the agreement beyond the standard free trade agreement has been reflected in the use of the term ‘PACER Plus’ to denote the inclusion in the agreement of other development issues, such as seasonal labour, rather than the ‘Plus’ simply referring to a free trade agreement.

However, putting this aim into practice and learning from the fractious EPA negotiations will require a change in the attitude of negotiators on both sides of the Tasman. It will also require flexibility. Australia and New Zealand are unlikely to be willing to sign an agreement that puts their exporters at a disadvantage compared to the EU. This was clearly articulated in the New Zealand cabinet paper that stated “There is a bottom line here: neither we nor the Australians could ever accept that our exporters were placed at a relative disadvantage to any other third party’s exporters.”¹²

Pacific leaders and negotiators have therefore been keenly aware that any agreement with the EU will be the starting point for negotiations with Australia and New Zealand, so any concessions given to the EU will be demanded by Australia and New Zealand, the region’s most important trading partners. There is potentially a ratcheting effect in operation: the interim EPAs contain a Most Favoured Nation (MFN) clause, requiring the PICs to extend to the EU any more favourable terms offered to Australia and New Zealand (although this is negated if there are additional benefits to the Pacific). Any future trade agreements negotiated by the PICs are also very likely to be subject to MFN clauses, meaning that successive negotiations may further open Pacific economies to trading partners.

The Global Economic Crisis

The current global economic crisis puts these negotiations into even sharper relief. The world economy as a whole is forecast to contract for the first time since the Second World War. Current projections are that this crisis could increase world unemployment by up to 59 million people and poverty by 49 million people.¹³ Countries are most exposed to the impacts when they are more highly integrated into the global economy, have high rates of poverty and are now facing declining growth.¹⁴ Economic growth across the Pacific region in 2008 hit a historical high of 5.1%. This is forecast to slow to 3.1% in 2009 with larger than expected contractions in Gross Domestic Product in Fiji and Samoa and conditions deteriorating in the Solomon Islands.¹⁵

The PICs, to varying degrees, are vulnerable to downturns in demand for commodities, tourist numbers, remittance flows and income from tariffs as a result of reduced demand. In the Solomon Islands, for instance, the decreased demand for timber, combined with the depletion of forests, is contributing to a rapid decline in income and potential balance of payments crisis. The Asian Development Bank (ADB) predicts further impacts in the Pacific region in 2009-2010.¹⁶

In part, the Pacific Islands have been cushioned by their lack of wholesale integration into the global economy and it seems likely that an FTA will make the region less resilient to shocks such as the current crisis. A free trade agreement could increase the potential for the transmission of shocks in the future by reducing the policy options of PIC governments, removing a key source of revenue from tariffs, and making economies more vulnerable to transmission channels. A time of uncertainty, when cracks are appearing in the global economic system, necessitates negotiations that are cautious and put sustainable development at their core.

¹¹ New Zealand Cabinet “Minute of Decision” CAB Min (09) 13/3B para 17, April 2009.

¹² Ibid. para 19.

¹³ International Labour Organisation, *Global Employment Trends Update, May 2009*, Geneva, 2009. World Bank, *Swimming Against the Tide: How developing countries are coping with the global crisis*, 2009, p9.

¹⁴ World Bank *Policy Note: The Global Economic Crisis: Assessing Vulnerability through a Poverty Lense*, 2009. <http://siteresources.worldbank.org/NEWS/Resources/WBGVulnerableCountriesBrief.pdf>

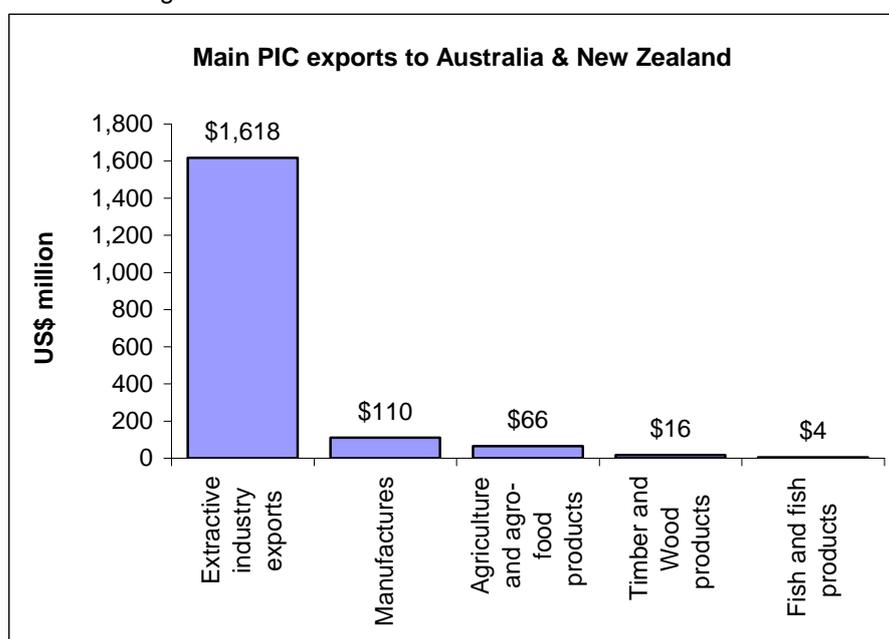
¹⁵ Asian Development Bank, *Pacific Economic Monitor, May 2009*, Mandaluyong City, 2009.

¹⁶ Ibid.

2. Current Trade

Despite favourable trading arrangements under SPARTECA, the PICs have been unable to make the most of access to the Australian and New Zealand markets. By far the largest PIC exports to their two neighbours are from the extraction of Papua New Guinean oil and gold. With these two items excluded, PIC imports from Australia and New Zealand (US\$1,905 million) far outweigh exports (US\$332 million) by a factor of nearly six to one.¹⁷ This is of particular concern given that Australia and New Zealand are the most important trading partners for the region. A 2007 study by Nathan Associates commissioned by the Pacific Islands Forum Secretariat found that, for 10 of the 14 PICs, either Australia or New Zealand was the primary source of imports.¹⁸

The report found that PIC exports to Australia and New Zealand were “narrow and limited to a few key product areas”, and dominated by crude oil and gold exports from PNG.¹⁹ It also notes that “limitations within many FICs [Forum Island Countries] make it improbable that trade alone will result in achieving the objectives of a PACER-Plus agreement. PACER-Plus must be more than a trade agreement.”²⁰



Data Source: Nathan Associates 2007

It is particularly striking that so few agricultural products are exported to Australia and New Zealand from the PICs, given the predominance of agriculture for subsistence and cash income in many of the PICs, and the comparative advantage of climate vis-à-vis Australia and New Zealand. The dominance of extractive industry exports further highlights the weak links between the productive sectors in most PICs and the region's export profile.

¹⁷ Australian Government: Department of Foreign Affairs and Trade, *Composition of Trade: Australia 2007-8*, 2008, p.48. Statistics New Zealand *Global New Zealand International Trade, Investment and Travel Profile: June 2008*, 2008, p.15. For more detailed analysis of current trade see annex 1.

¹⁸ Nathan Associates Inc, *Pacific Regional Trade and Economic Cooperation: Joint Baseline and Gap Analysis*, Pacific Islands Forum Secretariat, Suva, 2007, p.6.

¹⁹ *Ibid.*, p.5.

²⁰ *Ibid.*, p.77.

A variety of factors have been blamed for the difficulties the PICs have had in leveraging access to the Australian and New Zealand markets into significant export returns. These range from technical issues that could be resolved in a new or revised trade agreement (such as rules of origin, discussed later) to more substantial issues, such as distance from markets, poor transport and other infrastructure, a lack of economies of scale, limited skills and experience in most manufacturing and services industries, a lack of existing supplier base, and so on. These more substantive supply constraints will not be resolved through a traditional free trade agreement, but will need to be tackled if trade with Australia and New Zealand is to provide significant benefits for the Pacific.

Australia and New Zealand's exports, by contrast, are broad-based, including processed and unprocessed primary products, as well as a wide range of manufactures (see annex 1 for details). The importance of agricultural exports, particularly in the New Zealand export figures, shows that the challenge for the Pacific is not only in boosting exports, but also increasing production for the domestic market to replace imported goods, such as food, that could be competitively produced in the Pacific.

Services Trade

Some of the imbalance in goods trade is likely to be offset by trade in services, particularly travel and tourism by Australian and New Zealand citizens. While statistics on services trade are limited, it is estimated that around US\$542 million is spent by Australians and New Zealanders visiting the PICs, with roughly half of that going to Fiji.²¹ However, a large proportion of tourism spending "leaks" straight back out because large scale tourism, in particular, is often not closely linked to the domestic economy, meaning that there is sometimes little value added by (and revenue flowing back to) the local economy.

Tourism is also only one form of services trade (alongside banking and mining services for example), and consequently there are likely to be several PICs that have a negative services balance with Australia and New Zealand. Australian statistics show that Papua New Guinea, for instance, had a US\$120 million deficit in services trade with Australia in 2007/8.²²

Although tourism helps to offset some of the goods trade imbalance, there is still a very large gap between PIC exports to Australia and New Zealand and their imports, even when services trade is included in the ledger. The figures highlight that many PIC economies are both struggling to export *and* having difficulty in competing with imports as well as failing to sufficiently gain local benefits from the tourism industry.

3. Likely implications of a traditional FTA

The PACER agreement stipulates that "the Parties will enter into negotiations with a view to establishing reciprocal free trade arrangements between the Forum Island Countries and Australia and New Zealand."²³ With negotiations not yet formally launched it is obviously not possible to predict exactly what any final agreement might look like, nor precisely what its impacts on the Pacific and its people will be. It is also not clear whether the stated ministerial intention of achieving a developmentally-oriented agreement will survive the general tendency towards

²¹ This figure should be taken as indicative only and was arrived at by taking the latest year for which arrival figures were available for each PIC and then multiplying them by the estimated average spend in each PIC for all tourists as calculated in Simon Milne, "The Estimated Impact of Tourism in SPTO Member Countries", 2005, pp 13-14. For non-SPTO member PICs the average tourist spends were estimated by extrapolation from similar member countries. Arrival data taken from Secretariat of the South Pacific's "Pacific Regional Information System (PRISM)" <http://www.spc.int/prism>, accessed 16/07/2009.

²² Department of Foreign Affairs and Trade, *Composition of Trade: Australia 2007-8*, p.67.

²³ PACER, article 5.

adversarial trade negotiations. Therefore, the baseline scenario is that PACER Plus would be negotiated as a WTO-compatible, reciprocal FTA. This section will expand on what such an agreement, if negotiated, might entail for the Pacific.

Trade in Goods

All members of the WTO, when negotiating a trade agreement, must adhere to its rules on bilateral and regional trade agreements. Although the WTO's "enabling clause" recognises that developing countries may need to protect some, or many, sectors of their economies from open competition with other countries' exporters, the clause *does not* extend to regional trade agreements involving developed countries.²⁴ By agreeing to an FTA that includes Australia and New Zealand, all the PICs, even including those that are not WTO members, will, at a minimum, need to adhere to the WTO's GATT Article XXIV that requires the elimination of "substantially all" their import tariffs in a "reasonable" period of time.²⁵

The Potential Impacts of Substantially all Trade

The elimination of "substantially all" tariffs is predicted to increase the amount of trade between the PICs and Australia and New Zealand. An Australian Government-funded report prepared by the Institute for International Trade used a Gravity Model to make some preliminary predictions for PACER Plus. The model predicted that "if both countries in a given country pair are part of this agreement, then bilateral trade will increase by an additional 30 percent than would otherwise be the case."²⁶ This figure at first glance seems encouraging for PICs that wish to increase their level of exports, but the report notes that "we cannot specifically say out of the total increase in the volume of trade, what percentage would in favour of the Pacific Island countries"[sic].²⁷

As Australia and New Zealand already provide mostly duty-free access under SPARTECA, it seems reasonable to assume that most of the increase would be in PIC *imports* (because of the elimination of tariffs), not PIC *exports*. The report provides a caveat that poor data means that its predictions should be taken as indicative only. It assumes that an increase in trade will result in improved welfare but notes that:

there is a higher risk that the net welfare impacts could be small or negative if one regional partner is much larger than the others (terms-of-trade losses) or initial tariffs are high (some of the tariff revenue becomes a 'transfer' to the regional trading partner). Finally, the classic gains from trade (due to specialization) may be reduced for very small economies in an RTA [Regional Trade Agreement] because the opportunity for gain depends on regional liberalisation exposing a complementarity of the partners' economies. There is less prospect of two economies being 'complementary' if one is much smaller than the other, resource-constrained, and geographically isolated.²⁸

These are, of course, exactly the conditions that face most of the PICs.²⁹

²⁴ The "Enabling Clause" (officially the "Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries", adopted in 1979), allows developed countries to provide more favourable treatment to developing countries than they do to each other. It also provides the legal basis for a more flexible approach to regional trade agreements that only involve developing countries.

²⁵ The General Agreement on Tariffs and Trade (GATT) Art XXIV: 8ai, 5c. These rules are open to interpretation as discussed later in the paper under "Alternative Options".

²⁶ Institute for International Trade, *Research Study on the Benefits, Challenges and Ways Forward for PACER Plus*, University of Adelaide, Adelaide, 2008, p.55.

²⁷ *Ibid.*, p.109.

²⁸ *Ibid.*, p.53.

²⁹ For further discussion on the report's analysis of trade flows see Rosenberg, Bill *Notes on Appendix I: A Quantitative Analysis of the Potential Benefit and Cost of a PACER-Plus Agreement*, Pacific Network on Globalisation, Suva, 2009, available at <http://www.pang.org.fj> accessed 30/06/2009.

Consumer gains?

The reason that trade would be likely to increase is that the elimination of PIC tariffs would make Australian and New Zealand exports cheaper than they had been previously. PIC consumers are therefore likely to switch from other import sources, or from domestically produced items, that would now be relatively more expensive. While this represents a gain for Pacific consumers it clearly poses a significant problem for Pacific producers who must either reduce their own costs or go out of business.

Conventional trade theory suggests that this is a good thing, helping to stimulate efficiency and encouraging the parties to the agreement to concentrate on the things that they do best (ie their comparative advantage). However, as noted in the Institute for International Trade study above, it is a poor guide to the situation in most PIC economies where very few of the restrictive assumptions behind trade theory apply in reality. It is likely that, instead of encouraging "efficient resource allocation", dropping tariffs will lead to business closures and a loss of scarce formal employment opportunities, and will inhibit the development of future industries.

Most PIC businesses are already facing severe challenges in trying to compete with their overseas competitors. The situation will become even more difficult when tariff protection is removed. Australian and New Zealand industries have significant advantages over their PIC competitors: while tariffs are now low, they have had a long period of tariff and quota protection to build their capacity and efficiency, they have had far larger domestic markets, and, in the case of agriculture, guaranteed overseas markets for most of the last century, and they have historically had considerable government assistance.³⁰ They have also had a far longer period for industry development and have sophisticated economic infrastructures, well-developed supplier bases and the benefit of a large pool of educated and skilled workers and managers.

By contrast, PIC producers face high cost structures that result from their countries' small size and geographical isolation.³¹ As a result, the cost of overseas-sourced inputs is often high (even for items that are already duty-free), and services such as telephone, electricity and water supply can be expensive and unreliable. Similarly, many PICs lack the basic business infrastructure of competitive suppliers, capital markets and business services, as well as physical infrastructure such as efficient transport links between rural and urban centres. Current efforts to overcome these problems are likely to be hampered if PIC producers are pushed out of their own market. As most exporters focus first on their domestic market before attempting to export, there is a risk that both the short-term welfare of domestic producers and the long-term prospects of establishing export-focused industries will be harmed.

Most PICs also suffer from poor education systems, with many children excluded from formal education, or leaving school with low levels of literacy and numeracy. Even where there has been progress towards universal primary education, many of the children who enrol do not complete primary school (eg. 54% in PNG). Overall, only 33% of children of secondary school age in the Pacific were in secondary school while 6% were still in primary school and 62% were out of school – the highest out of school rate for any region worldwide.³² There are few opportunities for

³⁰ A classic example is the (now) highly competitive New Zealand dairy industry that enjoyed guaranteed and protected access to the British market for most of the 20th century, was the recipient of a range of subsidies, and enjoyed legendary protection of its domestic market. Up until 1972, for instance, the sales of butter-competing margarine were severely limited by the requirement to have a doctor's prescription to buy it. New Zealand is now the world's largest butter exporter as well as accounting for a third of all dairy products traded on world markets, with dairy exports making up 22% of New Zealand's total exports in 2008 (including around US\$40 million to the PICs). Statistics New Zealand *Global New Zealand International Trade, Investment and Travel Profile: June 2008*, p.22, Ministry of Foreign Affairs and Trade, *Pastoral Agriculture: The Competitive Edge: The New Zealand Dairy Industry*, <http://www.maf.govt.nz/mafnet/rural-nz/overview/nzoverview007.htm> (accessed June 9, 2009).

³¹ See, for instance Winters, Alan and Pedro Martins "When Comparative Advantage is not Enough: Business Costs in Small Remote Economies", *World Trade Review*, 3, Cambridge University Press, Cambridge, 2004, pp.347-83.

³² United Nations, *Millennium Development Goals Report 2008*, New York, 2008.

youth to acquire the skills required in order to secure employment in the intensely competitive manufacturing or service sectors, and widespread shortages of managerial skills.

There are many instances, of course, where PIC producers can and do compete with their bigger neighbours, but the wholesale removal of remaining PIC tariffs is likely to result in a large number of business closures. This is likely to be particularly the case for trade-exposed sectors that play a crucial role in the health of the economy and in limiting the growth of imports and trade imbalances.

Producers, of course, are also consumers, so the knock-on social and economic effects are likely to be large, especially in societies where the extended family groupings are supported by a few people in formal employment. Loss of local business production means losses of income, savings, jobs, foreign exchange earnings and erosion of the economic base of the country. The impacts are likely to be different for men and women, with typically a greater proportion of men employed in the formal economy, and a larger proportion of women employed in the informal and subsistence economies. If new formal employment opportunities do arise it is also likely to be more difficult for women to access them due to their social status and an historical legacy of poor access to education.

The effect of locally-owned businesses closing could potentially be compounded by foreign-owned subsidiaries relocating to central hubs, such as Fiji, or to Australia or New Zealand, once tariffs are removed. The tobacco and brewing industries have been identified as particularly vulnerable to centralisation as the removal of tariffs means that there is no incentive for companies to keep several subsidiaries open.³³

Revenue losses

One of the key concerns for PIC governments is the potential loss of government revenue as a result of PACER Plus. As outlined above, Australia or New Zealand is the largest source of imports for the majority of the PICs, so eliminating tariffs on those imports will have a large impact on the income of PIC governments. The Pacific Islands Forum Secretariat commissioned Watergall Consulting to estimate what those losses might be.

Revenue loss as % of total revenue from FTA's*							Error	GDP (mn USD)
	PICTA Only FICS	EPA Only EU	PACER ANZ	MFN US	Total			
Papua New Guinea	0	0	2	0	2	1	4,908	
Fiji	0	0	3	0	3	1	2,711	
Samoa	1	0	12	3	16	5	418	
Vanuatu	2	1	18	0	22	3	358	
Solomon Islands	1	0	4	0	6	2	298	
Federated States Of Micronesia	0	0	1	6	8	1	237	
Cook Islands	2	0	6	0	8	3	176	
Tonga	6	0	19	2	27	10	160	
Palau	0	0	0	4	4	1	142	
Republic of the Marshal Islands	0	0	5	20	25	1	138	
Kiribati	4	0	15	0	19	5	79	
Tuvalu	8	0	5	0	14	4	20	
Niue	0	0	7	0	7	2	12	
Nauru	0	0	6	0	6	1	n.a	

Notes: GDP data for 2005 except for Tuvalu (1998), Niue (2004) and Tonga (2004)

Source: Watergall Consulting Ltd, *Responding to the Revenue Consequences of Trade Reforms in the Forum Island Countries*, (Port Vila: Pacific Islands Forum Secretariat, 2007), p.4.

As can be seen from the table, some of the PICs' projected losses are relatively small, although still significant, while for others the losses are very high. The report notes that the figures are

³³ Narsey, Wadan, "The Inclusion of Alcohol and Tobacco Products in PICTA", Report for Pacific Island Forum Secretariat, Suva, 2003.

actually likely to *under-estimate* the losses as some imports from Australia and New Zealand will become more competitive and will gain market share from tariff-paying import sources (ie trade diversion), thereby increasing the revenue loss.³⁴

It should also be noted that the revenue losses from PACER alone are likely to understate the longer term losses, since the PICs' other trade partners are also likely to call for similar trade agreements. For example, the effect of Most Favoured Nation treatment being offered to the United States (US) will be significant losses of government revenues for PICs that are in association with the US (Palau, Micronesia, the Marshall Islands), as shown in the MFN US column above.

As the table below shows, the projected revenue loss for many of the PICs' governments would equate to a significant proportion of, and in some cases more than, their entire education or health budgets.

Government expenditure as % of total budget

Country	Education	Health	PACER revenue loss
Cook Islands (2005)	13.9%	11.3%	6%
Fiji (2002)	29.4%	14.3%	3%
Kiribati (2005)	14.0%	9.3%	15%
Papua New Guinea (2002)	10.0%	5.7%	2%
Samoa (2005)	22.1%	16.7%	12%
Tonga (2002)	12.9%	13.9%	19%
Vanuatu (2005)	22.7%	11.1%	18%

Source: Azmat Gani, "Health care financing and health outcomes in Pacific Island countries," *Health Policy and Planning* (Oxford University Press) 24, no. 1 (2009): 72-81 citing Asian Development Bank figures.

Any decline in income would reduce investment in social services from a low base. Pacific Island citizens have low levels of access to health and education and only Fiji and the Cook Islands have established social safety nets. If lost revenue translated into decreased spending on health, education and other essential services, then women and children are likely to be disproportionately impacted. Similarly, if services are unaffordable, inaccessible, or both, then it is women who are most often excluded. In the case of women's sexual and reproductive health, a lack of access to affordable health services is likely to mean that the high rates of maternal and infant mortality in some PICs will increase even further.

In order to try to recoup the revenue losses, PICs are likely to introduce new consumption taxes, or raise the rates of existing indirect taxes. These will be levied on locally produced goods as well as on imports. There is therefore likely to be a higher burden of tax on the poor as a result of replacing import tariffs by regressive consumption taxes. Part of the tax burden then shifts from wealthy consumers of imported luxury goods to poorer consumers of locally produced necessities. The result is that some imported items will be cheaper, local products will become more expensive, and the total tax burden on the poor is likely to increase.

It is also likely that less revenue overall will be raised. An International Monetary Fund study has found that developing countries that have introduced or raised consumption taxes in the past

³⁴ Watergall Consulting Ltd, *Responding to the Revenue Consequences of Trade Reforms in the Forum Island Countries*, Pacific Islands Forum Secretariat, Port Vila, 2007, p.4.

have failed to recoup lost tariff revenue, typically only clawing back around 30% of the foregone income from tariff liberalisation.³⁵ As the Nathan Associates study notes

The transition to alternative taxation methods can be difficult for small economies. Trade is a fairly simple item to tax with a limited scope for avoidance. Implementation of alternative tax schemes, such as a General Sales/Value Added Tax (GSVAT), which have a broader scope for avoidance can be challenging for developing countries.³⁶

The likely resulting revenue loss means that it is very difficult to imagine a scenario where several PICs were *not* forced to make serious cuts to their key social services. These cuts, and the impact of regressive taxes, are likely to mean further hardship for those already struggling to raise their families. The burden of adjustment to a standard FTA is therefore likely to fall heavily on the poor, with the wealthier likely to be able to pay for services while the poor are left without. The marginalisation of the poor in this way is not only undesirable from a social perspective, but also inhibits economic growth as it raises further barriers to large numbers of citizens being able to participate in the formal economy.

Agriculture and food security

The recent food crisis has forced developing country governments to re-evaluate their approach to food security. A recent UN report found that

Encouraging these [developing] countries to open up their agricultural sector to competition by binding themselves to low rates of import tariffs may... constitute a serious threat to the right to food particularly if we take into account that food insecurity is mostly concentrated in the rural areas and that a large portion of the population in the countries which are most vulnerable depends on agriculture for their livelihoods: in 2000–2003, 70 per cent of the economically active population was engaged in agriculture in the LDCs, as against 52 per cent in other developing countries, and 3 per cent in the developed countries.³⁷

Statistics for the Pacific suggest that the threats to food security are likely to be at least as severe as outlined above for many countries. In Papua New Guinea, for instance, around 90% of the population lives rurally, with the large majority engaged in agricultural production, both cash-cropping and for subsistence.³⁸ In more urbanised Fiji there is a roughly 50/50 split between rural and urban living and a proportionally lower percentage engaged in agricultural production. Samoa comes somewhere in between, with a roughly 3:1 rural/urban ratio.³⁹ Trade impacts are likely to be greater for women who usually play a greater role in subsistence farming. In Papua New Guinea 74% of employed women and 61% of employed men were engaged in subsistence production at the most recent census, while Vanuatu had an even more dramatic split with 74% of women and 38% of men engaged in subsistence production.⁴⁰

³⁵ Baunsgaard, Thomas and Michael Keen, *Tax Revenue and (or?) Trade Liberalisation*, International Monetary Fund, June 2005, p.22.

³⁶ Nathan Associates, *Pacific Regional Trade and Economic Cooperation*, p.52.

³⁷ De Schutter, Olivier, *Report of the Special Rapporteur on the Right to Food*, Human Rights Council, United Nations, New York, 2009, p.12.

³⁸ United Nations. Economic and Social Commission for Asia and the Pacific. Pacific Operations Centre, *Improving employment opportunities in Pacific Island developing countries*, Suva, 2007, p.4.

³⁹ Ibid.

⁴⁰ PRISM. Papua New Guinea census 2000, Vanuatu 1999.

The UN report goes on to recommend that, amongst other measures, developing countries should:

- Limit excessive reliance on international trade in the pursuit of food security and build capacity to produce the food needed to meet consumption needs, with an emphasis on small-scale farmers
- Maintain the necessary flexibilities and instruments, such as supply management schemes, to insulate domestic markets from the volatility of prices on international markets⁴¹

Under PACER Plus such measures may be difficult or impossible to enact, particularly when the projected fall in government revenue is taken into account.

The impact of the rise in food prices over recent years has illustrated the problem. In most countries, the reliance on imported foods meant a sharp increase in the costs of foods such as rice and bread, and hardship for many families. Oxfam interviews in the Papua New Guinean Highlands revealed that families coped with an almost doubling of prices for rice and other imports by eating less, reducing their intake of protein and taking children out of school (due to their inability to afford school fees).⁴²

The prevalence of natural disasters, particularly cyclones, in the Pacific region also poses a unique challenge as they can completely decimate an island's food production for a season or more. An example is the devastation wrought on Samoa by the 1990 and 1991 cyclones followed in 1993 by the spread of taro leaf blight. Governments are able to use tariffs to help local producers get back into the market once food production has resumed. However, if tariffs are bound at zero under an FTA, governments are unlikely to have this option, potentially resulting in long-term damage to local food production.

Binding import tariffs at zero will also restrict governments' ability to impose barriers to imports of unhealthy foods. The detrimental health impacts of the import of low quality "waste" meat such as mutton flaps, chicken wings and turkey tails are well known.⁴³ However, WTO rules require well-documented and very high standards of proof before a country can ban a particular import. This has meant that WTO members such as Fiji have been unable to impose import bans on health grounds. A traditional FTA is likely to include WTO-style rules in this area, even for non-WTO members.

Multilateral negotiations

Currently, developing-country members of the WTO are permitted to maintain high levels of import tariffs. Even those members who have progressively reduced their applied tariffs are strongly resisting deep cuts in their bound tariffs, on the grounds that they need the policy flexibility to protect their food security, maintain a strong base of small domestic businesses, raise government revenue and promote future economic development. As a result, most developing countries are insisting that they have the right to retain relatively high levels of bound tariffs under the negotiations on Non-Agricultural Market Access in the WTO Doha negotiations. The Small and Vulnerable Economies in the WTO (including those PICs that are WTO members) have negotiated far less stringent requirements for tariff reductions in the negotiations.

A reciprocal FTA that reduced tariffs to zero for PICs would undermine the developing countries' position in these multilateral negotiations. It would be particularly severe for the non-WTO members that would need to transition rapidly from having no WTO obligations to an extreme form of compliance through an FTA. Their obligations for tariff reductions would extend far

⁴¹ De Schutter, *Report of the Special Rapporteur on the right to food*, p.28.

⁴² Oxfam, "Interviews in Simbu and Southern Highlands provinces", August 2008.

⁴³ See for example Evans, Mike, Robert C. Sinclair, Caroline Fusimalohi, Viliami Liava'a, "Globalization, diet, and health: an example from Tonga," *Bulletin of the World Health Organization*, 79, no. 9 Geneva, 2001, pp.856–862.

beyond the commitments of even the large competitive developing countries such as India, China and the Asian tigers, which do not have FTAs with their major trading partners.

Trade in Services

PACER Plus negotiations are very likely to include trade in services. Like trade in goods, trade in services is covered by WTO rules (the General Agreement on Trade in Services, GATS) that must be adhered to by WTO members. GATS is a relatively flexible 'bottom-up' agreement, allowing countries to opt-in for specific types of trade liberalisation in specific sectors. WTO-compatible regional or bilateral trade agreements do not have to include trade in services, but if included there must be "substantial sectoral coverage" for developed-country members. However, this term is not defined. In acknowledgement of the difficulty that developing and least developed countries would have in including such coverage, they are allowed special and differential treatment, although again, exactly what this might mean is not defined. In the Doha round of WTO negotiations least developed countries are not required to make *any* services commitments.

The most important aspects of negotiations under PACER will be what the WTO terms "mode 3"- the "commercial presence" of one country's service supplier in another's territory (ie foreign investment) and "mode 4" – the presence of one country's "natural persons" in another's territory to provide their services (ie working visas). As there are no tariffs on the import of services, the main thrust of a services agreement is to guarantee foreign service suppliers access and non-discrimination, so that when one country's service supplier is in another's territory (be it a company or an individual), that service supplier is treated at least as well as domestic suppliers.

Australia and New Zealand are most interested in pursuing mode 3 access for their companies to Pacific markets, while Pacific negotiators are likely to focus on securing mode 4 access for their workers to Australia and New Zealand. Pacific governments may also be hoping that including services in PACER Plus will encourage private investment from Australia and New Zealand.

Mode 3 access – What might it mean?

The term "services" covers an incredibly wide range of activities, from traditional commercial services such as banking, tourism and mining to public services more typically provided by governments such as healthcare, education and water supply.⁴⁴ Services make up more than 60% of the formal economy for most PICs.⁴⁵

Most countries allow foreign service providers to operate in their territory whether they have a services agreement with the provider's home country or not. When operating in the other's territory, foreign providers are bound by local laws, and the host country's judicial system is the arbiter of any disputes. Services agreements change this by setting rules for how host countries must treat foreign providers and providing a dispute settlement mechanism outside the host country's jurisdiction. Some of the typical clauses that are likely to be subject to negotiation for Pacific Island countries include: host countries must treat foreign companies at least as well as they treat their own, are prohibited from expropriating their assets and must allow repatriation of profits. Also common is a ban on stipulating "performance requirements" for foreign investors, often used by host governments as a way to ensure that foreign investors make a positive contribution to the local economy. They can include stipulations such as requiring employment of a certain percentage of local staff, requiring the use of local products and services, providing specific levels of training or requiring joint venture partnerships with locals.

Agreeing to these conditions as part of a services agreement is likely to significantly constrain PIC governments' options for economic development that benefits their local companies and their people. The most obvious concern is that governments are not allowed to favour their own

⁴⁴ For a full list of services covered by GATS see World Trade Organization, *Services Sectoral Classification List*, Geneva 1991, www.wto.org/english/tratop_e/serv_e/mtn_gns_w_120_e.doc accessed 26/05/2009

⁴⁵ Nathan Associates, *Pacific Regional Trade and Economic Cooperation*, p.17.

companies over foreign ones. This means that fledgling PIC services companies will be required to compete with foreign companies on an ostensibly level playing field. This is likely to prove very difficult for many, as they have not had the advantage of being sheltered from foreign competition in their early stages, nor have they had access to large markets, government support or access to low cost finance. The challenge for small domestic companies is exacerbated by the difficulty of regulating international companies to ensure that they do not use practices such as predatory pricing to force local competitors out of business.

Signing a GATS-style services agreement is likely to reduce governments' ability to introduce new regulations, or revise existing ones, that might impact on foreign services companies. Regulations can be challenged as trade restrictive or "more burdensome than necessary", even if they are non-discriminatory with regard to foreign companies. This could affect areas as diverse as reforming customary land ownership laws (a request that the EU made of some PIC members of the WTO), environmental protection, education and healthcare provision and so on. This could be particularly problematic where foreign providers end up with monopolies, a scenario that is especially likely in PICs with very small markets.

Opening up essential services such as healthcare, education, water provision and so on carries particular risks as private providers will be tempted to "cherry pick" the most lucrative markets and neglect poorer and more remote communities, with a particular impact on women who usually bear caring and reproductive tasks in the family. Even where, in negotiations, governments manage to retain the right to require private companies to provide service to all communities (ie. universal service), this can be administratively difficult to enforce, requiring well-developed and efficient government agencies.

There is little argument that foreign investment can have a positive role to play in improving the efficiency of PIC services sectors. Foreign investment, when managed properly, can be a real boon: providing jobs, transferring knowledge and skills, creating demand for local produce and providing scarce capital. However, a GATS-type agreement is likely to reduce the ability of PIC governments to harness that investment to the benefit of the PICs as well as foreign investors.

What's more, there is little evidence that making GATS-type commitments actually increases foreign investment. The World Bank has argued (in the context of investment treaties) that "creating new protections does not seem to be strongly associated with increased investment flows", while the United Nations Conference on Trade and Development has found that "there is no empirical evidence to link any significant increase in FDI [foreign direct investment] flows to developing countries with the conclusion of GATS."⁴⁶

PICs are already able to selectively and gradually open up service sectors such as telecommunications where there are sound reasons to do so. This will often result in major savings for consumers and improved service offerings. However, to do so does not need binding commitments in a GATS-style trade agreement. Such commitments are difficult, if not practically impossible to reverse, and it is impossible for any PIC (or any other country) to foresee what flexibility they will require in decades to come. The decision to 'lock in' service sectors under a trade agreement should be treated with extreme caution.

Mode 4

For many of the PICs, the area of services negotiations that holds most interest is mode 4, the temporary movement of natural persons to provide their services in the Australian and New Zealand job market.⁴⁷ With several PICs experiencing rapidly growing populations and a shortage of employment in the cash economy, mode 4 negotiations are seen as an opening to negotiate

⁴⁶ World Bank, *Global Economic Prospects and the Developing Countries 2003: Investing to Unlock Global Opportunities*, Washington, 2003, p.133. United Nations Conference on Trade and Development, *A Positive Agenda for Developing Countries: Issues for Future Trade Negotiations*, New York and Geneva, 2000, p.172.

⁴⁷ It should be noted, however, that for some countries the focus is more on attracting their nationals back, rather than creating opportunities for them to leave.

expanded opportunities for Pacific nationals to work overseas and provide remittances while obtaining relevant training and experience.

Under the GATS framework mode 4 is typically oriented to professionals and inter-company transfers. While an agreement along those lines may be of some value, in many cases PIC professionals are already able to gain access to the Australian, New Zealand and other job markets, creating a “brain-drain” problem. The type of agreement that is likely to be most useful to the majority of PICs is one that covers those without formal qualifications (termed “unskilled workers”), or various categories of semi-skilled workers. Although Pacific workers have increasing access through New Zealand’s Recognised Seasonal Employer (RSE) scheme and Australia’s Pacific Seasonal Worker Pilot Scheme, these schemes are unilaterally offered, and so can be modified or withdrawn at any time.

A possible advantage of including movement of labour in the PACER Plus negotiations is the possibility of *binding* the access so that Australia and New Zealand would not be able to unilaterally withdraw it when circumstances change, such as a rise in their unemployment rates. The AusAID-funded Institute for International Trade report, however, sounds a warning note on what Australia and New Zealand might be prepared to agree to, recommending that an evaluation should be undertaken “so as to minimize misunderstandings about the limits that may be placed on any eventual access arrangements.”⁴⁸ Both Australia and New Zealand’s existing trade agreements provide only relatively limited access for foreign workers, mostly restricted to executives, intra-corporate transferees and professionals, and often subject to labour market tests and job offers.⁴⁹

The likelihood of the Australian and New Zealand governments offering significant *numerically bound* labour market access therefore seems slim as both governments will see their primary responsibility in times of higher unemployment as being to their own workers.⁵⁰ In the context of the current global economic crisis the Australian Government has cut the permanent skilled migration programme by 14% to protect local jobs.⁵¹ It is also significant that New Zealand’s scheme is titled the Recognised Seasonal *Employer* scheme, and is based primarily on the needs of New Zealand *employers* and the (current) shortage of New Zealand-based labour, as is the Australian pilot scheme.⁵²

⁴⁸ Institute for International Trade, *Research Study on the Benefits, Challenges and Ways Forward for PACER Plus*, p.10.

⁴⁹ For a summary of Australia’s agreements see: <http://www.dfat.gov.au/trade/ftas.html> for New Zealand’s see <http://www.mfat.govt.nz/Trade-and-Economic-Relations/Trade-Agreements/index.php> accessed 27/05/2009. An analysis of New Zealand’s existing commitments in its FTAs by Professor Jane Kelsey found that “existing commitments on mode 4 and labour mobility show there are very limited precedents for binding and enforceable rights of access from the Pacific Islands, and none for workers with low skills or education.” Kelsey, Jane “NZ’s Commitments on Trade in Services & Labour Mobility,” University of Auckland, Auckland, 2009, p.1.

⁵⁰ For instance, Australia’s Parliamentary Secretary for Pacific Island Affairs, Duncan Kerr, in an article on the low take-up of the Australian scheme, highlighted the point that it was important that Pacific Islanders were not taking jobs that Australian citizens were willing to perform. Doherty, Ben, “Slim Pickings for Islander Workers”, *The Age*, 21 July 2009, <http://www.theage.com.au/national/slim-pickings-for-islander-workers-20090720-dqth.html>. Accessed 22/07/2009

⁵¹ Evans, Senator Chris “Government cuts migration program”, Press Release, 16 March 2009, <http://www.minister.immi.gov.au/media/media-releases/2009/ce09030.htm>, accessed 17/07/09.

⁵² The New Zealand Government’s Department of Labour website notes that “the number of available places can be adjusted, depending on the number of New Zealanders available and industry demand.” <http://www.dol.govt.nz/initiatives/strategy/rse/index.asp> accessed 27/05/2009.

As Australia's Parliamentary Secretary for Pacific Island Affairs, Duncan Kerr, has stated

Any labour mobility program has to be demand-driven. We are not contemplating a program to create artificial jobs. Any program would only work if there was real demand for real jobs, and employers came forward and contributed to the quite substantial costs of relocating temporary employees from overseas.⁵³

Mr Kerr's statement also raises the question as to the value of any quota, should one be negotiated, when unemployment increases in the two countries.

Oxfam welcomes New Zealand and Australia's labour mobility schemes that are based on mutual benefit. However, including labour mobility as part of a trade agreement runs the risk of PICs being asked to make concessions in other areas in return for little more than what Australia and New Zealand are willing to offer on a unilateral and mutually beneficial basis. Interestingly the labour mobility scheme *between* New Zealand and Australia is not part of the two countries' FTA, but pre-dates it, and as New Zealand's Department of Labour notes "is not a binding bilateral treaty but rather a string of procedures in the immigration policies of both countries."⁵⁴

An element in that scheme that may also be of interest to the Pacific is one "that entitles people registered to practise an occupation in one country to register to practise the equivalent occupation in the other country without the need to undergo further testing or examination."⁵⁵ This provision is also outside the two countries' FTA. A similar scheme for PICs, coupled with commitments by Australia and New Zealand to assist in providing training to PIC nationals, may prove to be of more practical value than anything that is likely to be included in an FTA, and would certainly not require a trade agreement to be implemented.

Trade-related measures

Besides chapters on trade in goods and trade in services, traditional FTAs typically include a range of "trade-related" measures. These can include rules on intellectual property, government procurement, competition policy and investment. On most of these issues the PICs decided to suspend negotiations with the EU because, as the region's chief negotiator, Hans Joachim Keil, explained in a letter to the European Commission "the implementation of the obligations would require significant financial, technical and human resources beyond the current capabilities" of the PICs.⁵⁶

Apart from the significant technical burden, including such issues in an FTA is also likely to have significant negative implications for development.⁵⁷ While policies such as sound regulation of competition are important, these need to be formulated in ways that promote the development process, not merely protecting the interests of foreign investors. There is no WTO-requirement to include such issues in a trade agreement. Indeed, government procurement, competition policy and investment were explicitly thrown out of the Doha round of trade negotiations after developing countries refused to allow their inclusion.

⁵³ Kerr, Hon Duncan, speech to the Victoria University Symposium on Pacific Islands Migration and Labour Mobility, 6/08/2008 available at http://www.foreignminister.gov.au/parlsec/speeches/2008/080806_labour_mobility.html accessed 27/05/2009

⁵⁴ New Zealand Department of Labour "International Trade Negotiations and the Trans-Border Movement of People: A Review of the Literature", http://www.dol.govt.nz/publications/research/trade-negotiations/trade-negotiations_04.asp, accessed 22/07/2009.

⁵⁵ Ibid.

⁵⁶ Keil, Hans Joachim, "Letter to Peter Mandelson, Commissioner for Trade, European Commission", 11 June 2008. Keil's letter did, however, leave the possibility of negotiating an agreement on competition law.

⁵⁷ For an analysis of these issues in the context of the EPA see Oxfam International, "Partnership or Power Play? How Europe should bring development into its trade deals with African, Caribbean, and Pacific countries", 2008, as well as a series of background papers commissioned to inform the study available at www.oxfam.org.nz under *what we do: issues we work on: make trade fair: resources and links*.

Costs and Benefits

This overview has provided a sharper focus on the risks of a traditional FTA for the small and vulnerable nations of the Pacific, at least in part as a means of balancing the overly optimistic treatment provided by other reports.⁵⁸

Traditional FTA pros: Consistent with Australia and New Zealand's approach to other FTAs
Complies fully with WTO provisions and would not be challenged
Reduction in costs of imported goods for consumers
Could encourage competition and efficiencies in PIC economies
Policy "straightjacket" means consistency over time

Traditional FTA cons: Likely loss of trade-exposed businesses and employment
Higher indirect taxes that fall more heavily on the poor and raise costs of locally-produced goods for consumers
Likely to result in reduced government revenues overall
Loss of flexibility to support domestic industry in future or to provide temporary protection in case of crisis
Loss of flexibility to regulate service sectors that are covered under GATS commitments
Margins of preference are likely to be increasingly limited despite a very significant 'price' having been paid to protect them

4. Alternative Options

There has been some debate about whether negotiations with the EU have "triggered" the requirement for all PICs to engage in PACER Plus negotiations, but most PIC governments appear to believe that as the 2011 deadline for commencing negotiations under PACER fast approaches, there is little to gain by putting off the inevitable. The 2008 Pacific Islands Forum communiqué outlined "the need for officials to formulate a detailed road map on PACER Plus with the view to Leaders agreeing at the 2009 Forum to the commencement of negotiations". The June 2009 Forum Trade Ministers' meeting has recommended that this timeline be followed. The negotiations do not, however, require the parties to agree to a reciprocal FTA, but merely that they enter talks "with a view" to establishing one.⁵⁹ Unlike negotiations with the EU, where duty-free access to the European market was being withdrawn at the end of 2007, failure to agree to a reciprocal FTA in the PACER Plus negotiations would not affect Pacific access to the Australian and New Zealand markets. This leaves Pacific negotiators with several options.

The status quo (SPARTECA)

The PACER agreement guarantees that Australia and New Zealand "shall maintain all existing arrangements relating to market access" until "new and/or improved trade arrangements providing equal or better access to their markets" have been concluded. Existing arrangements are contained within the SPARTECA agreement.

SPARTECA has assisted PICs in efforts to export to their neighbours, for instance playing a critical role in the formation of the textile and clothing industry in Fiji.⁶⁰ Despite recent declines,

⁵⁸ Notably the Australian government commissioned report: Institute for International Trade, *Research Study on the Benefits, Challenges and Ways Forward for PACER Plus*, 2008.

⁵⁹ PACER, Article 5:1.

⁶⁰ Fessehaie, Judith, *The Review of SPARTECA Rules of Origin*, Pacific Islands Forum Secretariat, Suva, 2007, p.21.

the industry is still the second largest in Fiji and employs some 14,000 people.⁶¹ There is little doubt that SPARTECA is still of value to the Pacific, although there are several problems with it.

One such problem is the rules of origin. Under SPARTECA at least 50% of the value of any product must have been created in the Pacific before being allowed duty-free access to Australia or New Zealand.⁶² This is not a problem for most commodities, but has been a particular target of criticism in relation to manufactures that are increasingly integrated into global commodity chains, relying on inputs from several countries. Even relatively basic items such as shoes have inputs from multiple countries, with the leather, laces, fabric, eyelets, soles and so on all potentially coming from diverse sources. The outdated SPARTECA rules work against PICs becoming links in those international supply chains, as they reduce PIC exporters' options when sourcing inputs for products destined for Australia or New Zealand. This can result in either less competitive products, or no products at all.

Basic commodities do not face the same problems with rules of origin, but are subject to another serious barrier for PIC exporters: Australia and New Zealand's quarantine standards. These are a particular problem for agricultural and wood-based exports as most PICs do not have suitable treatment facilities to ensure products are pest-free, laboratory and research facilities to prove the safety of produce, or sufficient bureaucratic efficiency to fulfil administrative requirements. This sort of problem results in the nonsensical outcome that it is easier to import bananas into New Zealand from Latin America, half-way round the world, than it is to bring them in from Samoa. Eddie Wilson, Pacific Co-Chairman of the International Kava Executive Council in a recent media article noted that agricultural produce is the most viable export option for Samoa. However, frustration with the difficulties in meeting increasingly strict quarantine standards, as well as virtual bans such as that imposed on kava exports by Australia led him to claim that the two countries "ban virtually everything... especially Australia."⁶³

Australia and New Zealand also have strict product standards that can be difficult for PICs to adhere to. The two countries' labelling requirements can also prove a barrier to many PICs who do not have sufficient laboratory facilities to accurately test their products in order to provide mandatory specifications such as nutritional information. Incorrectly labelled products are liable to be sent back by customs.

Once products are actually in the country, a further challenge is their marketing. The Nathan Associates study notes that it is difficult for producers in the PICs to gauge what products will sell in Australia and New Zealand, and goes on to note that "Pacific Islands Trade and Investment Commission (PITIC) assistance has been instrumental to many businesses, but their resources are limited compared to what needs to be provided."⁶⁴

A further long-term problem for Pacific exporters is that Australia, New Zealand (and other trading partners) are increasingly reducing their tariffs on other countries' exports, so that what had been a useful margin of preference for Pacific exporters in 1981 is now of much less value for all but a few products. This has happened as a result of Australia and New Zealand's commitments at the WTO, through their unilateral tariff reductions (including providing duty-free access to all Least Developed Countries), and as a result of negotiated FTAs (for instance the recently signed Association of Southeast Asian Nations–Australia–New Zealand Free Trade Area). Nonetheless, a 2006 OECD report on Australia's tariff regime found that SPARTECA preferences saved Fiji exporters nearly US\$24m in duties, and Papua New Guinean exporters nearly US\$15m.⁶⁵ Samoa is also likely to have benefitted extensively from SPARTECA preferences, but as much of its exports are classified as "confidential" it is difficult to quantify this.

⁶¹ World Trade Organization, "Trade Policy Review: Report by Fiji", Geneva, 2009, p.12

⁶² There is a special exception for textiles, clothing fabrics that allows a lower threshold of 25%.

⁶³ Ah Mu, Alan, "Frustrated Exporters Speak Out," *Samoa Observer*, 28 June 2009, http://www.samoobserver.ws/index.php?option=com_content&view=article&id=9839:frustrated-exporters&catid=1:latest-news&Itemid=50 (accessed June 30, 2009).

⁶⁴ Nathan Associates, *Pacific Regional Trade and Economic Cooperation*, p.11.

⁶⁵ Lippoldt, D. "The Australian Preferential Tariff Regime", *OECD Trade Policy Working Papers*, no. 33, Paris, 2006, pp.31, 34.

A final problem is that SPARTECA could potentially be challenged at the WTO as it does not adhere to the requirement that regional trade agreements involving developed-country WTO members must make “substantially all” trade duty-free.

When this happened with the ACP-EU Lomé convention the EU negotiated a temporary waiver from WTO rules with the affected third parties (by giving them extra quotas for their affected exports), and agreed to negotiate a new agreement with the ACP that did adhere to WTO rules (the EPAs). The likelihood of a country actually lodging a challenge to SPARTECA seems relatively slim and the associated costs in both financial terms and political capital would be comparatively high. Therefore any challenger would need to weigh those costs against the fact that the Australian and New Zealand markets are small in world terms, and the volume of competing exports from PIC countries that receive more favourable treatment under SPARTECA is extremely small. It is also worth noting that relatively high-profile agreements, such as the United States’ African Growth and Opportunities Act (AGOA) and Caribbean Basin Initiative (CBI) that both provide non-reciprocal access for developing countries to the US market have remained unchallenged.

SPARTECA pros: Provides guaranteed, duty-free access for PIC exports
Not reciprocal (PICs do not need to reduce their own tariffs)
Allows PICs to set and change their tariffs according to their own priorities, so does not constrain PIC development strategies

SPARTECA cons: Rules of origin restrictive and administratively burdensome
Does not overcome non-tariff barriers such as quarantine, product standards and labelling requirements
Margin of preference likely to be increasingly limited
Countries outside SPARTECA could potentially challenge its legality at the WTO

Improvements to the status quo – “SPARTECA Plus”

Should the PICs decide that a reciprocal FTA is not in their interests, a viable alternative would be to improve SPARTECA (ie a “SPARTECA Plus”). A place to start would be the rules of origin. Since negotiations began on SPARTECA in the late 1970s, the rules of origin have consistently been a bone of contention, criticised by Pacific exporters and governments as being too restrictive. The current system has perverse incentives to keep labour productivity low, is vulnerable to currency fluctuations, and is administratively burdensome for both customs officials and exporting companies (particularly small firms).

One of the objectives of SPARTECA is “to achieve progressively in favour of Forum Island countries duty free and unrestricted access to the markets of Australia and New Zealand over as wide a range of products as possible”.⁶⁶ While duty-free access has largely been achieved, the existing rules of origin mean that that access is not unrestricted. There have been several attempts by the PICs to negotiate better rules, but these have been only partially successful, most notably in getting the rules for certain clothing and textile products relaxed. The most recent attempt to look into the rules was mandated by Forum Trade Ministers in 2006, and reported on in 2007, but Australia and New Zealand have been reluctant to consider revising them before negotiations under PACER are undertaken.

As part of the negotiations with the European Union, the Pacific put forward a proposal for simple and flexible rules of origin based on the “change in tariff heading” system, as opposed to the

⁶⁶ SPARTECA, Article IIa.

current “value added” approach.⁶⁷ This proposal could potentially form the basis for a proposal to Australia and New Zealand.

A SPARTECA Plus agreement should also address the problem of quarantine standards. Australia and New Zealand have very high standards to protect their own agricultural industries, and these will not be relaxed. However, there are a number of initiatives that could be taken, such as providing resources for PICs to meet those standards (for example pre-shipment treatment facilities), providing additional technical advice and assistance to exporters (above the existing assistance provided, for instance, through NZAID), prioritising Pacific products for quarantine risk analysis and streamlining documentation requirements.

Similar initiatives could be taken with regard to product standards, labelling requirements and marketing. Improvements in PIC exporters’ ability to meet Australian and New Zealand requirements would also have a flow-on effect, as other developed countries have similar standards. The existing SPARTECA promises “to promote greater penetration by exports from Forum Island countries into the Australian and New Zealand markets through such measures as co-operation in the marketing and promotion of goods from Forum Island countries”.⁶⁸ As Australian and New Zealand consumers become more concerned with the origin of the products they consume there are also increasing opportunities for marketing Pacific Island produce, particularly for Fairtrade and organic products.

SPARTECA Plus pros: Provides guaranteed, duty-free access for PIC exports
Not reciprocal (PICs do not need to reduce their own tariffs)
Allows PICs to set and change their tariffs according to their own priorities
Addresses current shortcomings of SPARTECA

SPARTECA Plus cons: Margin of preference likely to be increasingly limited
Countries outside SPARTECA Plus could potentially challenge its legality under WTO rules (like the current SPARTECA agreement)

Generalised System of Preferences (GSP)

In the (unlikely) event that SPARTECA (or a new SPARTECA Plus) was successfully challenged by a WTO member, the immediate fallback option for Pacific exporters would be Australia and New Zealand’s GSP schemes. These schemes provide differing levels of low and duty-free access for exports from all developing and least developed countries. They are based on the WTO’s “enabling clause” that allows WTO members to “accord differential and more favourable treatment to developing countries without according such treatment to other contracting parties”.⁶⁹ Both Australia and New Zealand’s schemes provide duty-free access (with some exceptions) for countries classified as “least developed”, and reduced tariffs for countries classified as “developing”. None of the schemes, however, would provide access as good as that provided under SPARTECA, particularly for products such as clothing and textiles.

A second problem with reverting to the two countries’ existing GSP schemes is that the schemes are open to all developing countries. Existing margins of preference under SPARTECA would be gone and PIC exporters would have to compete with countries such as China and India without the advantage of tariff preferences. What’s more, the GSP schemes are unilateral in nature and so provide less certainty for investors in the PICs, as either Australia or New Zealand could withdraw (very unlikely) or change (more likely) their GSP schemes at any time.

⁶⁷ The Pacific negotiators favoured the change in tariff heading approach mainly because it is less administratively burdensome to apply (the value added approach requires sophisticated accounting practices) and more likely to encourage improvements in productivity.

⁶⁸ SPARTECA, Article IIe.

⁶⁹ Enabling Clause, p191, paragraph 1.

All of these problems, however, could be overcome. In a report prepared for Britain's Department for International Development, Stevens and Kennan note that a WTO Appellate Body ruling "has confirmed that differentiation within the GSP is possible provided that it is related to objective and internationally accepted differences in circumstance."⁷⁰ The European Union provides a specific GSP scheme aimed at vulnerable economies (known as GSP+), based on the argument that the scheme should be "targeted on the developing countries that most need it, such as the LDCs and the most vulnerable developing countries (small economies, land-locked countries, small island states, and low-income countries)".⁷¹

All the PICs are recognised by the United Nations as Small Island Developing States (SIDS), have small and vulnerable economies, and have low per capita income. These are objective criteria that could be used by Australia and New Zealand to include PICs in an enhanced GSP scheme. The terms of that scheme could then be adjusted to match SPARTECA (or SPARTECA Plus). Initiatives to overcome quarantine difficulties, product standards, labelling requirements, marketing and so on could still be offered to PICs through existing bilateral and regional processes.

One downside to this approach from the perspective of the PICs is that it would be likely that the scheme would also provide access for other SIDS. This possibility would need to be weighed against the downsides of other alternatives, and research undertaken on how much of a competitive threat others SIDS would pose to Pacific exporters. Another potential downside is the unilateral nature of GSP that reduces certainty for PICs and their potential investors. This problem is perhaps more theoretical than real, as neither Australia nor New Zealand are likely to withdraw their GSP schemes once offered. Former WTO Director-General Renato Ruggiero, however, has suggested the problem could be overcome by the GSP providers binding their concessions at the WTO, thereby removing any uncertainty.⁷²

GSP pros: Could provide duty-free access for PIC exports if reformed
Not reciprocal, so allows PICs to set and change their tariffs according to their own priorities

GSP cons: If unreformed, provides reduced market access, especially for PICs not classified as least developed countries (LDCs)
Reforming GSP requires unilateral action from Australia and New Zealand so it may be more difficult for PICs to influence terms
Provides equal access for other qualifying SIDS (a disadvantage for PICs, but has advantages of being equitable in treatment for other SIDS)

PACER-lite

A further option to consider is a negotiated FTA that makes the most of potential flexibilities in WTO rules in order to avoid some of the negative impacts inherent in a "standard" FTA, as outlined earlier. World Trade Organisation rules are open to interpretation when it comes to FTAs. The relevant document for trade in goods (GATT Article XXIV) was drafted in 1948, long before regional trade agreements that included a mixture of developed and developing countries were even considered. A WTO panel concluded in 1999 that the wording of the rules "is of sub-optimal

⁷⁰ Stevens, C and Kennan, J "GSP Reform: a longer-term strategy (with special reference to the ACP)", Report prepared for the Department of International Development, Institute of Development Studies, Brighton, 2005, p.1 citing World Trade Organisation 'European Communities – conditions for the granting of tariff preferences to developing countries. AB-2004-1. Report of the Appellate Body', WT/DS246/AB/R, Geneva, 7 April 2004.

⁷¹ Ibid., p.5.

⁷² Bilal, Sanoussi and Francesco Rampa, *Alternative (to) EPAs: Possible Scenarios for the Future ACP Trade Relations with the EU, (Policy Management Report 11)*, European Centre for Development Policy Management, Maastricht, 2006, p.89.

clarity” and that “it is quite evident that no consensus was reached, nor was any practice agreed upon regarding Article XXIV of GATT.”⁷³

In part, the inability to agree how the rules should be applied stems from the fact they were never intended to be applied to developing countries that are explicitly granted greater flexibility in other areas of WTO law, for instance the “enabling clause”.

The peripheral nature of the PICs in world trade, and to a lesser extent Australia and New Zealand, would provide opportunities to push the boundaries on WTO-compatibility as PACER Plus would be a trade agreement of little interest to the rest of the world. A flexible agreement for the PICs would pose little threat to other countries’ exporters, and it is unlikely that it would make a WTO challenge worthwhile, particularly in light of the poorly defined rules.

Perhaps in part due to these considerations, Australia and New Zealand have recently indicated that they may be willing to consider a more flexible approach than they would normally take. For instance, New Zealand’s Minister of Foreign Affairs, Murray McCully, has said that PACER Plus “will not be a typical WTO-style FTA”.⁷⁴

Should their leaders decide to forge ahead with negotiations, PIC negotiators have the legal and political room to be ambitious in demanding maximum flexibilities from Australia and New Zealand. Of course, for the majority of PICs that are not WTO members, even an unusually flexible “PACER-lite” agreement would represent a quantum loss of flexibility compared with being unbound by WTO rules at all. For existing WTO members, PACER-lite would also mean less flexibility than currently enjoyed, as Australia and New Zealand are very unlikely to accept WTO members merely re-stating their WTO commitments in an FTA, but are instead likely push for greater concessions.

Trade in Goods - Substantially all trade

There has been extensive research on how much trade needs to be liberalised to pass as a WTO-compatible FTA. The closest the WTO has come to defining it was an appellate body finding that “It is... clear that “substantially all the trade” is not the same as all the trade, and also that “substantially all the trade” is something considerably more than merely some of the trade.”⁷⁵ In negotiations for the EPAs, the EU insisted that at least 90% of goods trade must be duty-free. As the EU was offering the African, Caribbean and Pacific (ACP) countries 100% duty-free access for their exports, it required the ACP countries to provide at least 80% duty-free access for imports from the EU, so that an average of 90% of total two-way trade would be duty-free.⁷⁶ The 90% figure, however, is one chosen by the EU, not set by the WTO. Both Papua New Guinea and Fiji were required to accept this figure in the interim EPA that protects their exports to the EU, but the Pacific region as a whole is still negotiating on this issue for any final EPA.

The West African region has taken the position that liberalising 80% of trade in the final EPA would be sufficient, meaning that West Africa would allow 60% of EU imports in duty-free. This, argues trade lawyer Dr El Hadji Diouf, is consistent with the WTO’s various rulings on how regional trade agreements should be assessed.⁷⁷ It would be reasonable for the PICs to take a similar approach in negotiations with Australia and New Zealand.

⁷³ World Trade Organisation, “Turkey – Restrictions on imports of textiles and clothing products”, Panel Report WT/DS34/R, 1999, paragraph 9.97 and 9.166 as cited in Diouf, El Hadji A. *Article XXIV of GATT and the EPA: Legal Arguments to support West Africa’s Market Access Offer*, ENDA Third World, Dakar, 2009, p.24.

⁷⁴ McCully, Hon. Murray, *Speech to the Pacific Wave Conference*, Auckland, 3 June 2009, <http://www.beehive.govt.nz/speech/speech+pacific+wave+conference> (accessed June 30, 2009).

⁷⁵ Turkey - Restrictions on imports of textiles and clothing. Report of the Appellate Body, 22 October 1999 (WT/DS34/AB/R), paragraph 48 as cited in Diouf, *Article XXIV of GATT and the EPA*, p.27.

⁷⁶ It should be noted that there are several options for how the percentages are calculated. They can be worked out on total value, or total number of tariff lines, or a combination of both. This can be further complicated by applying the calculation to the region as a whole, or on a bilateral basis.

⁷⁷ Diouf, *Article XXIV of GATT and the EPA*, p.28.

A potential difficulty, however, is the precedent set by the EPA. Fiji and Papua New Guinea have agreed to remove 80% or more of their tariffs for the EU. Either they will need to be able to convince Australia and New Zealand to accept a lower percentage of tariff removal, or there would need to be differential treatment within the PACER Plus agreement. The interim EPA increases the complexity of the regional basis of PACER Plus negotiations, but does not mean that the same terms need to be adopted in PACER Plus.

Trade in Goods – A reasonable length of time

A second area of flexibility is the “reasonable length of time” allowed before PICs would need to reduce “substantially all” their tariffs to zero. The WTO provides some guidance in this area, stating in 1994 that “the “reasonable length of time”... should exceed 10 years only in exceptional cases.”⁷⁸ In 2002, however, the WTO reported that “In the recent surge of RTAs [Regional Trade Agreements]... transition periods have been known to go well beyond ten years. These cases are becoming the rule rather than the exception.”⁷⁹ Diouf notes that of the many agreements that have long transition times the USA-Morocco agreement has the longest, allowing 24 years for Morocco to reduce its tariffs.

Of more direct relevance to the PICs, both Australia and New Zealand have agreements with Thailand that have 20 year transition periods. Long transition periods are not restricted to “mixed” agreements between developing and developed countries either; the Australia-US agreement has a phase-in period of 18 years. None of these agreements have been found incompatible with WTO rules. Given the circumstances of the PICs, it would be reasonable for negotiators to demand a transition period at least as long as the USA-Morocco agreement. Again, however, the interim EPAs set an unhelpful precedent, with Papua New Guinea eliminating all tariffs from day one and Fiji taking a more phased approach, with the bulk liberalised within 10 years and the remainder within 15.

Trade in Services

Trade in services is almost undoubtedly the most complicated area of trade law, and PICs have little experience in negotiating or implementing trade in services agreements. The PICs that are WTO members have few commitments in trade in services with the exception of recently-joined Tonga, which was required to make significant commitments, but has yet to fully implement them. Samoa and Vanuatu have had some experience in negotiating on services in their efforts to join the WTO, but have not completed WTO accession negotiations. With the EPA services negotiations effectively put on hold before really starting, the only other experience of services negotiations is the yet-to-be-concluded extension of PICTA to include services. Services negotiations with Australia and New Zealand therefore represent a significant risk for the PICs.

There are two ways the PICs can seek to mitigate this risk in a PACER-lite. The first is by not including services in the final agreement at all. There is no requirement to include services in a FTA, and in fact most do not. Therefore PICs may decide either not to negotiate on services, or having negotiated, conclude that a worthwhile agreement could not be reached and opt to exclude a services chapter from any final agreement.⁸⁰

If services *are* included in an FTA, however, then it must adhere to WTO rules that require “substantial sectoral coverage” in a “reasonable timeframe”. However, unlike for goods, the rules

⁷⁸ World Trade Organization, “Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994”, Geneva, 1994, paragraph 3.

⁷⁹ Report by the WTO Secretariat, 2002 (WT/REG/W/46, pg 22) as cited in Diouf, *Article XXIV of GATT and the EPA*, p.32.

⁸⁰ This latter option is similar to the course of action that the region has taken in the EPA negotiations, having initially engaged in services negotiations but after failing to elicit worthwhile offers from the EU proposing to defer negotiations to a (perhaps much) later date.

explicitly require that “flexibility shall be provided... in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors.”⁸¹ In part due to the relatively small number of services agreements that have been notified to the WTO, there is little guidance on exactly how much flexibility might be acceptable.⁸² Given small and often under-developed services sectors in the PICs, coupled with the relative inexperience with services commitments, it would seem that a very flexible approach involving only minimal services commitments would be acceptable.

PACER-lite pros: Would provide guaranteed, duty-free access for PIC exports
Allows for some control of tariffs (and revenue) by PICs
Potentially risky provisions on services and trade-related issues could be left out
Shortcomings of SPARTECA could be addressed
Very unlikely to be challenged at WTO

PACER-lite cons: Margins of preference are likely to be increasingly limited despite a significant ‘price’ having been paid to protect them
Significant proportion of tariffs would need to be removed
EPA precedent may limit potential flexibility

Trade and Development

As discussed in the options above, the final outcome of negotiations for a new agreement on economic relations could improve or damage the PICs’ trading prospects. Beneficial trading arrangements are necessary for PICs to make the most of the opportunities that global trade offers, but not sufficient. A lack of market access does not constitute the major current constraint on development for the PICs. Under SPARTECA the PICs have had tariff-free access for 28 years. Yet the imbalance of trade between the PICs and Australia and New Zealand remains huge. It is clear that trading arrangements alone will not provide the stimulus to economic development that the Pacific needs.

The promotion of economic development is an urgent priority. There are signs that much of the Pacific is falling behind other developing countries in achieving an adequate level of human development. For example, according to the United Nations, it is likely that (on a population basis) most of the Pacific will fail to achieve most of the Millennium Development Goals and over one third of the Pacific’s people live below nationally defined poverty lines.⁸³ Therefore, if any economic cooperation agreement is to contribute significantly to the Pacific’s development, it needs to go well beyond providing limited-term transition assistance with the costs of implementation. The ‘Plus’ in any final arrangement, be it SPARTECA Plus, PACER Plus or some other framework, needs to contain a substantial, country-specific and well-targeted development component.

There are promising signs that the New Zealand government has recognised that a fundamental change in trade policy towards the Pacific is required. The new government has said “We should be clear about one thing: present policy directions are not advancing the interests of the Pacific

⁸¹ World Trade Organisation, General Agreement on Trade in Services, Article V, Paragraph 3.

⁸² For an exploratory discussion on GATS Article V flexibilities see Kelsey, Jane, “A Pro-Development Reading of GATS Article V and Agreements on Free Trade in Services”, Auckland, 2009 available at http://web.me.com/jane_kelsey/Jane/Services_Toolkit.html accessed 07/07/09.

⁸³ UNESCAP/ADB/UNDP Joint Project on MDGs in Asia and the Pacific, *The Millennium Development Goals: Progress in Asia and the Pacific*, Bangkok, 2007.

region and we should not be deterred by such considerations.”⁸⁴ How willing Australia and New Zealand are to move in new policy directions is still to be determined.

Designing a developmentally-oriented economic cooperation agreement that includes trade provisions is not an easy task, and there are few, if any, examples that governments can draw on. It is beyond the scope of this paper to define a comprehensive framework, but the following provide some key principles for governments and civil society to consider in generating proposals.

1) Broad Scope: Trade agreements are oriented towards removing barriers to trade, but where market access or trade restricting rules are not the main form of constraint, other elements are required. There has been an international commitment in forums such as the WTO to provide ‘aid for trade’ and ‘trade facilitation’ (including under the existing PACER), but such commitments tend to focus narrowly on trade-related mechanisms such as customs procedures. As yet, little tangible assistance has been provided to the PICs and there has been little benefit in terms of increased production or exports from the region.

A broader scope has implicitly been understood in the ‘informal consultations’ on PACER Plus through including seasonal labour schemes within the scope of a possible agreement. However, as noted above, the temporary movement of labour is justified on its own terms since it is clearly of benefit to the horticultural sectors of Australia and New Zealand. There are other elements of a substantive package that could form part of the negotiations.

Using the agricultural sector as an example, assistance could include supporting locally-appropriate research and development, a revival of agricultural extension services, access to credit for small scale farmers, improved roads, shipping and rural infrastructure, assistance with meeting quarantine and food standards and scaled-up assistance with marketing. The most active constraints on agriculture vary amongst the Pacific countries and the types of assistance need to reflect the needs of each country.

Other packages could be constructed for the key sectors of priority for PICs (such as small business, agriculture, fisheries, tourism and/or cultural sectors). One way towards defining the development component for a ‘Plus’ agreement would be for each of the PICs to identify, through a process of broad consultation, the key sectors of their economies that would become their priorities. In accordance with the principles of aid effectiveness, nationally-defined development plans for these sectors could be prepared, and support provided by Australia and New Zealand, as a means to enhance the production and trade potential of these key sectors.

2) Equitable and sustainable forms of economic development: Both Australia and New Zealand have a commitment to support economic development that reduces poverty.⁸⁵ This implies that the forms of economic development being promoted through an integrated agreement need to accord to basic principles, such as being:

- Sustainable - environmentally, socially, culturally, economically and financially
- Broad-based - with equitable distribution of the benefits
- Appropriate - to the culture and situation (no ‘one size fits all’ approaches)
- Scaleable - to the Pacific’s resources and needs⁸⁶

These principles should provide guidance for both the trade measures that would form part of the package and the development components.

⁸⁴ New Zealand Cabinet “Minute of Decision” CAB Min (09) 13/3B para 24, April 2009.

⁸⁵ The incoming government in New Zealand has changed the mandate for the government aid agency, NZAID, to “support sustainable development in developing countries, in order to reduce poverty and to contribute to a more secure, equitable and prosperous world”, and specified that the core focus within that mission be the pursuit of sustainable economic development. Ibid.

⁸⁶ Coates, B, “Getting serious about achieving the MDGs in the Pacific: strengthening economic development.”, *Institute of Policy Studies Quarterly*, August 2009, Victoria University, Wellington, 2009, (forthcoming).

3) *Additionality and certainty:* It is clear that any credible development component of an agreement must include significant funding to support the enhancement of the PICs' productive capacity. Both Australia and New Zealand already provide aid to the Pacific, including some support for economic development.

Therefore, if the development elements of an agreement are to be additional to the planned aid programmes, new funding will be needed, above the existing aid commitments. If there is no new funding, it is difficult to see what additionality can be claimed from the agreement.

The funding also needs to be assured into the future, just as the PICs will be asked to undertake binding obligations on tariffs and other trade elements. Therefore, the structure of any agreement could include a defined set of thresholds for funding that would provide PICs with the confidence to plan for the long term programme of economic development that is essential if there are to be tangible outcomes.

4) *Process of negotiation:* As noted above, it will be a difficult challenge to design a new form of integrated economic cooperation agreement that has development at its core. Officials and Ministers will be breaking new ground. An integrated approach will need strong cooperation across government departments – this has so far been lacking. It will need extensive consultation with Parliamentarians, traditional leaders, civil society, the private sector and others.

Such a process is incompatible with the absence of a regional negotiating secretariat and the types of arbitrary deadlines for negotiations that have been discussed so far. If negotiations on a new form of economic cooperation agreement are to be initiated, as has been promised by Forum Trade Ministers, there must be a sufficient initial period to consider carefully such crucial framework issues as scope, negotiating structures and sequencing.

A staged form of negotiations is crucial to avoid reverting back to inadequate FTA-like provisions because of the lack of time to develop more appropriate alternatives. The commencement of each subsequent stage of negotiation should be contingent on the satisfactory completion of the previous stage.

Conclusion

Pacific Island Countries are already involved in a wide variety of trade agreements and initiatives, but an agreement with Australia and New Zealand under PACER is likely to have far greater impacts than all previous agreements combined. From the provision of government services, to the impact on food security, to the viability of domestic industries and exporters, few aspects of life in the Pacific will be unaffected.

Although government to government consultations under PACER are being undertaken “with a view” to negotiating an FTA, the best outcomes will only be achieved if *all* the options are considered, not just a traditional FTA. This paper has laid out several options that are available, ranging from a full reciprocal FTA to an enhanced version of the existing non-reciprocal arrangement.

The highest risk option is concluding a full reciprocal FTA. This would entail significant and binding commitments on the part of PIC governments, businesses and citizens, and an array of costs, both in PIC government autonomy and in economic terms. However, PIC negotiators may be able to negotiate greater benefits from Australia and New Zealand than might not otherwise be forthcoming.

The more flexible “PACER-lite” option would still entail significant binding commitments, but would provide more room for PIC governments to pursue their own policy agendas, and make changes to policy as priorities and circumstances changed.

The non-reciprocal option of improving the existing agreement (ie SPARTECA Plus) has the benefit of preserving PIC governments' policy flexibility, as well as existing tariff revenues. Depending on the willingness of Australia and New Zealand to address some of the shortcomings of the existing arrangement (SPARTECA), this option could also go some way to addressing the large trade imbalance. However, such an option would depend to a large extent on the goodwill of Australia and New Zealand.

Finally, in the very unlikely event that SPARTECA was challenged, Australia and New Zealand's GSP schemes could be modified to continue non-reciprocal access for PIC goods.

The first conclusion of this paper is that there are viable alternatives to a standard FTA. It is vital that decisions be made based on the development needs and aspirations of the PICs rather than those aspirations being made to fit into a framework imposed from the outside. After all, this is in the broader interests of the region, including the interests of Australia and New Zealand. As Australian Trade Minister Simon Crean has said: "It's in our interests to have an economically sustainable grouping of countries within the region".⁸⁷

A second conclusion is that favourable trading rules are necessary for economic development, but not sufficient. There needs to be a substantial programme to improve the productive capacities in sectors of key priority for each PIC if trade is to be of real benefit. These priorities must be decided through national processes and cannot be decided in Canberra and Wellington.

A third conclusion of this paper is that the creation of a new framework will take time, requires capacity at the national and regional levels, and needs wide consultation. Otherwise, the tendency will be to revert to familiar structures, such as a standard free trade agreement, which would risk undermining economic development rather than enhancing it.

Finally, it will be difficult for negotiators who have been schooled in the language and mindset of adversarial trade negotiations to respond to this challenge. Lessons need to be learned from the failure of the EPA negotiations. Serious consideration should be given to the composition of negotiating teams within all governments, including Australia and New Zealand. While the two governments' decision to assign Pacific division staff from their Foreign Affairs and Trade ministries to lead the negotiations is a good start, if development is to be the priority, those who know about development should be in the lead. The past adversarial framework for preparatory negotiations must be replaced by a cooperative model of seeking to identify those policies that would realistically enhance the Pacific's development. A continuation of the strong push for an earlier start to negotiations, a short duration, with little regional support and standard trade negotiations approaches will lead to bitterness, poor relationships and an abject failure to meet the worthy aims for an economic cooperation agreement.

⁸⁷ Crean, Hon. Simon, "The Pacific Region: Realising the Potential", speech delivered to the Papua New Guinea Ministerial Forum, Business Breakfast, Brisbane, 10 June 2009.

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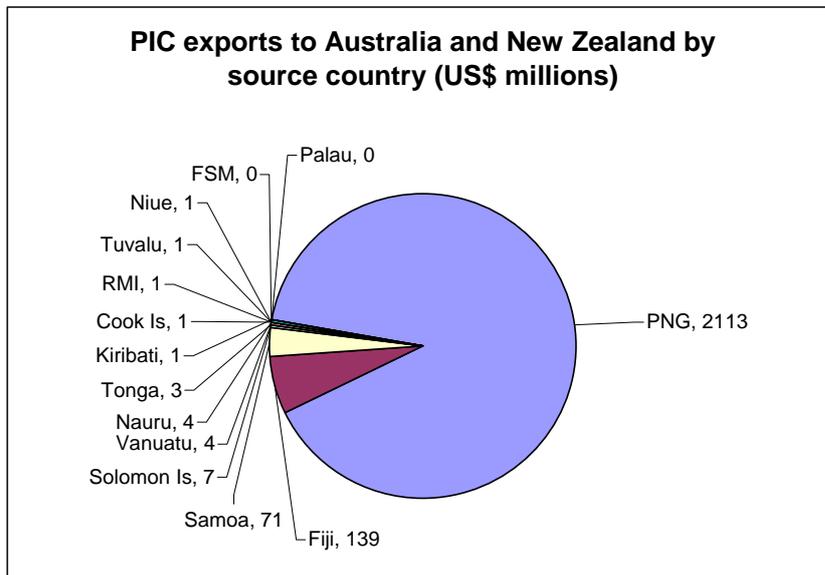
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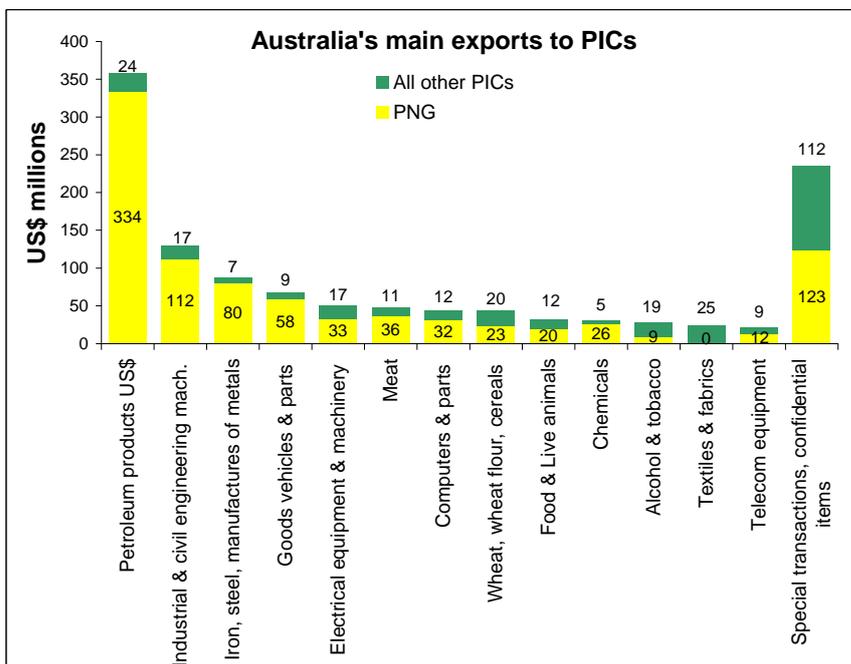
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Annex 1- Trade statistics



Data Source: Global New Zealand June 2008, Composition of Trade Australia 2007/8⁸⁸

Taken as a group the PICs are Australia's 17th most important export market, taking 1.3% of Australia's total exports.⁸⁹ For New Zealand the PICs are the 12th most important export market, taking 2% of exports.⁹⁰

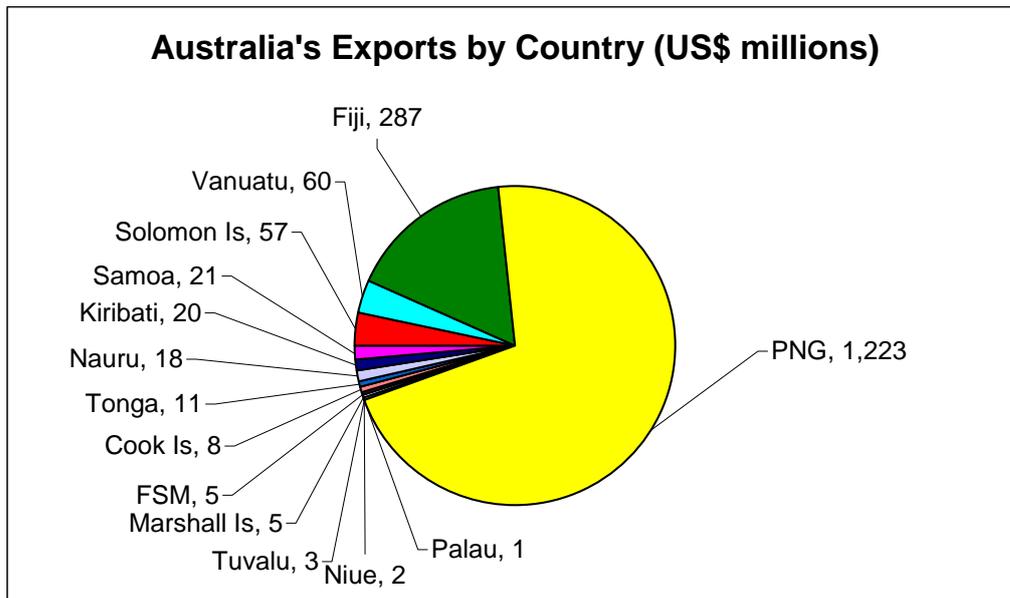


Source Data: Australia Composition of Trade 2007/8

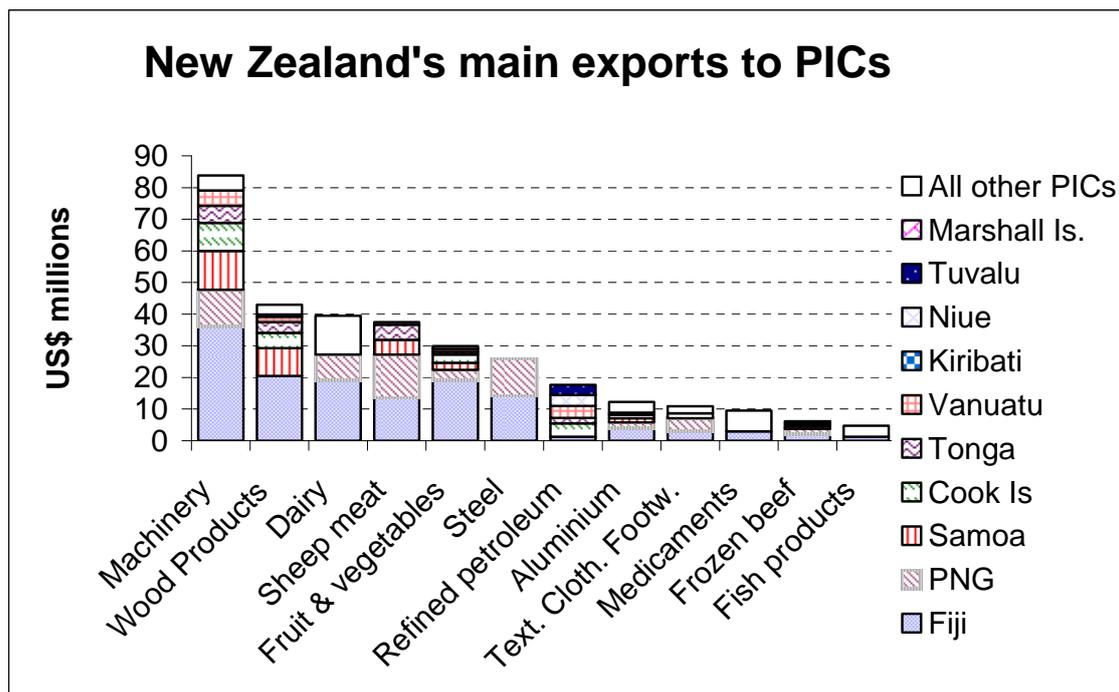
⁸⁸ For this and following charts conversion from A\$ to US\$ done at 0.7565 and from NZ\$ to US\$ at 0.6814 to match Nathan Associates study.

⁸⁹ Department of Foreign Affairs and Trade, *Composition of Trade: Australia*, p.48.

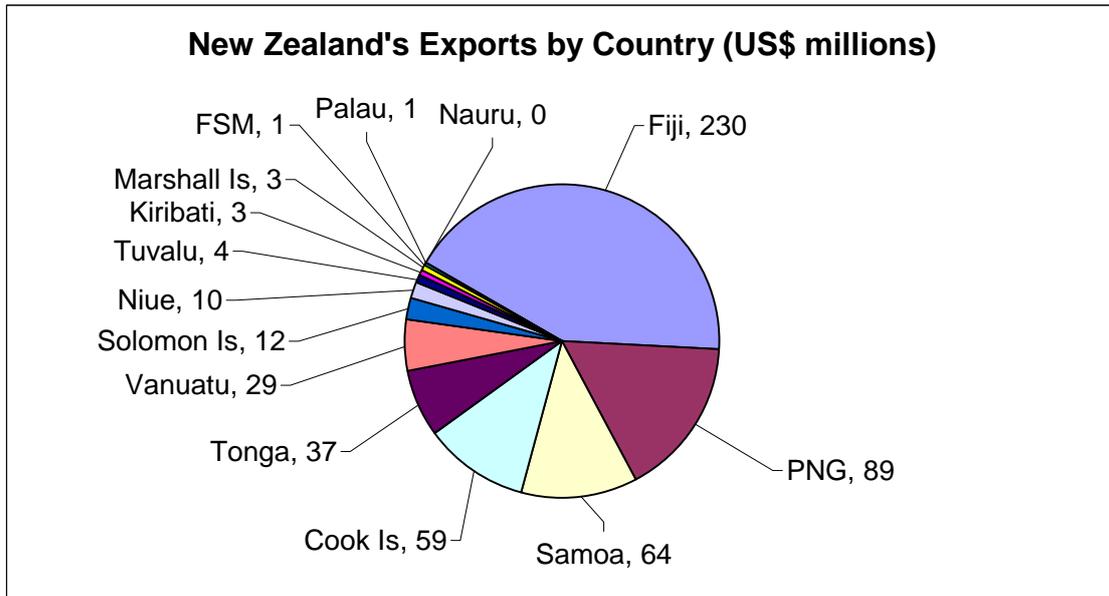
⁹⁰ Statistics New Zealand, *Global New Zealand International Trade, Investment and Travel Profile: June 2008*, p.15.



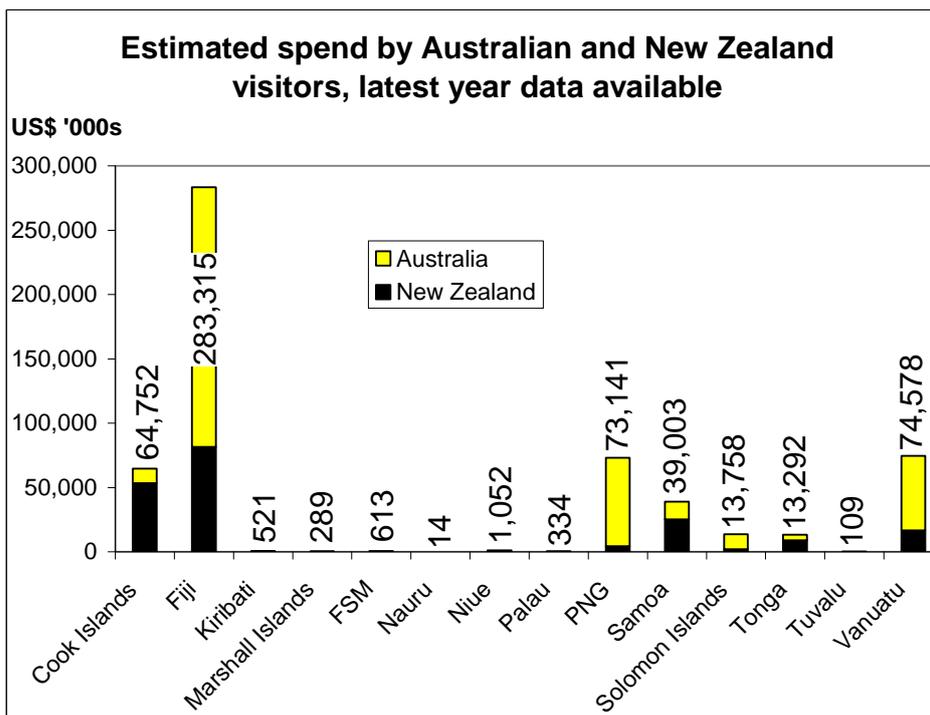
Source Data: Australia Composition of Trade 2007/8



Source Data: Global New Zealand June 2008



Source Data: Global New Zealand June 2008



Source data: SPC PRISM, South Pacific Tourism Organisation⁹¹

⁹¹ The figures should be taken as indicative only and were arrived at by taking the latest year for which arrival figures were available for each PIC and then multiplying them by the estimated average spend in each PIC for all tourists as calculated in Simon Milne, "The Estimated Impact of Tourism in SPTO Member Countries", 2005, pp 13-14. Non-SPTO member average tourist spends were estimated. Arrival data taken from Secretariat of the South Pacific's "Pacific Regional Information System (PRISM)" <http://www.spc.int/prism>, accessed 16/07/2009.