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FREE TRADE IN THE SOUTH PACIFIC: AN OVERVIEW

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INTRODUCTION

Trade liberalisation brings real economic challenges for small Pacific Island countries (PICs).[1] Free trade rules articulated under regional free trade agreements (FTAs) have created a combination of circumstances that threaten the viability of Pacific Island economies and political and social stability in the region. This paper assesses the impact of regional FTAs. Examples to support arguments are drawn from three countries namely, Fiji, Solomon Islands and Vanuatu. The paper also discusses the main challenges for the effective implementation of FTAs in the Pacific. The final part of the paper suggests possible strategies for meeting those challenges in view of the inevitability of an open global economy and its reach into the South Pacific.

The free trade dilemma in context

Recent research shows that FTAs do not automatically lead to poverty eradication and are often harmful to countries at the different stages of development.[2] FTAs reduce government tariff revenue, and can increase unemployment and fuel social crises.[3]

What Pacific Islanders know about FTAs, especially from the media, are the bountiful benefits and reduced prices of goods that may result from reduced tariffs. Very rarely do they know the negative effects or costs of implementing these agreements. The negative effects are usually dismissed with the assertion that the Pacific has no choice but to comply.[4] This approach is clearly inadequate because (PICs) are not fully aware of the consequences of joining an FTA. As one commentator has stated, 'we do not fully assess the impact of FTAs and/or understand what we are getting ourselves into before actually implementing them.'[5]

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[1] My definition of PICs is based on the member countries of the Pacific Islands Forum. The Pacific Islands Forum member states are: Australia, Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, New Zealand, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Of these all except for Australia and New Zealand are PICs.

[2] See for example, Pacific Network on Globalisation (PANG*),* 'Social Impact Assessment of the Economic Partnership Agreement (EPA) being negotiated between the European Community and the Pacific ACP states' (Report to the Pacific Islands Forum Secretariat, March 20, 2008) http://www.pang.org.fj/doc/EPA_SIA_PANG.pdf (Accessed 9 October 2009).

[3] Jane Kelsey, 'People's Guide to PACER: The implications for the Pacific Islands of the Pacific Agreement on Closer Economic Relations (PACER)'(2004) http://www.bilaterals.org/IMG/pdf/A_Peoples_Guide_to_PACER.pdf (Accessed 9 October 2009) ; Jane Kelsey, 'Ten Reasons to Challenge the Pacific EPA' (PANG Fact Sheet 01, April 2009) http://www.pang.org.fj/doc/10_Reasons_to_Challenge_PACER-Plus.pdf (Accessed 9 October 2009).

[4] Ibid.

[5] Andrew Signn, 'World Trade Organisation for Vanuatu: Good for colonisers but maybe not good for the colony' *Vanuatu Daily Post* (Port Vila, Vanuatu) July 28 2008.

Usually, a concern for small developing PIEs is their relative powerlessness in comparison to the larger richer nations and economies of transnational corporations.[6] A government's ability to maintain control over its economy can be greatly hampered by its obligations under an FTA because a significant outcome of FTAs is the reduction of governmental barriers to entry and investment into the domestic economy by the transnational giants. FTAs compel member countries to align national law and policy to a pre-determined formula that has numerous ramifications for vulnerable small island economies. This may be disastrous for emerging local businesses.

This paper argues that in order for PICs to benefit from FTAs, they must be fully aware of their implications and how these can be adequately addressed. Critical studies on the legal and economic implications of FTAs must be carried out and policy making at the regional and national level informed by these studies.

REGIONAL FREE TRADE AGREEMENTS

PICs are currently in a process of forming themselves into a free trade area and concluding a series of free trade associations. An umbrella framework agreement, the Pacific Agreement on Closer Economic Relations (PACER) was formalized on 18 August 2001 in Nauru and came into force on 3 October 2002.[7] It pilots the road for new trade relations and economic cooperation by providing guidelines for the future development of trade relations and development between Pacific Islands Forum member countries, which includes Australia and New Zealand as well as PICs. The Pacific Island Countries Trade Agreement (PICTA) is the first FTA established under PACER. It was formalised in Nauru on the 18th August 2001 and came into effect on 13th April 2003 after ratification by six countries.[8] The primary objective of PICTA is to gradually reduce tariff or import duties on substantially all goods originating from the territories of FICs.

A further sub-regional FTA, the Melanesian Spearhead Group Trade Agreement (MSGTA) was formalised and signed in Rabaul, Papua New Guinea on the 22nd of July 1993 and entered into force in 1994.[9] It was further amended in 2005. Now 'all duties have now been eliminated among the four members except for a small number of "negative list" products.'[10]

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[6] Jane Kelsey, 'People's Guide to PACER: The implications for the Pacific Islands of the Pacific Agreement on Closer Economic Relations (PACER)' (2004), 16 http://www.bilaterals.org/IMG/pdf/A_Peoples_Guide_to_PACER.pdf (Accessed 9 October 2009).
[7] Ibid, 13.
[8] These countries are Fiji, Kiribati, Nauru, Papua New Guinea, Samoa and Solomon Islands.
[9] Ahmadu and Hughes,*Commercial Law and Practice in the South Pacific* (2006) 393. The Melanesian spearhead group members are Papua New Guinea, Solomon Islands, Vanuatu, Fiji and New Caledonia although trade agreements do not bind New Caledonia, which is not independent but is a territory of France.
[10] Pacific Institute of Public Policy, 'Beyond fish and coconuts: Trade agreements in the Pacific islands' Briefing Paper Number 3, August 2008, 2.

All Pacific Island FTAs are consistent with the General Agreement on Tariffs and Trade (GATT) which means that in their implementation the spirit of GATT will be upheld. The reduction of tariff and other barriers to trade and the elimination of discriminatory treatment in international trade relations is thus ensured.[11]

Legal requirements

There are two essential requirements for free trade rules as articulated under regional FTAs. First is the requirement that products from all countries must be treated equally. This principle of equal treatment has its basis in the GATT Article 1, most-favoured-nation (MFN) rule.[12] According to this principle the preferential trade deals under the SPARTECA and Lomé Conventions that give Pacific Island products preferential treatment over products from other countries are not acceptable.[13]

Second, countries must not discriminate against foreign goods and products. They must be treated in the same way as identical local goods and products. This principle of non-discrimination has its foundation in the GATT Article 3 National Treatment (NT). Under this principle countries are required to stop protection of domestic industries and local producers.

In order to achieve this free trade agenda, "unacceptable" trade barriers must be removed. Unacceptable trade barriers can be classified in various categories.[14] At present the standard list of unacceptable trade barriers that countries must reduce or abandon includes the following:

- *Tariffs.* Tariffs are taxes that can be imposed on imported goods and products, making them more expensive than locally produced goods. Countries usually impose tariffs for two reasons. First, a tariff is imposed on foreign products in order to protect domestic producers and industries that cannot effectively compete with foreign producing firms or producers. Second, a tariff is imposed to raise revenue for the government. In fact, tariffs are the main source of revenue for most PICs.

- *Import quotas.* Import quota are import duties which are imposed on imported goods and products. Import quotas are often regarded as a form of quantitative

[11] See preamble to the Marrakesh Agreement establishing the World Trading Organisation in GATT Secretariat, *The results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Text* (1994).
[12] The MFN principle was embraced under PICTA Article 6 and MSGTA Article 5. (See generally Jane Kelsey, 'Analysis on the PIC's Draft Text of the Pacific EPA' (2006) http://www.bilaterals.org/IMG/pdf/COMMENTS_ON_THE_DRAFT_TEXT_OF_PACIFIC_EPA.pdf (Accessed 9 October 2009).
[13] Jane Kelsey, 'Big Brother Behaving Badly: The Implications for the Pacific Islands of the Pacific Agreement on Closer Economic Relations (PACER)' (2004) http://www.pang.org.fj/doc/040401bigbrothersjanekelsey.pdf (Accessed 9 October 2009).
[14] Generally discussed by Kelsey, above n 6.

restriction because they restrict the amount of products and goods that are imported into the territory of a particular country.[15]

- *Subsidies.* Subsidies can be in the form of export and domestic subsidies. Export subsidies provide fiscal support to exporters thereby enabling their products to be cheaper on the international market. Domestic subsidies provide fiscal support to local producers thereby enabling them to compete against imports or guaranteeing local products a minimum price.

- *Temporary Import bans.* Such bans can protect "infant industries" by banning the importation of a particular good in order for a new local business to get established or as an "emergency safeguard measure" to inhibit a sudden flood of imports that may have swamped a local producer and threatened its survival.

IMPACTS

FTAs impact in many areas of PICs but this paper focuses on the impact of FTAs on government tariff revenue and employment.

Tariff and import duties provide all PIC governments with a large amount of their recurrent revenue. Therefore the removal of basic tariff, import duties and other related taxes has a significant impact on government revenue. Figure 1 (below) shows tariff revenue as a percentage of tax revenue and tariff revenue as a percentage of total revenue in Fiji, Solomon Islands and Vanuatu, clearly indicating the importance of tariff revenue as a source of government income in these countries.[16]

Figure 1: Tariff revenue[17]

COUNTRIES	Tariffs as % of tax revenue	Tariffs as % of total revenue
Fiji	32.8	21.9
Solomon Islands	23.7	14.3

A Revenue Impact Assessment study undertaken in 2007 clearly shows the impact of tariff reduction through PICTA, MSGTA or other similar WTO compatible trade deals

[15] For instance, quantitative restrictions are prohibited by Article 9, GATT and Article 7, MSGTA.
[16] It should be noted that different sources vary on the importance of tariffs as a source of government revenue. For instance Kelsey states that '[m]ost Islands rely on tariffs for between 20% and 70% of their government's income.' (Kelsey, above n 6, 14).
[17] Source: R Scollay and M Stephenson, 'Services Sector Liberalisation for FIC WTO members. Issues in the Current WTO Negotiations' (2001) Forum Secretariat: Suva. It should be noted that different sources provide different figures. It should also be noted that countries have been restructuring tariffs in anticipation of FTAs, so these figures are not constnace.

with the European Union (EU) or the United States of America (US).[18] This study illustrated the need for major adjustments to PICs tax bases in order to enable free trade.

Using the Solomon Islands as an example, 'the adjustment required to enable free trade would be in the range of 2 - 4% of total recurrent revenue which is the equivalent of about 12 – 18 million USD.'[19] Despite this, in 2007 the country substantially lowered its tariffs on basic goods such as soap, noodles, clothes, boots, exercise books, water tanks and mattresses, reducing its top rate of duty from 20% to 10%.[20] The Minister for Finance explained the reduction as desirable to benefit rural communities by reducing the pressure on the price of many basic goods.[21]

Similarly, in Vanuatu the required 'adjustment would be in the range of 20-25% of total recurrent revenue or about 1.4 to 1.8 billion vatu. However, this assumes no substitution or other trade flow effects – adding those in would make the impact larger.'[22] Vanuatu does not have any income tax and thus import tax serves as a major source of revenue. However, the Government has been reducing selected duty charges since 1998.[23] To lessen the impact the Government introduced an excise duty on alcohol and cigarettes.

In Fiji's case analysis shows that the impact on current revenue of PICTA, the EPA and any similar potential trade deal under PACER or with the US would be small. The adjustment required for PACER would be in the range of 2-4% of total recurrent revenue or about 22 to 45 million FJD.'[24]

While it is generally accepted that tariff cuts will force governments to raise revenue in ways that do not disrupt trade, the introduction of a new tax regime can be unfavourable to consumers. A good example of this is the proposed introduction of Value Added Tax (VAT) in Solomon Islands. A VAT system hits poorer people harder than import taxes that tend to be structured so as to be highest on luxury items, as VAT indiscriminately increases the price of goods. The increase in cost of basic necessities may lead to more dependence on cash incomes will in turn increase the drift to the towns, and associated problems of unemployment and squatting.

It is inevitable that with the removal of subsidies many local firms will go out of business and affect the employment rate. The loss of jobs in domestic industries which cannot compete with cheaper imports resulting from tariff reductions has already been experienced in various Pacific Island countries. In the 1990s the Fiji garment, clothing and textile industry was a major source of employment for Fiji's growing labour force. At this time the industry was protected and facilitated by tax-free concessions and preferential trading arrangements primarily under South Pacific Regional Trade and

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[18] Nikunj Soni, Belinda Harries & Betty Zinner-Toa, 'Responding to the Revenue Consequences of Trade Reforms in the Forum Island Countries' (Final Report, Port Vila, September 2007).
[19] Ibid, 148.
[20] Ibid.
[21] PANG, above n 2, 71.
[22] Nikunj Soni, Belinda Harries & Betty Zinner-Toa, above n 18, 172.
[23] Ibid; see also PANG, above n 2.
[24] Nikunj Soni, Belinda Harries & Betty Zinner-Toa, above n 18, 70.

Economic Cooperation Agreement (SPARTECA).[25] Statistics in 1999 show that employment in the clothing and textile manufacturing industry rose from 32 percent to 49 percent providing a total paid employment of 12.8 percent of the total Fiji population.[26] The industry provided thousands of jobs to unskilled workers especially women who would otherwise have been unemployed.[27] However, following the implementation of PICTA the workforce was halved by in 2005.[28] As some economists have commented, the current free trade agenda and the probable cessation of tax free concessions have the potential to wipe out this industry, unless policy makers and industry stakeholders recognise the need to re-organise the industry towards niche market production, and are able to improve its competitiveness.[29]

While it can be argued in Fiji's case that liberalising trade and the consequential competition from imports will force local firms to become more efficient, it is apparent that only a few local producers will be able to compete with cheaper food and goods from countries that have bigger scale and higher-technology producers. As Fiji's Trade Minister has commented,

> [I]in our collective enthusiasm for creating a new world trading system, we run the risk of forgetting one vital factor. Trade development is all about people.[30]

CHALLENGES

Free trade is premised largely on the promise of mutual gains from international trade. According to the principle of comparative advantage it would be mutually beneficial for countries to specialise in goods that they can produce most efficiently.[31] If countries stop producing what they cannot produce as efficiently as other countries, they can refocus on what they can produce better than any other country. This results in global efficiency of production. It also allows countries to be better able to compete in international markets.

This theory assumes that the global marketplace is a "level playing field" where the Pacific Islands will get access to new markets for their exports in return for opening their own borders.[32] However, some Pacific Island governments, argue that the principle itself is not self evident and harbour doubts about the theory in practice. In 1996 Fiji's

[25] Narayan and Prasad 'Fiji's Sugar, Tourism and Garment Industries: A Survey of Performance, Problems and Potentials' (2003) 1(1) *Fijian Studies* 3.
[26] Lal and Rita' (2008) 'Sugarcane production in Fiji: Farmer Profile and Farm Profitability' (Report for the Sugar Commission of Fiji, Lautoka, 2008).
[27] Ibid.
[28] Lal and Rita, 'Potential Impacts of the EU Sugar Reform on the Fiji Sugar' (2005) 20(3) *Pacific Economic Bulletin* 18.
[29] Ibid.
[30] The Honourable Mr. Isimeli Bose, Minister for Commerce, Industry, Trade and Public Enterprises for Fiji, Statement to WTO Ministerial Conference: Singapore Dec. 10, 1996. Available at http://www.wto.org/english/thewto_e/minist_e/min96_e/st54.htm. (Accessed 12/03/09).
[31] David N Hyman, *Economics* (1989).
[32] Kelsey, above n 6.

Minister for Commerce, Industry, Trade and Public Enterprises, Isimeli Bose, in his statement at the first Ministerial Conference in Singapore expressed such a concern:

> [T]he nature of the micro-economy island State that I represent, and the restrictive influences it imposes on the range of decisions and options we, as leaders, have to make, are indeed overwhelming. We are told in a forum such as this, that we are all equal and we have a level playing field. However, when I consider my inability to influence opinion, to mobilize razor-sharp executives who lobby convincingly on our behalf, to stage-manage events as they unfold, and my lack of authority to influence the debate, then I realize that there is no level playing field in trade, and some are indeed more equal than others.[33]

The unlevel playing field is also apparent in other aspects of trade. Normally the main concern between international trading partners is production efficiency. But there are very few high-value foods and goods that Pacific Islands can produce more efficiently than their regional and international trading partners.

PICs specialize in very few products and they cannot realistically compete with other products in international markets. For instance, Fiji produces only fish, sugar and garments, while Solomon Islands has fish and Vanuatu has cattle and fish.. Compounding this problem, most of these Pacific products were exported in almost the same international market with Australia, Japan, New Zealand and Europe. These developed trading partners have more sophisticated technology and production capabilities which enable them to efficiently produce identical products domestically. If these international traders open their markets and export/import similar products to and from other regions of the world, such as the Caribbean or Africa, competition to secure access for Pacific products in those markets would become extremely difficult.

Furthermore, PICs are remote and surrounded by large tracts of ocean. They have high transport costs for exporting. They also lack the necessary skilled workers, technology and capital.[34]

> [L]imited natural resources, small labour force, geographical fragmentation, remoteness from major markets and susceptibility to natural disasters such as flooding and hurricanes are typical features of most islands in the South Pacific region. Moreover, our economies are dependent, for foreign exchange, on one or two major commodities that are sold under preferential trade arrangements, and only a couple of major industries provide the bulk of our domestic employment.[35]

The problems of geography, limited labour force and natural resources have been frequently raised by various Pacific Island governments, but are yet to be properly recognised under regional trading regimes.

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[33] Bose, above n 32.
[34] Kelsey, above n 32.
[35] Bose, above n 32.

While richer nations may bring added investment to PICs the developed nations will benefit more from the opening up Pacific markets. As one commentator has observed,

> there are very few high-value foods and goods that Pacific Islands can produce more efficiently than other countries. They are too small scale and remote with high transport costs and lack the necessary skilled workers, technology and capital. Realistically, few foreign investors will bring those inputs to the Islands. Unrestricted global competition means most Islands will be left selling unprocessed natural resources like fish, timber or minerals to other countries that make the big profits out of "adding value". And a natural disaster can wipe out those natural resources overnight.[36]

If this observation is precise, then opening up Pacific markets would not be disastrous to domestic industries that strive to develop and to be efficient in the production of these raw materials. However, these raw materials are non-renewable and exploitation of them leads to serious environmental degradation. Further, the money is in the "value adding", not in the sale of raw materials.

Moreover, trading amongst PICs will also be challenging. In particular, the ideal of forming a regional market as a pedestal for stepping into the global economy as required under PACER and facilitated under PICTA would bring many complications. This perceived difficulty is of course rooted in practical reasons. It is clear that most islands nations will find it difficult to diversify their economies since most of them produce and import 'identical products', whether it is fish, timber, cocoa or copra. For example, if Solomon Islands and Vanuatu have to trade fish or copra or cocoa on the WTO MFN basis, this will lead to arguments regarding domestic industries, protection of domestic products and so on. Likewise to focus only on the production of one of these products would reduce government export earnings. Thus to assume that PICs will achieve economies of scale under a single regional market is not practical because of the homogeneous nature of their products.

Finally, the same issues of geographical location which make transportation difficult, narrow resources base and limit internal market are all important factors affecting the efficiency of regional economies. Having said that, it is difficult to see how PICs will automatically reap any tangible benefits from integrating their small economies into global or regional trading.

CONCLUSION

In light of the main impacts and challenges discussed above what can, or should, PICs do?

Assuming that free trade is unavoidable, to meet the challenges identified, infrastructure development and maintenance must be a primary focus. This should include the

[36] Kelsey, above n 6, 11.

development of domestic industries whether through encouraging new productive activities which contribute to economic development, or by the establishment of new industries or an extension of the range of commodities produced or manufactured by existing industries in each country. This will also help to ensure that alternative sources of employment and livelihood are identified and developed.

To mitigate the adverse effects of a possible reduction in government revenue through reduced tariffs, alternative revenue sources should be found, with some restructuring of the tax base. Also, those sectors adversely affected by reduced government budgetary allocation could be prioritised for aid funding. This strategy, however, is not without its down side. As noted by Kelsey,

> [T]he ever-present reality of aid and trade dependency by Pacific Island Countries on developed trading countries, made it difficult for even the unhappiest Pacific Island governments to express clear-cut complaints…[37]

The dependency of PICs on aid increases the pressure on them to accept the trade policy of developed trade partners, whether or not its impact on government revenue or employment is severe.

Finally, if free trade is unavoidable then the legal implications and economic impact of FTAs must be better understood in order to create the timely and effective implementation of FTAs. Because whether we create a regional free trade area or not, we have to adjust to a more open global economy or face stagnation and even greater marginalisation.

[37] Kelsey, above n 6, 22.