Submission to the Department of Foreign Affairs and Trade, Australia,

on PACER Plus

Comments from the Institute for International Trade at the University of Adelaide on a prospective trade and economic agreement between Australia, New Zealand and Pacific Forum Island Countries

July 2009

Executive Summary

The Institute for International Trade believes Australia can play a valuable role in contributing to and facilitating what we believe can be mutually beneficial objectives of a trade and economic agreement (PACER Plus), between Pacific Forum Island Countries, Australia and New Zealand. PACER Plus has the clear potential to contribute to closer regional integration and assist in building the sustainable economic growth objectives of Pacific Forum Island Countries consistent with the Pacific Plan. The Institute believes that among other things, PACER Plus could eliminate barriers to business investment and trade therefore making it easier for companies to invest, operate and create employment throughout the Pacific region.

PACER Plus can assist in reducing the price of imports for PIC consumers with welfare enhancing effects while allowing local PIC companies and PIC exporters access to cheaper inputs for local production or for re-export. There is considerable scope for the development of PIC domestic services and traded services as a result of PACER Plus and throughout the Pacific there is strong support for the development of traded services and increased labour market access for low and high skilled Pacific workers.

Nonetheless, while a comprehensive PACER Plus agreement can facilitate much needed investment, capacity building and technology transfer, these measures will take time to implement and the short term impact of initial revenue loss and job loss could alienate some Pacific communities. Therefore Australia needs to carefully consider the need for sufficient time and policy space to be allocated to allow Pacific governments, the private sector and communities to embrace the potential opportunities and benefits which PACER Plus has to offer.

The Institute for International Trade has undertaken significant research, training and consultation on PACER Plus throughout the Pacific region and will continue to do so with its focused research and analysis on specific PIC economies. To date, there is recognition by many, that PICs must not be 'left behind' by economic globalisation and that closer integration into the region with its two developed country partners offer an important stepping stone if the long-term economic development aspirations of Pacific Island Countries are to be met. It is this recognition that has lead to the strong support from most member countries who would be party to the comprehensive trade and economic agreement envisaged in PACER Plus.

1. Introduction

The Institute for International Trade in Australia together with the University of the South Pacific in Fiji and the Pacific Institute of Public Policy in Vanuatu undertook much of the initial analysis on the potential implications of a comprehensive PACER Plus agreement. This included consultations with key private and public sector representatives across the Pacific region and has given the Institute reasonably comprehensive feedback on the challenges, issues and opportunities that a comprehensive economic and trade agreement might offer.

Since this initial report, the Institute has continued to take an active interest in the development of PACER Plus and trade related capacity building activities for Pacific Island Countries. The Institute has been managing a trade related capacity building program focused on building the trade negotiation skills of Pacific Island officials. The program consists of 10 one-week modules allowing Pacific Officials to explore a range of issues and options for the development of a potential PACER Plus agreement. The course has allowed for highly interactive simulated negotiations and discussions with presenters from the Pacific, Australia and New Zealand offering their expertise and advice.

The main facilitators are Margaret Malua an experienced trade official from Samoa and Jim Redden, a trade and development expert. One early result is that some of the Pacific officials undertaking the training and who will also be the official negotiators for their country, have been strong in advocating the needs of their country in early informal discussions towards a PACER Plus roadmap. The training program has seen a range of trade experts, private sector representatives, government and NGO presenters from Australia and the Pacific, present on key trade policy topics. There has also been strong emphasis on simulated trade negotiations giving Pacific Islanders first-hand experience of negotiating conditions and effective strategies to be prepared and be successful. Further training and capacity building support for Pacific Island officials is strongly recommended in the future in order to consolidate a body of trade policy knowledge and negotiation skills vital for FICs to advocate their trade and development positions. In terms of this submission, the training program has allowed the Institute a well-informed understanding of the concerns and issues confronting PIC officials with respect to the potential negotiation and implementation of PACER Plus.

Of recent, the Institute has also been requested by a number of Pacific Island governments to further analyse the potential impact of PACER Plus on their specific economies. These studies will include more rigorous analysis of trade and economic data along with the potential challenges and opportunities for industry and communities in each of the economies we have been invited to review.

As part of this research, the Institute will continue to work with our regional partners and colleagues at the Pacific Island Forum Secretariat, with Pacific Island appointed spokespeople on PACER Plus, representatives from the Melanesian Spearhead Group (MSG), the Pacific Island Private Sector Organisation (PIPSO) as well as with trade officials from the New Zealand and Australian governments. We will also be seeking the views of trade unions and local communities who may be impacted by PACER Plus.

In summary the Institute is well placed to comment on the potential benefits and challenges a PACER Plus agreement may bring with the obvious caveat that at this stage, the scope, coverage and detail of such an agreement is not yet known and as such some of our observations below are necessarily speculative or of a general nature.

2. Potential Benefits and Opportunities

There has been a discernable degree of optimism in the Pacific region for future regional collaboration in part based on the priority given by the Rudd Government to meetings in PNG shortly after coming to power, the resolution of some of the outstanding issues with the Solomon Islands and the announcement by the Australian Prime Minister of a long-term Pacific Partnerships for Development Program. It has helped create a degree of good faith that Australia has the mutually inter-dependent, longer term interests of the Pacific region at the forefront with respect to upcoming PACER Plus negotiations.

Through the research and training activities undertaken by the Institute, the major perceived benefit of PACER Plus was without doubt the potential of increased labour market access[1],

[1] We do note however that for a few PICs, such as the Cook Islands or Niue, labour mobility is of little interest and their focus will be on other potential benefits.

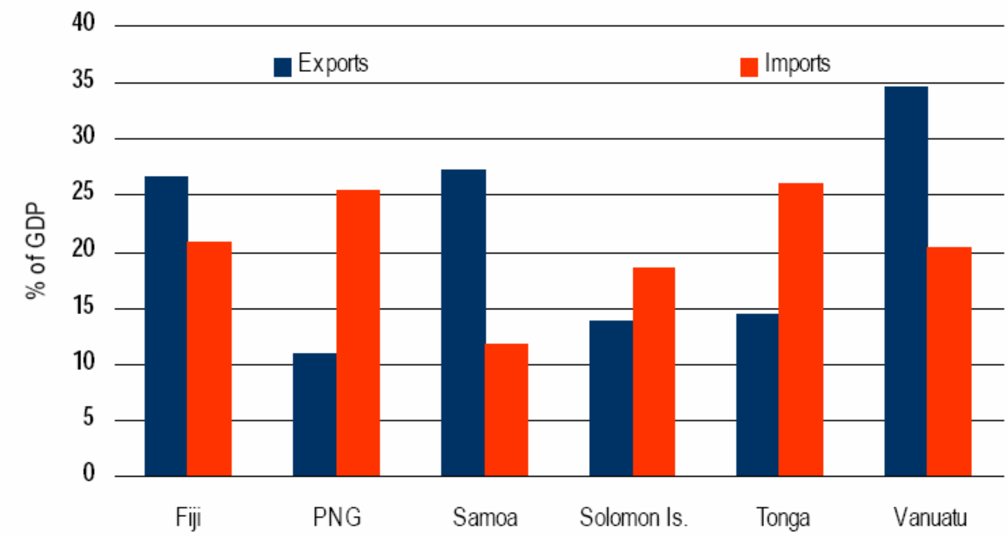
particularly for low and unskilled Pacific workers to Australia and New Zealand. The Institute believes the temporary movement of labour should form part of the trade architecture for a PACER Plus agreement and that, if carefully designed, could be created, with discriminatory quotas, in a way that is unlikely to raise concerns under the GATS or with Australia's other trading partners. To negotiate the temporary movement of natural persons outside a WTO compliant trade agreement such as PACER Plus will open the prospect of positive discrimination in favour of Pacific Islanders to question and therefore will likely run counter to the interest of Pacific Islanders.

There has been support in the region for a trade architecture of a general nature applying to the whole of the Pacific region but with specific schedules for each Pacific Island Country according to each PIC's particular circumstances, for example with respect to the phasing of tariff reduction or its capacity to embrace services liberalization with the necessary regulatory regime in place to ensure free and fair competition. This is consistent with the current Australian Government position to tailor PACER Plus agreements and schedules to the specific needs of PICs, a position which the Institute strongly supports.

There has been genuine interest in the region for how services liberalisation might encourage greater competition and efficiencies in PIC economies with some citing the recent air services agreement between ANZ and Vanuatu as a vital success for tourism and business travel. In general the hope was expressed that a services agreement might lead to greater supply of investment and technology as well as competition in sectors such as education, transport and tourism. Because of the profound importance of education services to the Pacific population where a significant proportion of the population is aged under 25, there was enthusiasm for increased trade in vocational, technical and university based educational services particularly if PACER Plus increased joint investment in off-shore educational institutions and partnering arrangements between ANZ and Pacific education providers. Pacific leaders have also welcomed an increase in the opening up of labour mobility for professionals, managers and business entrepreneurs who might more easily move among PICs to assist in building their capacity and competitiveness.

The service sectors in FIC economies, in particular, education, health and tourist services, offer unique opportunities to serve as a sustainable mechanism for future economic growth. Graph 2 below shows the growing importance of services to FIC economies.

Graph 2 - Services trade (imports/exports) as a share of GDP



Source: Asian Development Bank's Key Indicators (2008)

Another key area mentioned by most of those who have been consulted by the Institute was the potential for increased investment in agriculture and fishing. Improvements in agriculture and fishing capacity and in productivity, along with infrastructure development, were highlighted as major challenges that PICs could tackle through efficiency reforms and trade related capacity building that could potentially flow from PACER Plus. One company in Fiji, for example, with only modest external assistance, has been able to take measures to overcome ANZ quarantine restrictions and grow its horticultural exports significantly over the last ten years. More of this would be welcome.

A key aim of Pacific leaders and officials is to build a stronger employment base at home and more than one Pacific official has put forward the idea of an upfront investment liberalisation agreement as a forerunner to PACER Plus to facilitate an increase in productive investment in the region. While this requires further analysis, the potential benefits were identified if a PACER trade agreement could facilitate the development of niche overseas and tourist markets with Fiji Water being cited as a good example of a uniquely Pacific trade success story.

The Institute believes PACER Plus can also assist with domestic reform by driving down the cost of protection to PIC consumers and by increasing competition and the quality of both goods and services into PIC markets. The PIC business community with whom we have spoken see the potential benefits from promoting competitiveness within PICs, including what may be a long term benefit to domestic producers and suppliers who are also consumers of goods and services.

Many referred to the current cost of doing business in the Pacific and that given the remoteness and size of PICs, as much as possible needed to be done to bring down trade and business costs.

2.1 The Cost of Trade and Business for Pacific Forum Island Countries

The people of Pacific Island Countries are suffering from high tariff and non-tariff barriers to trade, resulting in higher prices for consumer goods while increasing the difficulty for local business to export or re-export on a competitive basis. Table 1 compares the average applied tariffs for all products, for agriculture products and for industrial products, respectively, of some Pacific Forum Island Countries with Australia, New Zealand and other developed countries. The comparison shows that some Pacific Islands continue to exercise relatively high protectionism with average applied tariffs for agriculture products topping 40 per cent (for example in Fiji, Kiribati, Tonga, Solomon Islands and Vanuatu).

Table 1 Average Applied Tariffs (in per cent) …

Country	… for all products	… for agriculture products	… for industrial products
Fiji	39.55	83.44	32.96
FSM	4.21	4.42	4.19
Kiribati	17.22	49.21	15.00
Palau	3.02	1.68	3.11
PNG	4.88	19.32	2.48
Solomon Isl.	13.05	39.18	8.84
Tonga	24.09	60.07	18.15
Vanuatu	25.13	90.05	14.49
Singapore	0.04	1.22	0.00
Hong Kong	0.00	0.00	0.00
Denmark (EU)	1.07	9.30	0.49
Australia	9.42	1.47	9.90
New Zealand	1.10	0.69	1.13
United States	1.68	6.69	1.29

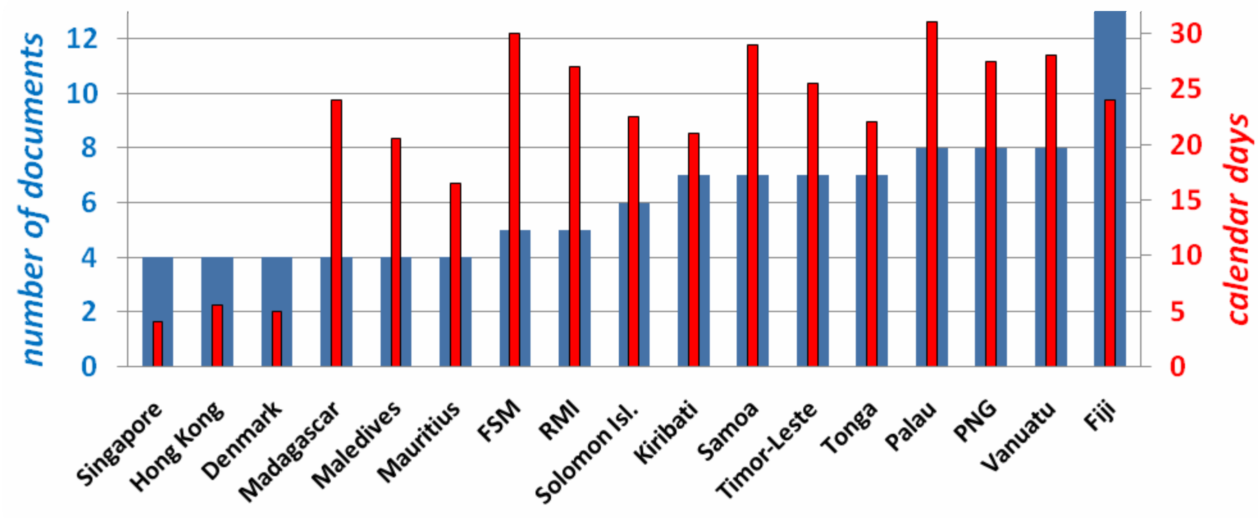
Source: International Trade Centre (2009)

Table 1 also reveals that some Pacific Island Countries such as Micronesia (FSM), Palau and Papua New Guinea (PNG) have lower average applied tariffs than Australia, implying that the abatement of both trade and non-trade barriers especially for agricultural exports from FICs to Australia could be of significant benefit, if also accompanied by capacity building support for PICs to meet Australia's stringent SPS and quarantine requirements.

The World Bank's 'Doing Business Report on Trading Across Borders' is also a useful tool to quantitatively assess non-tariff barriers to trade. Graph 1 compares FICs with the world leaders Singapore, Denmark and Hong Kong and some other developing nations by summarizing their average time for the processing of goods and documentation required for exporting and importing. It shows, for example, that the average time needed to undertake a trade transaction in many PICs is a major constraint to trade and investment.

In Fiji it takes on average 12 documents and 24 days to trade cargo. Even though, as mentioned above, Palau and Micronesia have relatively low tariff constraints, their non-tariff barriers to trade are very significant. In Palau, Micronesia (FSM) and Samoa the average time to import or export exceeds 29 days.

Graph 1 - Trading Across Borders: Average documents required and days needed to trade



Notes: 1. Documents comprise the average required documents to export and import. This includes bank documents, customs clarification, licenses for import / export and others
2. Time is recorded in average calendar days required for the procedure of imports and exports from the moment the cargo initially runs until it is finalized for trade by customs.

Source: World Bank Group Doing Business (2009)

Taking both tariff and non-tariff measures of PICs into account, the results shown in Table 2 below come as no surprise. On average, over the ten-year period of 1997 to 2007, most Pacific Island Nations manage a negative trade balance, widely varying from just negative 0.02 per cent of GDP in the Solomon Islands to more than a 100% of GDP deficit in Tuvalu and RMI. Of the 14 PICs, PNG and the Cook Islands were the only countries having a positive average trade balance.

Table 2 Trade balance (goods and services) of the PICs

	Trade Balance Average 1997-2007		Trade Balance in % of GDP	Average growth in trade in %
	in million US$	in % of GDP	2007	(1997-2007)
Cook Islands	13.65	10.08	11.74	9.30
Fiji	-212.63	-7.64	-16.10	5.41
FSM	-178.95	-80.94	-80.94	2.60
Kiribati	-52.44	-89.78	-144.13	9.17
Nauru	-21.05	-89.78	-144.13	5.14
Niue[2]	-3.37	n/a	-20.45	10.75
Palau	-39.23	-32.35	-11.79	12.17
PNG	506.00	11.97	14.99	6.88
RMI	-121.95	-100.10	-100.21	3.60
Samoa	-78.47	-24.59	-23.24	7.93
Solomon Isl.	-0.04	-0.02	-0.04	1.73
Tonga	-76.70	-41.82	-45.30	3.82
Tuvalu	-18.59	-101.44	-101.44	8.25
Vanuatu	-46.97	-15.00	-19.51	5.69
TOTAL	-527.53	-6.26	-6.81	6.51

Notes:
1. Trade balance refers to exports minus imports in goods and services.
2. Average data for Niue for the years 1996-2004 and Trade Balance in % of GDP for the year 2004.
3. Average data for Timor-Leste for the years 2000-2007.
4. Total refers to the aggregated numbers of the Pacific Island Countries reported above, excluding Niue.
5. Average growth in trade reports the average change of the sum of imports and exports in goods and services per year.

Source: United Nations Statistics Division, 2009.

The Institute for International Trade therefore believes that Australia can play an important role in assisting PICs to reap the benefits of a PACER Plus agreement in two ways:

1. By increasing market access for PIC goods and services into Australia – through lower tariffs and NTBs in Australian and through capacity building support to meet Australian SPS and TBT standards

2. By support to FICs to improve their trade facilitation and customs procedures through capacity building programs and technical assistance in collaboration with well developed multilateral programs such as ASYCUDA.

Breaking into regional beef markets

The Vanuatu beef industry, based on production at every scale from small subsistence farms to commercial farms, is one of the country's most successful. The most important factors in the success of VAL Pacific have been the support of the Government of Vanuatu through its Livestock & Quarantine Department and the cooperation of Australian and New Zealand quarantine services.

Under cooperative arrangements the three governments have helped VAL maintain very high standards throughout the production and export process. The Vanuatu Department is staffed with New Zealand and Australian trained veterinarians, and New Zealand trained meat inspection staff. All meat exports are subject to quality control and meat inspection systems that operate under the supervision of these staff.

VAL Pacific has obtained international standards accreditation through AgriQuality New Zealand and IFOAM With its current configuration the company can export to New Zealand, Australia, Fiji, Papua New Guinea, Japan, Kiribati, Tuvalu, Wallis & Fortuna, Samoa, Tahiti and New Caledonia.

Put simply, and as the case-study above shows, Australia can assist FICs to lower the cost of trade and doing business that will facilitate an increase in investment flows, technology transfer and employment creation throughout the Pacific region.

2.2 A Single Pacific Regional Economic Market

The Institute found support in the region for the view that by aligning themselves with the larger, more robust economies of Australia and New Zealand, PICs would be far better placed to benefit from the economies of scale and flow on effects of closer integration with two relatively successful, developed country trading partners. This include greater ease of market access, increased investment flows, greater cooperation and capacity building and increased leverage in advocating for the needs of the Pacific region.

Perhaps in contrast to many of the fears being expressed by some about loss of import tariff revenue, a number of academics and trade experts in the region pointed to the potential of a gradual decline in import prices in terms of its welfare enhancing/poverty reducing effect as it increases accessibility to lower cost and higher quality imports for Pacific Island consumers. Lower consumer prices might also assist some in lowering overall food costs and implies a higher disposable income for consumers to invest in other goods and services.

In addition, some exporters consulted in the Pacific (who do not benefit from current protection) pointed out that future tariff reduction/elimination would mean a reduction in costs for intermediate goods/inputs and cheaper technology necessary for domestic production and re-exporting and saw the potential for their country to increase their export capacity into the future. The case-study below on Kiribati is a case in point.

Importing to export

How does a Kiribati firm take advantage of local shipwright skills when there are no local inputs for the manufacture of a modern boat on the tiny atoll? By importing everything.

Kiricraft Central Pacific is the ultimate export-processing success story. Its owner moved back to Kiriabati from Australia in 2005 to take advantage of the local skills but can compete in the Australian (and possibly the United States) market only by keeping margins low. The transport costs of importing all but the labor inputs—about 60 percent of the final value—and exporting all of the final production - are high in the remote islands.

However the key to profitability, according to the owner, is developing and retaining local skills in order to maintain high-quality production. But trade facilitation, including efficient customs clearance and low duties on both ends of the import-export transaction, are also essential for success.

Opponents of closer regional integration and closer trade and economic cooperation between PACER Plus members tend to focus solely on import revenue loss faced by some PICs. While this is no doubt an issue, there is often a curious lack of attention paid to the welfare enhancing aspects of lower prices for consumers, increased capacity for export and reduced cost of doing business – meaning more jobs and investment in FICs. Some opponents of PACER Plus would therefore appear to advocate a position that would likely exacerbate poverty, entrench cronyism and protectionism and maintain dependency on foreign aid, a position the Institute for International Trade firmly rejects.

3. Issues and Challenges

While there are a number of benefits to reduced tariff rates, as noted earlier, an immediate challenge for the Pacific Island Governments is to deal with the short-term effects of reduced import tariff revenue. A number of strategies have already been devised by PICs to off-set reduced import tariff revenue. Some of these are spelt out in the report undertaken by the

Institute for International Trade in its studies on PICTA (funded by the Pacific Forum Island Secretariat) and on PACER Plus (funded by AusAID). Strategies range from the improvement of tax collection and customs revenue systems, the development of alternative tax and revenue raising mechanisms to the creation of 'tariff off-set trust funds'. These and other strategies need to be put in place before the impact of tariff reduction takes effect and capacity building support from Australia (and New Zealand) for these initiatives would be valuable.

Of other concerns or challenges identified by the Institute perhaps the most outstanding was the repeated emphasis that Pacific officials placed on the size and vulnerability of their economies and on their lack of capacity to fully realise the potential gains from trade - due in their view to the absence of infrastructure, the scarcity of technology and highly skilled labour and the lack of trade negotiating experience.

PNG officials, for example, were concerned about the lack of a level playing field and felt that they could be undercut or out-smarted by experienced ANZ negotiators. They also highlighted the need for the development of 'business infrastructure' and industry assistance that would allow them to gradually become more competitive in the future. Vanuatu officials emphasised the importance of strengthening institutions, especially their 'customs and revenue collecting' system. What these concerns point to is the need not only for training programs to increase negotiating skills and policy knowledge, but attention to significant infrastructural needs and policy institutions over time both in the lead up to negotiation, during negotiations and then during implementation phases. The Australian Government can be commended for the support for such initiatives it has shown to date, but more can be done in a timely fashion to assist PICs to fully benefit from a potential PACER Plus agreement.

One fear expressed during the training program and in consultations has been the fear of being swamped by ANZ goods and services to the detriment of local businesses and local employment. PIC officials and private sector representatives are looking to ANZ for much greater assistance to increasing the supply side competitive capacity of PICs, for example through the training and up-skilling of the Pacific workforce, through assistance to meet Australia's stringent quarantine requirements, through a more flexible application of rules of origin or through the harmonisation of regulatory requirements that wherever possible are consistent with those required by other developed nations such as the EU or the US. It may also be important for PACER Plus to be flexible and allow for subsidies and other direct assistance to support local industries and sectors, particularly those with future export potential.

More than a few representatives from the private sector emphasised the value of technical assistance to identify how Pacific companies could better integrate with ANZ supply chains and on how to better market their products or services overseas. There was generally open acceptance of the value of liberalising investment and labour mobility services if it could lead to greater joint investment and greater cross-fertilisation of business professionals and managers throughout the region. The importance of government and private business working closely together on PACER Plus was clearly identified.

Finally, one of the major ongoing challenges identified by the Institute is the need to inform and consult with the private sector and general public on the value of trade reform, including the challenges and the costs, as well as the long-term benefits. Although such benefits may be marginal for some smaller PICs, reform will facilitate the most efficient allocation of resources, improve labour mobility options, increase investment inflows and assist in the development of competitive advantage for small niche markets. Tuvalu’s ‘TV’ license revenue is a case in point of how one nation has benefited from ‘being globally connected’.

In its earlier report on PACER Plus, the Institute recommended joint work on media, training and education events which allow for honest and open debate on the benefits and the challenges of trade reform. Such events could include high profile visits of private sector investors to the Pacific, better marketing of Pacific goods through trade fairs in ANZ, public forums, joint media statements and opinion pieces on the benefits and challenges of trade reform and economic integration. Crucial to this is to allow sufficient time for an informed debate, capacity building and technical assistance to flow through so that PICs are both informed and prepared to advocate their key national interests but also so that they have the capacity to successfully implement the trade reforms and economic measures needed to maximise the benefits of PACER Plus.

4. Conclusion

The Institute for International Trade has undertaken significant research, training and consultation on PACER Plus throughout the Pacific region and will continue to do so with its focused research and analysis on specific PIC economies coming up in the near future. To date, there is recognition by many, but not all, that PICs must not be ‘left behind’ by economic globalisation and that closer integration into the region with its two developed country partners offer an important stepping stone if the long-term economic development aspirations of Pacific Island Countries are to be met. It is this recognition that has lead to the strong support from most member countries who would be party to the comprehensive trade and economic agreement envisaged in PACER Plus. What is needed therefore is sufficient time and preparation for PICs to ensure that they are in a position to capture the benefits of a potentially comprehensive and reciprocal PACER Plus agreement.