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TRADE ISSUES AND DEVELOPMENT PROSPECTS OF ISLAND DEVELOPING COUNTRIES OF THE PACIFIC

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Chapter I

TRADE PERFORMANCE OF THE PACIFIC ISLAND DEVELOPING COUNTRIES[1]

(a) Overview

1. The Pacific Island Developing Countries (PIDCs) are characterized economically by several key features:

- small populations;
- limited resource base, including natural, human and capital resources;
- open, trade-dependent economies - overall, exports are valued at 55 per cent of GDP while imports are valued at 67 per cent of GDP; and remoteness from the major world markets.

2. None of the PIDCs are industrialised nations and their level of economic development varies widely. Five of these countries are among the Least Developed Countries (Kiribati, Solomon Islands, Tuvalu, Vanuatu and Western Samoa).

(b) Growth in merchandise exports

3. The only PIDCs which have experienced growth in merchandise exports in the past five years are Papua New Guinea, Solomon Islands, Tonga and the Federated States of Micronesia, although in the case of the latter two countries, growth has been modest. Fiji experienced export growth in the late 1980s, but this has now levelled off. While exports grew in Nauru in the late 1980s, they are now declining rapidly, due to the depletion of the country's phosphate resources.

4. The low degree of merchandise export dependence in countries such as Western Samoa, Tonga and Vanuatu reflects the importance of other sources of foreign exchange earnings, including tourism and private remittances. In contrast, in Fiji, Papua New Guinea and the Solomon Islands, merchandise export orientation now constitute more than 30 per cent of GDP, reflecting the increasing export orientation of these economies.

5. The composition of PIDC exports has changed during the past decade. The increased contribution from manufactures and the decline in agriculture are particularly evident.

6. PIDC export development continues to be highly variable. An example can be seen in the growth and sudden decline of Fiji's garment exports to New Zealand. Exports grew rapidly from F$ 312,792 in 1987 to F$ 54.6 million in 1989, but by 1993, had declined to F$ 19 million.

(c) Growth in merchandise imports

7. In all the PIDCs, import dependence is high and equivalent to at least 40 per cent of GDP. Import dependence is greater in the smaller economies such as Kiribati, Western Samoa, Tuvalu and Vanuatu where the production base for many consumer and intermediate goods is comparatively under developed. Following the 1987 coups in Fiji, imports increased dramatically, but the trend has reversed slightly since 1991. Import growth is a predominant economic feature in most Pacific island economies. Exceptions are Vanuatu, which has experienced a decline in imports, and Tonga and Kiribati where import levels have remained stable.

8. Imports greatly exceed exports in most Pacific island economies. For example, since the mid 1980s, in Kiribati, Western Samoa and Tuvalu, imports have been over 10 times greater than exports. While import growth is stimulated by a number of factors, including high population growth rates.

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[1] Data used in the preparation of this report will be available in a separate annex document.

9. High population growth rates are a feature of many of the PIDCs and are seen as one of the key development issues to be addressed in the South Pacific in the next decade. Population growth continues to outpace economic growth in many PIDCs, averaging 2 per cent per year. These rates are unsustainable, particularly in the small island states, and have offset the growth in national income that has occurred in the last decade. Current rates of population growth are creating increasingly difficult economic, social and environmental problems for the PIDCs.

10. Population growth trends and PIDC import growth appear closely related. If population growth trends continue in the next decade as they have in the past, the import dependency of a number of the PIDCs is likely to continue, further undermining limited gains in exports, and increasing balance of trade deficits. Unless the PIDCs can improve their economic performance and lower high rates of population growth, they face a continuing decline in per capita incomes and standard of living[2].

11. The composition of PIDC imports has changed only slightly during the last decade. The increase in service imports is the only notable trend.

12. One of the key import issues to be addressed by the PIDCs is that of energy imports. PIDC petroleum imports account for between 6 per cent to 23 per cent of total import values, and from 10 per cent to over 400 per cent of total export revenue in some of the small island states. Improvements in the performance and efficiency of the energy sector would lead to significant savings in foreign exchange.

(d) Balance of trade in goods

13. Papua New Guinea and Nauru are the only Pacific island economies which have surplus balances of trade in goods. In PNG's, case this has only been achieved since 1991. Nauru's favourable position is deteriorating rapidly as exports of phosphate, its principal source of export earnings, are experiencing massive decline. The Solomon Islands' balance of trade in goods position has improved dramatically since 1992, largely due to log exports. However, log exports are widely viewed as unsustainable. Fiji's deficit balance of trade in goods has been steadily improving in the period since 1990. The remainder of the Pacific island economies have relatively large deficit balances of trade in goods, and in many countries, balance of trade figures are progressively worsening.

(e) Terms of trade

14. Pacific island economies are highly vulnerable to terms of trade shocks. The weakening of export prices relative to import prices was a major cause of the decline in Pacific island export earnings and balance of payments deterioration in the 1980s. It is difficult to analyze terms of trade in most Pacific island economies as statistics are not consistently available. However, it can be noted that the Pacific island economies are heavily dependent on primary commodity exports and there are often extreme year-to-year fluctuations in the commodity terms of trade. There has also been a long term adverse situation owing to weak prices for coconut products and other traditional primary product exports. As an example of the affects of commodity price fluctuations, changes in the price of sugar accounts for 80 per cent of the variation in Fiji's export earnings.

15. A report by the World Bank[3] found that there was a strong link between exogenous shocks, terms of trade fluctuations and overall growth. In an analysis

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[2] Pacific Economic Cooperation Council (PECC). "Pacific Island Developing Economies: Priorities for the 1990s." The PECC Pacific Economic Development Report. 1995.

[3] World Bank. Pacific Island Economies: Building a Resilient Economic Base for the Twenty First Century World Bank. 1995.

of economic shocks to the economies of Fiji, Western Samoa and the Solomon Islands in the period 1983 - 1993, it was found that terms of trade shocks (positive and negative) can be very large, difficult to anticipate, and of long duration. Because of difficulties in responding through economic and trade policies, PIDCs have generally sought increased financing through aid and private remittances. However, in some PIDCs exchange rates depreciation has contributed to decreases in imports and higher export competitiveness.

(f) Growth in service exports

16. Exports of services contribute more than 50 per cent of total export earnings in the PIDCs, excluding Papua New Guinea. Trends in growth of service exports and imports are difficult to identify because of the paucity of data available. However, broad patterns have been determined by a range of studies during the past several years. Fiji and Papua New Guinea are the two largest exporters of services, although both export only a relatively small share of their total services output. During the period 1982 to 1993, the share of services as a percentage of PIDC total exports decreased by 1 per cent.

17. With the exception of Papua New Guinea and the Solomon Islands, Pacific island service exports are dominated by tourism. Tourist arrivals in the South Pacific increased by 5.9 per cent from 1992 to 1993. Annual growth is expected to continue at around this rate for the rest of the decade. However, the economic significance of tourism varies around the region. In several countries, tourism is the largest single earner of foreign exchange, generating considerably higher earnings than the value of merchandise exports. Other countries have yet to develop tourism to its full potential, in some cases due in part to access constraints such as inadequate air services

18. The only detailed time series data set available for services covers trade between Australia and Fiji and Papua New Guinea. In both cases, service exports have declined since 1990. It can be reasonably assumed that similar trends may exist for other PIDCs. In broad terms, most of the PIDCs record a small services trade surplus with Australia, primarily as a result of the region's importance as a major tourist destination.

(g) Growth in service imports

19. The Pacific island economies are significant importers of freight and insurance services as a result of their reliance on overseas shipping groups. They are also net importers of telecommunications and professional services. Papua New Guinea and the Solomon Islands are highly dependent on service imports, with service imports more than double the value of service exports. In 1982 the share of services as a percentage of PIDC total imports was 30 per cent, by 1993 this had increased to 37 per cent.

(h) Balance of trade in services

20. While the service sector varies widely among PIDCs, trade in services is dominated by tourism, associated transportation and the finance sector. Papua New Guinea, the Solomon Islands, Tonga and Western Samoa all have deficit balances of trade in services, although in the case of the latter two countries, this deficit is not substantial. In Fiji and Vanuatu, surpluses in the trade in services account are principally due to revenue from tourism.

(i) Public and private transfers (aid, remittances)

21. Most Pacific island economies are significantly linked with former colonial power economies or those of nearby countries, such as Australia and New Zealand. There are large inflows of aid from these sources. These relationships also provide opportunities for migration, with, for example, large numbers of Samoans and Tongans migrating to New Zealand, and increasing Fiji Indian migration to Australia. As a result, private remittances have become an important source of foreign exchange earnings, particularly in the smaller economies.

22. In Western Samoa, private remittances represent the largest source of foreign exchange earnings, and their share is growing, with a 16 per cent increase in the first six months of 1995. Tonga and Vanuatu are also highly dependent on private remittances for foreign exchange. In Kiribati, aid, interest and remittances represented more than 80 per cent of GDP in 1991. Large and increasing amounts of remittance transfers and aid in Tuvalu have boosted growth in real GDP to around 7 per cent per annum in the period 1986 to 1990.

23. Aid has been a dominant feature in South Pacific economies since their independence. Official development assistance averaged almost 27 per cent of GDP during the period 1980-1992. However, there is considerable variation ranging from 3.3 per cent of GDP for Fiji, to 56 per cent for Kiribati. The bulk of this aid (45 per cent) is in "services" i.e. technical assistance, or supplies "in kind" on grant terms, rather than loans - only in the Solomon Islands and Western Samoa does the ratio of loans in total aid exceed 15 per cent.

24. All PIDCs receive development assistance from bilateral and multilateral donors. Major donors to the region are Australia (49.7 per cent), New Zealand (4.5 per cent) and Japan (22.0 per cent).

25. Aid has clearly had a very positive impact on development in the South Pacific, according to the World Bank[4], but does not appear to have had substantial impact on growth.

26. This reflects both the target of aid (largely public services and facilities) and aid utilisation. The gross allocation of ODA is not the same as the transfer of financial resources that actually reaches a country - generally regarded as being below 60 per cent of total ODA. This largely results from supplies and consultant expenditure being made within the donor country rather than in the actual recipient country. The relationship between aid and growth issue is a controversial one. World Bank[5] analysts argue that large inflows of aid actually constrain economic development or compound economic constraints. One example is the overvaluation of real exchange rates by aid inflows raising wages and prices. This leads to losses in competitiveness, growth in imports, and deteriorating trade balances. The World Bank believes this problem may be occurring in the small island states of the Pacific particularly. Large aid inflows also tend to support growth in the public sector - often at the expense of the private sector.

27. Development assistance has been the main source of investment financing in the PIDCs for many years and is a large contributor to GDP in most of the PIDCs. As noted by PECC[6] nearly all economic infrastructure and social services have benefited from external aid support. PECC expresses the view that "although the effectiveness of foreign assistance has at times been questioned, there is little doubt that aid flows have made and will continue to make an important - and even crucial - contribution to economic and social progress in the PIDCs".

(j) Current account

28. When official transfers such as aid are excluded, current account deficits are a feature of the Pacific island economies. In Western Samoa, there has been a recent widening of the current account deficit, although the trend reversed somewhat in 1994. Fiji has moved from a current account surplus to a deficit. In the Marshall Islands and the Federated States of Micronesia, there has been no progress made in curbing the large current account deficits. While the Solomon Islands has managed to reduce its current account deficit, this has only

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[4] World Bank. Toward Higher Growth in Pacific Island Economies: Lessons from the 1980s World Bank, 1991.

[5] World Bank, 1995 - op cit.

[6] Pacific Economic Cooperation Council (PECC) - op cit., p. 39.

been as a result of increased log exports, which is not a sustainable industry.

29. Although Kiribati and Tuvalu maintain a current account surplus, when official transfers are excluded, there is a deficit situation. The large gap is attributable to the substantial funds Kiribati and Tuvalu derive from official aid flows and interest earnings.

30. The current account deficits (when official transfers are excluded) in the PIDCs are a reflection of fiscal policy, very low levels of savings and increased consumption. As a result, official international reserves have declined significantly in Fiji, Papua New Guinea, Solomon Islands and Western Samoa. With the exception of a depreciation by the Solomon Islands and the 1995 float of the Papua New Guinea kina however, exchange rates have remained relatively stable. External commercial borrowings have also largely been avoided except by the Marshall Islands. Containing budget deficits will be necessary if the Pacific island economies are to maintain or improve their external positions.

(k) Degree of concentration/diversification of trade in goods and trade in services

31. While Pacific island economies are highly dependent on commodity exports, several have undergone significant changes in their export base in recent years. With the exception of Western Samoa, the coconut industry has declined rapidly in most countries. However, natural resources including fisheries and forestry remain important sources of economic wealth.

32. World Bank analysis indicates very high export concentration ratios in many of the PIDCs, with average three product concentration ratios of 80 per cent. This compares to 64 per cent for Sub-Saharan Africa and 26 per cent for Australia. Fiji and Vanuatu are the only PIDCs to have reduced their export concentration in the past decade. These export concentration ratios highlight the continuing vulnerability of the PIDCs to changes in the global environment - particularly in commodity trade.

33. In the ten years to 1993, the share of agricultural commodities in total exports in Pacific island economies fell from 28 per cent to 16 per cent. In 1983, manufactured exports were insignificant, whereas by 1993, they accounted for 8 per cent of total exports. While most of this change is attributable to developments in Fiji, other economies are also diversifying their export mix.

34. The gradual change in export mix illustrates the ability of the Pacific island economies to respond to unfavourable primary commodity prices by diversifying into higher value-added products and manufactures and finding "niche markets", despite a formidable set of constraints typical of small island states. Even within traditional product categories, Pacific island economies have demonstrated an ability to seize opportunities for establishing successful new export industries, such as garments in Fiji, squash in Tonga, logs and timber in the Solomon Islands, veal in Vanuatu, seaweed in Kiribati, and fish for sashimi in the Federated States of Micronesia. Recent research conducted by the South Pacific Forum Secretariat found that good prospects also existed for a wide range of other products, including horticultural and floriculture products, bio-commodities, spices, furniture, handcrafts and garments.

35. Three groups of products dominate PIDC imports - foods, mineral fuels and manufactured goods (consumer products and machinery). Services constitute over 30 per cent of PIDC imports. The share of food in total imports is less than 20 per cent for the larger PIDCs and is above 30 per cent for smaller PIDCs. All PIDCs are dependent on imports of oil products. The relationship between population growth and imports of food and oil products is high, indicating that these imports are likely to continue increasing in total terms for most PIDCs.

(l) External dependence and vulnerability of the economies

36. The majority of PIDCs are highly import dependent, although the level of import dependence is not as great in Fiji, Papua New Guinea, Tonga and Vanuatu as it is in other countries. With the exception of Papua New Guinea and the

Solomon Islands, the level of export dependence in Pacific island economies is relatively low.

37. Countries such as the Marshall Islands, Micronesia, Cook Islands and the other small atoll states are highly dependent on imports for essential supplies. A 1995 foreign exchange crisis in the Cook Islands severely compromised the availability of essential food and medical supplies because of the high level of import dependence and the lack of foreign exchange to finance imports. The level of international reserves in Pacific island economies, and demonstrates the vulnerability of most of these economies (and in particular, Papua New Guinea and the Solomon Islands) as a result of their import dependence. There has been a recent trend towards decline of international reserves in Fiji, Papua New Guinea, the Solomon Islands and Western Samoa.

(m) Assessment of economic performance of Pacific island economies in relation to trade performance

38. Economic performance in PIDCs is characterized by low and volatile growth rates. This may be attributed to the PIDCs' vulnerability to exogenous shocks, and other factors such as domestic instability and heavy dependence on a narrow range of agricultural and primary products. The World Bank[7] found that while macroeconomic variables such as investment, consumption, inflation and aid flows were not highly volatile, large fluctuations existed in both export growth rates and economic growth rates. It concluded that there is a link, working through exports, between external shocks, terms of trade changes and economic growth in PIDCs.

39. PECC[8] has noted that the poor economic performance of the PIDCs is in sharp contrast not only to the region's intrinsic potential but also to the performance of other island nation groups. The Caribbean islands grew at an annual rate of 2.4 per cent, and the Indian Ocean islands at 3.7 per cent during the same period.

40. The traditional sources of economic growth in PIDCs are primary commodities and public investment. On the basis of economic performance over the past decade, there is little prospect that these factors will contribute significantly to future economic growth. New sources of growth will be found largely in the exploitation of niche markets by producers in the PIDCs. This will need to be accompanied by macroeconomic stability and a favourable investment climate for the private sector.

Chapter II

PRINCIPAL TRADE ISSUES AND PROSPECTS OF PACIFIC ISLAND DEVELOPING COUNTRIES IN THE CONTEXT OF TRADE Liberalization

(a) Overview

41. As the world economy continues to undergo rapid change, the PIDCs are faced with an increasingly competitive environment in which they must operate. The inevitable further integration of the world economy will present the PIDCs with a range of challenges which will not be easily overcome without significant structural change. There is a growing realisation in the PIDCs that:

- trade development is fundamental to successful economic development;
- they are increasingly part of the global trading environment in which they are becoming less isolated and less protected; and

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[7] World Bank - op cit.

[8] Pacific Economic Cooperation Council (PECC) - op cit.

- preferential market access to developed markets is eroded, and has generally not been maximised by the PIDCs in any case.

42. This increased awareness has the potential to fundamentally change the way in which the PIDCs view their economic relationship with the rest of the world.

(b) Impact of GATT/WTO

43. As a result of the agreements of the Uruguay Round, the World Trade Organisation has forecast that trade in agriculture, garments and industrial goods will increase, with the net global effect estimated to be a 12 per cent rise in both trade and incomes. Other international organisations, such as the World Bank and OECD, agree that there will be substantial gains for world trade, but are less optimistic on some of the sectoral impacts. For instance, both these organisations have predicted that prices for temperate food crops will increase, while prices for tropical tree crops such as coffee and cocoa (exported by several PIDCs) will decrease. This will adversely affect the terms of trade of PIDCs.

44. The PIDCs are unlikely to benefit from trade liberalization as much as many other trading nations because of their smallness and other intrinsic structural disabilities which render them less competitive. Nevertheless, PIDCs should make greater efforts to benefit from the outcome of the Uruguay Round by exploiting new trading opportunities that arise therefrom. This will involve, inter alia, expanding their productive capacity, where the potential exists, and improving their marketing efficiency[9].

45. While there is strong regional support for the principles of free trade and trade liberalization, the issue of GATT/WTO membership is one which can only be taken at the national level. The Forum Secretariat and other regional and international bodies (UNCTAD, Commonwealth Secretariat, EU) have provided advice and assistance to PIDCs to assess the pros and cons of WTO membership. The concept of some form of “regional membership” of the WTO has been suggested, but this is unlikely to be realised as membership of the WTO is restricted to individual countries, and has no provision for regional groupings. However, a regional presence in Geneva to facilitate interaction between the PIDCs and the WTO may be worthy of further consideration by the PIDCs.

46. As of 31 January 1996, Fiji was the only PIDC member of the WTO. Tonga and Vanuatu have requested to join the organization and their applications are being considered by accession working parties. Papua New Guinea and the Solomon Islands have observer status. Among PIDCs which were neither members nor observers of WTO or being considered by accession working parties as of 31 January 1996 were the Federated States of Micronesia, Kiribati, the Marshall Islands, Nauru, Samoa, and Tuvalu. Participation of PIDCs in the WTO will:

- allow their involvement in successive rounds of negotiations in the GATS to stimulate efficiency, openness and growth in services trade in the Pacific;
- expose them to processes of bilateral and multilateral trade negotiations;
- provide them with the opportunity (albeit limited) to influence the trade negotiating process;

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[9] This view is supported by ESCAP: see UNESCAP. Uruguay Round: some implications for Pacific Island countries. Paper for the Seminar on Trade Policy Issues for Pacific Island Countries. Nadi, Fiji, Nov 1994.

- provide them with access to a mechanism to redress discrimination by their larger trading partners and more easily participate in dispute settlement procedures; and

- provide them with a more transparent and equitable framework of trade rules and disciplines.

47. It is, however, important to note that, for some PIDCs, it will be difficult to develop the infrastructure necessary to prepare schedules, deal with negotiations, and then (if successful in accession to the WTO) meet the reporting and compliance obligations. However, it can also be argued that by simply being involved in the process of WTO accession, the PIDCs will learn the mechanics of international trade, which will have wider benefits in increasing PIDC interaction with the global economy.

48. The WTO Secretariat has noted that while the PIDCs, as developing countries, are covered by special provisions relating to timeframes, accession and notification procedures, they must, nonetheless, fully understand that accession to the WTO involves commitments to make concessions to their trading partners. However, for the smaller PIDCs - namely Kiribati, Niue, and Tuvalu - such commitments may imply relatively high costs.

49. The "single undertaking" principle of the Uruguay Round package is an important consideration for the PIDCs. This principle seeks to ensure that contracting parties are in compliance with the entire package of new disciplines as outlined in the Final Act. This will mean that PIDCs seeking either to accede to WTO or to maintain GATT consistency on a *de facto* basis will have to assume more obligations and responsibilities arising out of GATT Articles and also from agreements on new issues such as Trade in Services, Investment and Intellectual Property. While provisions for special and differential treatment for developing and least developed countries are still important, the PIDCs will be subject to greater reciprocity under the new GATT provisions.

50. ESCAP[10] has identified two particularly important factors which the PIDCs must take into account in relation to WTO membership:

- ESCAP suggests that it will not be possible for the PIDCs to undertake such comprehensive changes in laws and policies without receiving technical assistance as WTO members. Even after initial changes are made, the PIDCs are likely to fall behind as new areas are included in the multilateral framework and new disciplines are developed.

- The Uruguay Round agreements extend into areas of domestic policy making,such as domestic support for agriculture, subsidisation etc. WTO membership will necessitate acceptance of uniform restraints on domestic policies in PIDCs.

(c) Erosion of preferential market access - a catalyst for change ?

51. With the exception of sugar, canned tuna, tree crops and garment exports, the erosion of preference may go largely unnoticed by many of the PIDCs as they have generally taken little advantage of preferential access arrangements. Despite virtually free market access under the Lomé Convention, the PIDCs have made no significant inroads into the EU market. In the Australian and New Zealand markets, only Fiji's garment industry and Western Samoa's automotive wiring harness industry have developed through the benefits of SPARTECA.

(d) Sectoral issues for PIDCs

52. Fiji supplies <u>sugar</u> to the EU under the terms of the Sugar Protocol of the Lomé Convention. It has a quota of 163,000 tonnes, sold at the EU intervention

[10] United Nations Economic and Social Commission for Asia and the Pacific, 1994 - op cit.

price, which is around two to three times higher than the world price. In 1991 Fiji received a net transfer from the EU of $90 million per annum or 4 per cent of GDP. As a result of the Uruguay Round it has been estimated that this price could decline by 12 to 15 per cent by the end of the decade. Grynberg[11] predicts this will result in a one-off decrease of Fiji's GDP of approximately 1 per cent in real terms. The result will be increasing marginality for the Fiji sugar industry.

53. The Sugar Protocol of the Lomé Convention has been the mainstay of the Fiji sugar industry since the mid 1970s. The past 20 years have seen the industry become dependent on high prices under the protocol leading to inefficiencies and high cost structures. Assuming that the Lome Convention expires in the year 2000, little incentive will exist for the EU to contest a legal challenge to the sugar protocol that might be raised by one of the non-ACP sugar exporting countries.

54. Given that the Sugar Protocol has not yet been challenged, Fiji has some "breathing space" to enhance the economic viability of its sugar industry. Its choices are all hard ones - as a high cost producer it must increase efficiency, diversify markets, diversify into new processed forms or by-products, and in the longer term possibly diversify out of sugar altogether. Domestic issues such as uncertainties over renewal of sugar land leases must also be addressed.

55. The PIDCs are all exporters of <u>tree crops</u>, notably coconut products. During the late 1980s, exports of coffee (Papua New Guinea), cocoa (Papua New Guinea and the Solomon Islands), and palm oil (Papua New Guinea and the Solomon Islands) expanded significantly. However, over the last decade, there has been a decline in the overall contribution of tree crops to the region's economies, with the copra industry in Tonga and the cocoa industry in Fiji and Western Samoa now almost non-existent. Vanuatu is the PIDC economy which is most dependent on copra exports, but while production has remained stable, there has been a sharp downward trend in earnings because of the price decline.

56. The agricultural sector has been one of the key focuses of global trade liberalization. It is believed that liberalization of agricultural trade will increase the prices of <u>food and food products</u> over the longer term. The PIDCs, as net importers of food, therefore stand to lose (in net terms) from higher world prices. ESCAP[12] noted that the GATT ministerial declaration on compensating net food importing countries is not very specific on the extent and modalities for such compensation.

57. Given the likelihood of increasing imports (most notably food) in all PIDCs as a result of high population growth rates the PIDCs need to secure their interests in more specific terms with real commitments from major trading partners. To maximise foreign exchange savings, the PIDCs need to enhance their food import procurement and management wherever possible.

58. At the same time, liberalization in the food sector will undoubtedly provide increased opportunities for niche marketing of PIDC food products, particularly into the (previously) heavily protected Asian consumer markets. PIDC success will only be achieved as a result of carefully targeted production and marketing strategies focused on agricultural products where real comparative advantages exist.

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[11] Grynberg, R. <u>The closure of the Uruguay Round and its impact of the South Pacific Forum Countries</u>. Paper for the South Pacific Forum Secretariat. 1994.

[12] United Nations Economic and Social Commission for Asia and the Pacific. <u>Enhancing the external trade and investment of Pacific Island Countries, in particular with Asia: policy issues and implications for the 1990s</u>. Note to the Special Body on Pacific Island Developing Countries. April 1995.

59. The tuna processing industry in Fiji, Solomon Islands, and soon in PNG, is almost totally dependent on the 24 per cent margin of preference for canned tuna exports to the European market. Grynberg[13] found that without this margin, the PIDC canned tuna industry would probably not survive as all three canning industries are virtually completely dependent on a single market - the European Union.

60. The PIDCs must try to preserve their margin of preference for as long as possible while simultaneously making concerted efforts to increase the efficiency of canning operations in the longer term. The PIDCs would be wise not to assume that their tuna canning industry will continue to be protected as a "spin off" from the EU's protection of its own canning industry.

61. The impact of trade liberalization, particularly in Australia and New Zealand, has already been felt by PIDC garment industries - most notably Fiji and Tonga. Fiji's relatively young garment industry - established through a combination of tax free zones, relatively low wage rates and preferential access under SPARTECA - faces considerable challenges if it is to survive the next decade.

62. The dismantling of the MFA and the phase-out of non-MFA restrictions under the Agreement of Textiles and Clothing will eliminate quantitative restrictions and open the sector to increased competition from low wage Asian producers and the more efficient suppliers from the Asian newly industrialising countries. The key issue for the PIDCs is to take advantage of the predicted 5-10 year transition period to restructure their export product mix, increase productivity, devote more attention to market research, design sophistication and product development.

63. The World Bank[14] has noted that exporters who have been induced by the MFA to enter the production of textiles and clothing without possessing comparative advantage in these goods are likely to suffer losses from the abolition of the MFA. The PIDC garment industry falls into this category.

64. The pressures placed on the Fiji garment industry from trade liberalization in Australia and New Zealand have been a significant factor in the decline of Fiji's trade. With SPARTECA preferences remaining unchanged, the value of the preference to Fiji has diminished (and will continue to do so) as tariffs against the rest of the world have reduced. In this environment, competitiveness has become the single most important determinant of a nation's ability to capitalise on global trading developments. How to exploit emerging opportunities in a changing and increasingly competitive marketplace is the key issue facing PIDC policy makers[15].

65. However, rationalisation of the world garment trade may also provide opportunities for Fiji if it is able to compete on the basis of its comparative advantage - particularly the ability to field and respond to small orders quickly. These orders are of little interest to high volume Asian suppliers, and can sustain the relatively higher production costs of Fiji.

66. The garment industry is notoriously transient. Whether the industry is willing (and is sufficiently viable) to make these changes is yet to be seen. Historical evidence would suggest that a significant percentage of the Fiji garment industry (particularly foreign owned companies) may simply "pack up" and move to another lower cost location, as soon as operations become marginal.

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[13] Grynberg, R. A study of the trade and economic effects of the Lomé Convention on Pacific ACP Countries. Report prepared for the Forum Secretariat. 1994.

[14] World Bank. The Uruguay Round: A milestone for the developing countries. 1995.

[15] World Bank, 1995 - op cit.

(e) Small- and medium-sized enterprises (SMEs) and the global trading environment

67. With the exception of mining company operations in Papua New Guinea and some forestry operations in Melanesia, virtually all enterprises in the PIDCs can be classified as small and medium enterprises (SMEs) - in fact, many are "micro" enterprises.

68. The role of SMEs in creating economic growth in developing countries, particularly their ability to invent, innovate and adapt to changing conditions far more rapidly than larger companies and conglomerates, is well recognised. Badrinath[16] notes that SMEs have demonstrated their important role in socio-economic development in the developing countries where they can account for as much as 90 per cent of industrial employment and 35 to 65 per cent of exports. However, it has been estimated that only about 5 per cent of SMEs are involved in exporting. Many international agencies, such as the International Trade Centre UNCTAD/GATT, have placed particular emphasis on SME development and increasing developing country SME activity in the export arena.

69. It is the inherent flexibility of SMEs that makes them well adapted to meet the rapidly changing needs of the global market. This has been demonstrated by the Asian "Tiger" economies, in particular Taiwan, Singapore, and Hong Kong, whose economic success has been based on the ability of their SME sector to rapidly adapt to changing market conditions.

70. This success has been demonstrated by a number of successful ventures in the PIDCs which have used their small size to fill market niches and adapt to market needs in a very rapid way. An example is the Fiji-based clothing company, Kalacraft Limited. Kalacraft manufactures "surf" clothing for the Australian market, based on short production runs, just-in-time delivery, and the ability to quickly change garment colours and styles as the fickle Australian teenage clothing market moves from season to season. The company's long term strategy views preferences under SPARTECA as a "bonus" rather than a "crutch". The company competes openly with Asian competitors and reinvests the SPARTECA "bonus" into upgrading technology and personnel training.

71. Badrinath[17] and Asia Pacific Economic Cooperation (APEC)[18] view the global changes in information technology, coupled with reductions to border and non-border impediments to trade arising from the Uruguay Round, as offering considerable new opportunities for SME expansion. While considerable expansion of communications systems in the PIDCs still needs to be undertaken, access to communications and information technology in the South Pacific is increasing rapidly.

72. The communications revolution has the potential to significantly reduce or even neutralise some of the comparative disadvantages currently faced by the PIDCs. It is certainly now possible for a small enterprise based in the PIDCs to operate in the international arena without a physical presence. The PIDC tourism industry, coffee roasters in Papua New Guinea and the Fiji garment industry are already reaping the benefits of modern communications to successfully market their products internationally.

(f) Trade liberalization in the Asia Pacific region - a key focus for PIDC attention

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[16] Badrinath, R. Trade expansion by small and medium enterprises and enhancing access to the markets of industrialized countries. Address to the Seventh International Conference of the World Assembly of Small and Medium Enterprises. Addis Ababa: ITC UNCTAD/GATT, March 1994.

[17] Badrinath, R. - op cit.

[18] Asia Pacific Economic Cooperation (APEC). APEC Survey of Small and Medium Enterprises. 1995

73. Trade and investment liberalization in the Asia Pacific region, driven by the rapid developments in Asia Pacific Economic Cooperation (APEC), have the potential for considerable influence in the PIDCs. Since the early 1980s, the emergence of East Asia as a trading region has changed the PIDCs' geographic pattern of trade. The PIDCs have responded to these developments by increasing their focus towards the Asia Pacific region. Trade and investment linkages with the APEC member economies have increased at a rapid rate. The Asia Pacific region offers significant opportunities for the PIDCs to diversify their international market. These opportunities have been exemplified by: the growth in Fiji's exports to Japan - from US$ 5 million in 1985 to over US$ 32 million in 1993. A similar growth pattern has been witnessed for Tonga and Solomon Islands' exports to Japan. The APEC economies are now the South Pacific's most important trading partners.

74. It is crucially important for PIDCs to take advantage of their proximity to the APEC region. High growth rates have positive spin-offs to neighbouring countries. Australia and New Zealand have both positioned themselves to benefit from Asia's high growth rates and marketing opening measures. Linking with APEC and its economies is a mechanism by which the PIDCs can strengthen institutional and market linkages with the fastest growing region in the world. The PIDCs can learn from the market-led policies of the East Asian economies, which have led to their dramatic success.

Chapter III

THE SCOPE FOR SUSTAINABLE TRADE DIVERSIFICATION IN PACIFIC ISLAND DEVELOPING COUNTRIES IN THE CONTEXT OF TRADE Liberalization AND Globalization

(a) Overview

75. The issue of trade diversification in the PIDCs has been the subject of considerable attention for the past two decades, with the fundamentals well known - PIDCs need to diversify both production and markets in a manner matched to domestic and international changes. While the theory is relatively straightforward, achieving real sustainable trade diversification in the PIDCs remains difficult to achieve - despite the plethora of reports and studies undertaken in the region on the issue.

76. A very short term focus on trade development planning is a major deficiency in the PIDCs. In general, little attention has been given to developing longer term strategies and assessing the possible external developments, competitive changes and movements in the global environment. Two of the PIDCs' most valuable export industries - squash from Tonga, and garments from Fiji - are examples of success which have become increasingly tenuous in the context of trade liberalization and globalization. At the same time, attention to broad industry development has tended to overlook the micro-enterprise private sector base of many of the PIDCs. More consideration needs to be given to a "bottom up" approach to trade diversification in the PIDCs.

77. The resource endowment of the PIDCs has meant that their comparative advantage has traditionally rested on agriculture, forestry, fisheries and tourism, with mineral resources playing a key role in PIDCs such as Nauru and PNG. However, these comparative advantages may be shifting as changes in production technology and markets induce products themselves to evolve, making less use of land and labour, and more use of information and capital - which the PIDCs must generally import. Assessments need to be made by the PIDC governments to discern where their comparative advantage will lie ten or twenty years ahead, and to then influence trade diversification by training people, planting forests, managing fish stocks, reforming land tenure, etc[19].

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[19] Hughes, A.V. "New bags, old copra" Pacific Islands Development Dialogue, Vol.1. Noumea: South Pacific Commission. April 1995.

78. Economic development based on expansion of PIDC exports depends on the ability of the PIDCs to compete internationally. By diversifying and adding value to exports, and substituting domestic production for manufactured imports (where commercially practical), the PIDCs can reduce the vulnerability of their open and shallow economies to external shocks. As the globalization of trade continues, these structural changes will become increasingly important.

79. External shocks will always remain a problem for the PIDCs - the key will be the speed and flexibility with which they can deal with shifts in the economic environment. As noted in Chapter II, the experience and success of the Asian "tiger" economies has shown that economies with a small and medium enterprise (SME) base have the greatest ability and flexibility to adjust to rapid market movements. Given that SMEs constitute almost the entire industry base in the PIDCs (with the exception of mining interests in PNG), further development of SMEs in the PIDCs can only assist their ability to meet changes in the global market.

80. The majority of PIDCs still maintain a very product driven approach to marketing. This is gradually changing but the shift from product driven strategies to a market driven approach needs to be made rapidly to enable PIDCs to gain maximum advantage of global market developments. Matching production capability, comparative advantage and market opportunities must be undertaken in an on-going and precisely targeted manner, with a focus on "micro-niche" marketing.

(b) Development opportunities for the export of goods

81. In light of the unique constraints applying to the export sectors in the PIDCs, it is clear that successful exporting from the PIDCs requires very carefully defined strategies. Accordingly, success will most likely be achieved when:

- foreign technology and investment are combined with the natural resources of the region; and
- specialised niche markets are secured.

82. The niche marketing approach will avoid head-on competition with more advanced and sophisticated competitors, by focusing on sectors which are relatively unattractive to producers of large volume items because of smallness of export volumes. Such markets are normally characterized by:

- relatively short production runs;
- relatively short seasons - in the case of fresh produce;
- distinctive design or taste characteristics;
- price inelasticity;
- supply through specialist distributors targeting a particular market segment (e.g. the ethnic market in some overseas countries);
- supply not being time-critical.

83. However, it must be noted by the PIDCs that niche markets are very volatile and often transitory. Constant market contact is therefore needed to take full advantage of market changes and fluctuations.

84. As part of a comprehensive study to assess the range of potentially exportable products from the South Pacific, the Forum Secretariat undertook a region wide survey in early 1995 based on government and private sector inputs.

85. The survey findings indicate that, taking the region as a whole, exports are undertaken in over 120 different product categories. While considerable

variations obviously exist - from only 2 products from Nauru to nearly 60 from Fiji - the findings support the view that tradeable product diversification is an achievable objective for the PIDCs.

86. By global standards, the range of PIDC exportable products is relatively small. The diversification of the export base of the PIDCs needs to be focused on products with a comparative and competitive advantage targeted at niche markets, rather than attempting to develop broader new "industries". This approach has proved extremely successful in Japan and is a valuable model for consideration by the PIDCs. In addition, the PIDCs need to consider more closely their comparative advantage relative to other PIDCs. It can be noted that eight of the 13 PIDCs surveyed indicated that "taro chips" had the potential to be developed as an export product in their country. The market for taro chips is limited (other PIDCs, Hawaii and New Zealand). If more than one or two PIDCs were to embark on a concerted programme of taro chip manufacturing development, it is likely that the market would rapidly become saturated, price would fall and benefits to the PIDCs would be reduced. PIDCs should therefore more closely assess and consider those products where they have a quantifiable comparative advantage.

87. With this in mind, from the broad list of products and sectors identified, through the survey and other regional research[20], two product groupings have been identified for consideration for further development and diversification by the PIDCs:

- products of primary importance and of most significance to the greatest number of countries; and

- products of secondary importance because of either limited potential or of interest to fewer countries.

88. Sectors and products not meeting these criteria may still be of primary importance to some countries. Taking these parameters into consideration, a list of potentially exportable products and sectors for the PIDCs is presented below:

Primary importance	**Secondary importance**
Fresh fruit and vegetables Handicraft Fresh & processed marine products Wooden products	Beef Coconut by-products Cut flowers Footwear Honey Light engineering products Organic coffee Processed food products Recycled scrap metal Stamps Aquarium fish

89. This information is based on current export performance, potential opportunities which are likely to develop as global trade liberalization increases and growth in the Asia Pacific region continues to draw in an increasingly diverse range of imports. Across all the PIDCs, fisheries resources are a vital domestic and export resource.

90. Prospects for attracting production of labour intensive goods such as garments will become increasingly more difficult as a consequence of expanding trade liberalization in major markets. In general, wage rates in the PIDCs are higher than those in many Asian countries, and productivity is lower. These industries will only move to the PIDCs when offered very large tax incentives

[20] Trade Development Institute (TDI) Ireland. Regional Trade Development Study. Draft report for the Forum Secretariat (unpublished). 1993.

and other conditions which are generally not sustainable over the long term[21]. The PIDCs should also be wary of overseas companies which seek to "play off" one PIDC against another to extract maximum levels of incentive and minimum levels of contribution to the PIDC economy.

91. Within each market there are specific sectors which will need to be targeted by the PIDCs through "micro-niche" marketing. An example is that of organically grown food products and products sourced from "environmentally friendly" countries. Considerable success has already been achieved in this micro-niche by coffee exporters from PNG, ginger processors in Fiji, and processed food producers (taro chips, jams and spreads) from Western Samoa. The PIDCs are generally viewed as having a clean environment and many products are grown organically (i.e. without the use of chemicals or pesticides).

92. Breaking into new niche export markets, or establishing downstream value added processing for existing export industries, and sustaining a profitable market share is not an easy task - it requires commitment, constant market research and a stable domestic economic infrastructure. The World Bank[22] supports this view stressing the following conditions for viable niche investment in the PIDCs:

- maintenance and enforcement of quality standards;
- competitive enterprise environment;
- steady improvement in economic infrastructure;
- sustained commitment to human resource development.

93. Against the background of trade liberalization, a critical factor for future market performance will be competitiveness. For the PIDCs, competitiveness is not simply about producing cheap products - it is about increasing efficiency and productivity in all business operations, particularly those associated with exports.

94. Badrinath[23] suggests the following key determinants for increasing competitiveness:

- Technological upgrading;
- Quality control and management;
    1. Packaging;
    2. Prudent financial management; and
    3. Export financing.

95. Hand-in-hand with increasing competitiveness is enhancing the market focus of PIDC production. This is important not only for determining market needs from a purely production focus, but also to ensure that PIDC export development is in step with international developments, which are changing rapidly. As an example, the internationalisation of standards and certification procedures through the WTO and APEC processes will necessitate benchmarking by PIDCs in these areas.

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[21] United Nations Economic and Social Commission for Asia and the Pacific, 1995 - op cit.

[22] World Bank. Pacific Island Economies: Building a Resilient Economic Base for the Twenty First Century World Bank. 1995.

[23] Badrinath, R., 1994 - op cit.

96. PIDC export competitiveness would also be enhanced by more effective management of exchange rates. For example, in Fiji, the currency was devalued by 30 per cent in an attempt to stem capital outflow following the coup in 1987. This depreciation in the real exchange rate boosted Fiji's competitive position. However, both the nominal and the real effective exchange rates have appreciated in recent years, with the real effective exchange rate appreciating by 12 per cent between 1990 and early 1994, adding pressure to other concerns about the country's export competitiveness. Further appreciation will undermine Fiji's prospects for export-led growth in the medium term.

97. Macroeconomic reform is also essential for the enhancement of export competitiveness in PIDCs. Increased private and public investments are needed for sustained economic growth and employment generation. Across the PIDCs, low investment levels may be attributed to political uncertainty, lack of confidence in the direction and continuity of public policy, and doubts about competitiveness.

(c) Development opportunities for the export of services

98. Services have increasingly become a major growth area in international trade. World exports of services rose by 12 per cent (US$104 billion) to US$ 960 billion in 1992. By world standards, the share of PIDC service trade is small, estimated at less than 0.001 per cent of world service trade[24], and is dominated by tourism, aviation, shipping, telecommunications and to a lesser extent offshore banking.

99. To date, the PIDC service industry has had very limited involvement in the international market. With demand for service outputs being a function of the size and level of diversification and sophistication of a country's economic base, the narrow economic bases of the PIDCs weaken the service sector's capacity to meet even domestic needs. Where service skills and capability do exist, a range of market imperfections weaken suppliers' ability to deliver services to external markets.

100. For the PIDCs, the development of an internationally tradable service sector would result in flow-on effects for employment, national income and standards of living. However, as noted by Price Waterhouse[25], "the potential gains from developing traded services need to be placed in the context of the structure of each (PIDC) economy and based on careful analysis of the strengths and weaknesses of their existing and potential service sectors".

101. There is little doubt that the benefits from growth in services trade extend beyond the sector itself - including the close linkage between trade in services and trade in goods. An internationally competitive service sector could assist the expansion of merchandise trade in a number of the PIDCs, assisting the integration of these economies into the global market. It is important however, to acknowledge the need for development of service sectors which are consistent with the rest of the economy, including the capacity to generate and utilise new service sector activities.

102. At present, the PIDC service sector is not in a favourable position to penetrate the world market for services. Most PIDC service firms lack sufficient capital, human resources and infrastructure to sustain international competitiveness. The position is further exacerbated by the existence of significant international and regional impediments to trade in services. The General Agreement on Trade in Services (GATS) establishes a multilateral framework of rules and principles governing trade in services which it is hoped will increase transparency and liberalization of services trade, reducing these

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[24] Price Waterhouse. Report for the South Pacific Bureau for Economic Cooperation on Trade in Services under SPARTECA 1992.

[25] Price Waterhouse - op cit.

impediments. International developments in trade in services flowing from the GATS and growth in PIDCs at the domestic level should improve their performance and share in services trade[26].

103. Tourism offers perhaps the best, and in some PIDCs, the only opportunity for long term sustainable economic growth and diversification in the Pacific region. Tourism is not an extractive activity - with careful management it constitutes a renewable resource.

104. A dynamic tourism sector offers other sectors the opportunity to grow through the provision of goods and services to tourists and to operators of tourist facilities. Tourism is not an isolated economic activity, having many linkages to other sectors and should therefore be fostered. As an example, tourists are major buyers of island products which serves both to increase revenue to indigenous producers, and acts as a form of trade promotion. Of critical importance to the PIDCs, tourism provides an economic rationale for the preservation of indigenous culture and heritage, and conservation of the natural environment.

105. To the year 2000, the projected average annual growth rate of tourist inflows to the region is 5.7 per cent, with the volume of tourist traffic in the region by 2000 anticipated at 1,028,000 arrivals per annum.
106. While scope for expansion in tourism exists in most of the PIDCs, achieving real expansion requires overcoming several major internal constraints including:

- shortages of trained staff; air transportation access, scheduling and pricing;
- quality and level of supporting infrastructure - bed shortages, restaurants, tour companies, airport facilities etc.;
- marketing and promotional effectiveness - limited budgets and tendency to compete between PIDCs;
- foreign investment - lack of capital, regulatory barriers and restrictions on land ownership remain key constraints to increases in FDI.

107. Given the diversity of constraints to growth, action is required to improve accommodation and recreational facilities, strengthen marketing and promotion, and stimulate activities that support tourism such as training and investment. All the PIDCs have further potential as tourist destinations, with a focus on niche opportunities based on PIDC comparative advantages in the global tourism market, such as: the existence of globally important natural resources, such as rainforests; cultural, anthropological and historical links and differences; participation by tourists in the conservation of natural, cultural and historical resources;
unique sporting activities - fishing, diving, surfing, triathlons.

108. There is scope in all PIDCs to develop a tourism industry of far greater significance. However, this will require greater coordination of government policy, particularly in respect of the operations of airlines, foreign investment and fiscal policies and the development of overseas marketing programs. Also, as noted by Price Waterhouse[27] "there are obvious conflicts of policy where particular countries adopt high foreign currency exchange rates for wider economic management purposes."

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[26] Yee Che Fong. The GATT Uruguay Round of negotiations on trade in services and their impact on Pacific Island Countries. Report for the UNCTAD/UNDP Regional Project for Asia and the Pacific "Institutional Capacities for Multilateral Trade" Geneva: UNCTAD, 1994.

[27] Price Waterhouse, 1992 - op cit.

109. Greater efforts will also be required in regional packaging of multi-island tourist products incorporating differentiated attractions in each PIDC. This will require greatly increased cooperation of PIDC tourist agencies, airlines and tourism operators to develop a regional approach to routing, planning, development, marketing and promotion. Yee[28] also suggests that PIDCs consider making some commitments in the tourism sector - particularly in hotels and infrastructure - as “entry fees” to the GATS.

110. The strong tourism orientation of the South Pacific is reflected in the importance of aviation services in PIDC service exports, when foreign country nationals use the air services of PIDC-based companies. The market for air services within the South Pacific is very small by global standards, while operators are many. This environment of low demand, often unsuitable aircraft, and subsequent low yields has an adverse affect on the frequency and reliability of air services and air ticket pricing in the region.

111. The PIDC airlines face competition from international carriers operating in the region. On the more viable routes, these carriers operate larger cost-efficient aircraft which return higher yields. The trend towards liberalization and privatisation in air services has resulted in increased entry possibilities for new carriers, both domestic and international, in a number of PIDCs. It is likely that Asian carriers will seek to expand services to the South Pacific. GATS could assist South Pacific carriers to gain terminal slots or better access to computerised reservation systems in developed country markets.

112. Considerable progress has recently been made towards regional air service rationalisation - Air Pacific and Royal Tongan Airlines have jointly leased an aircraft, and Polynesian Airlines has signed a new commercial alliance with Air New Zealand which will involve seat-sharing on several routes. However, without on-going adjustments to the number and efficiency of airlines operated by the PIDCs within the region, the opportunities for the PIDCs to increase international aviation could be limited.

113. Closely related to the operation of air services is the provision of support services such as ground handling (cleaning, refuelling, catering), repair and maintenance, computer reservation services, and marketing and selling. PIDC carriers undertake their own ground handling and, in a number of cases, limited repair and maintenance. Some of these services are already traded within the region and to extra-regional third party carriers.

114. The scope for increasing the provision of these services to non-regional international carriers is presently hampered by the smallness of the market and the large number of airlines operating in the region. However, opportunities do exist to increase trade in these services between PIDCs - particularly with repair and maintenance of similar aircraft operated throughout the region by PIDC carriers. Further assessment of opportunities to transfer Fiji’s skills and technology for ground handling services (from Air Terminal Services (Fiji) Limited) to other PIDCs should be considered.

115. Yee[29] suggests the need for greater collaboration in aircraft maintenance and repair services in the PIDCs in order to rationalise infrastructures, stocks of spares and mobility of specialised personnel. However, past experience in the South Pacific suggest that such cooperation will only be achieved if PIDCs overcome nationalism and inter-island rivalries.

116. While the PIDCs are almost totally dependent on shipping for their international trade, very limited scope exists to increase the provision of shipping services within the South Pacific and to external markets, except in two specialised areas - vessel crewing and “flags-of-convenience”.

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[28] Yee Che Fong, 1994 - op cit.

[29] Yee Che Fong - op. cit.

117. Some PIDCs already have large numbers of nationals working on international shipping vessels - in particular, the small island states of Kiribati, Tuvalu and Tonga. This employment generates valuable service trade inflows from remittances and wages. Under the GATS, it is likely that a more secure framework and environment for this employment may exist, if concessions could be negotiated with the major countries providing shipping services.

118. There is increasing interest from international shipping lines in Vanuatu's open shipping registry. Vanuatu has enacted legislation to provide for an international shipping register along lines similar to Liberia. The underlying law is the non-statutory maritime law of the USA. High standards are required, fees are low and there are no nationality restrictions on officers or crew. Vanuatu has also become a popular base for ship holding companies whose ships and/or subsidiaries are registered in Liberia, Panama or other jurisdictions. The Vanuatu shipping register has achieved considerable success, gaining a strong reputation for quality and safety standards for its ships and operators. Vanuatu Maritime Services Limited operates the registry, with its main office in New York, and offices in London and Hong Kong. Vanuatu's comparative advantage is the ability to offer a "packaged" service of ship registration, company registration, ship management services and ship financing.

119. Offshore banking and tax haven services are traded internationally by a number of the PIDCs, including the Cook Islands, Niue, Vanuatu and Western Samoa, with varying levels of development. While the services provided by these industries are generally extended through the operations of expatriate professionals, the industry is still a major generator of foreign exchange and employment for the PIDCs. Yee estimates that Vanuatu’s foreign exchange earnings from offshore banking and tax haven services represent one third of its export revenues.

120. The tax-free Offshore Financial Centre is one of the success stories of Vanuatu. The Centre was established in 1971 and contributed around 10 per cent of GDP in 1990. It employs about 450 people, including 380 ni-Vanuatu. One of the keys to Vanuatu’s success has been the establishment of a Financial Services Commission as an independent, well resourced statutory authority that can develop, maintain and enforce appropriate regulatory standards.

121. Temporary migration from a number of the PIDCs, in particular the small island atoll states, has been a common practice for many years. As noted in Section 1, remittances from PIDC nationals living overseas contribute significantly to overseas earnings for Kiribati, Niue, Tonga, Tuvalu, and Western Samoa. Such temporary migration is not normally regarded as the provision of manpower services, although in the strict sense it is exactly that. The two major areas where manpower services are exported by the PIDCs are ship crewing and workers for phosphate mining in Nauru (although this is decreasing as phosphate reserves are depleted).

122. The demand for I-Kiribati and Tuvaluan seamen is predicted to remain firm, especially as the recruitment of European crews becomes more difficult. More Kiribati and Tuvalu seamen are also being recruited by South Korean and other Asian fishing vessels. Long term prospects for these sources of employment may be reduced as a result of changes in marine technology. The involved PIDCs need to push for increased national employment on foreign fishing fleets operating within their economic zones.

123. Yee[30] suggests that the liberalization of movement of service personnel under GATS could assist the movement of manpower from the PIDCs to Pacific Rim countries where labour shortages exist. However, given the large pool of labour within East Asia, it is likely that such opportunities would be restricted to very narrowly defined niches - such as the recent agreement between Taiwan and Fiji for 400 semi-skilled Fiji workers to be employed on infrastructure development projects in Taiwan.

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[30] Yee Che Fong, 1994 - op cit.

(d) **The scope for trade diversification in relation to the environment**

124. The issue of trade and the environment has only recently started to attract attention in the South Pacific. In general, the interest has been driven by the environmental side of the equation, and has often been pursued on a confrontational basis vis-à-vis business circles, rather than in a cooperative manner.

125. The PIDCs are primarily dependent on natural resources and agricultural products. These areas are generally environmentally sensitive (particularly forestry, fisheries and minerals) and therefore feature high in the sustainable development debate.

126. If the PIDCs are to have sustained economic growth based on natural resources, the latter must be managed in a sustainable way. This must be taken into consideration by enterprises which are always tempted to seek short-term financial reward with little regard for resource sustainability.

127. Environmental protection and resource sustainability come at a cost. Developing countries generally find it difficult to absorb the full direct and indirect costs of environmental protection as they strive to feed a rapidly growing population. However, environmental damage also entails a real cost, which is borne by society (in particular the most disadvantaged groups), as it increases health hazards and lowers productivity. Therefore, it is crucially important to compare these costs with the economic burden of environmental protection and resource sustainability.

128. At the enterprise level, there are specific problems related to environmental costs. As the world becomes increasingly sensitive to environmental issues, markets are shrinking for products produced in the PIDCs which do not meet environmental conditions either in the production process (e.g. non-dolphin friendly tuna), or in the packaging and marketing process (e.g. products packaged in non-recyclable materials.)

129. Complying with high environmental standards imposed from the outside and which do not necessarily relate to domestic problems of sustainability in the islands usually implies high production and marketing costs. The latter can decrease competitiveness on international markets as these additional costs are added to the high production and shipping costs of products that are specific to the PDICs. The result is that many companies in the region cannot afford to move to processing and packaging methods that would meet environmental standards.

130. However, the PIDCs are well placed to take advantage of global environmental awareness in producing either products which use the environment as a marketing tool (e.g. organic agricultural products) or tourism services that are based on environmental factors (e.g. eco-tourism). Other sections of the paper have highlighted specific niche markets for both services and merchandise exports which can be developed on the basis of their environmental attributes.

131. In relation to imports, considerable efforts are being made to reduce the region’s reliance on petroleum imports through the development of alternative energy sources. The economic and environmental impacts of such strategies are significant and warrant further research within the region.

Chapter IV

REGIONAL COOPERATION FOR TRADE DEVELOPMENT IN THE PACIFIC: OVERVIEW OF SUCCESSES, SHORTCOMINGS AND PROSPECTS

(a) Regional economic integration

132. There is only very limited economic integration of the economies of the South Pacific. The concept of a free trade area for the South Pacific has been mooted many times, driven by the rationale that "regional collaboration that combines the PIDCs’ individually limited manpower, financial and natural

resources may in certain areas, allow for economies of scale, reduce vulnerability to external shocks, and thereby improve overall welfare"[31].

133. While the potential for greater development of trade among the PIDCs is being explored with vigour by a number of countries, trade flows suggest that little real progress has been made in increasing trade within the Pacific. For the period 1989 to 1991, inter-PIDC trade showed virtually no growth, and accounted for only 5.0 per cent of total exports of the PIDCs. Research undertaken by the Pacific Islands Development Program of the East West Centre, Hawaii[32] found that the total value of inter-PIDC trade fell in the 1980s both absolutely and relatively to the total value of trade. This trend has continued in the 1990s.

134. However, there are significant constraints to pursuing trade cooperation within the South Pacific. First, the theory of integration suggests that benefits accrue when the trade patterns and commodities traded between countries are quite different. This condition is not met by the PIDCs which, by and large, produce and trade the same, or similar commodities. Imports are dominated by machinery, other capital goods and petroleum - most of which are not produced in the region. Likewise, exports are predominantly raw materials which are processed in markets external to the region. In addition, benefits are maximised through regional trade integration when complementarities exist between the partner countries. With the exception of Papua New Guinea, potential gains are limited for PIDCs.

135. On balance, the World Bank[33] expresses the view that “the benefits from trade within the South Pacific are likely to be limited and largely offset by the administrative costs involved”. There is general agreement within the PIDCs that a too-narrow focus on the enhancement of intra-regional trade may detract from the implementation of policies aimed at stimulating trade and investment at a broader level. Direct measures to liberalise trade and investment regulations and policies aimed at fostering a conducive economic environment are generally considered to be a more important focus for development than regional integration. These developments would assist in building up economic linkages with the "growth centres" of the wider Asia-Pacific region and beyond. It is also likely that such developments would stimulate increased trade within the region.

136. Another prerequisite for closer bilateral, sub-regional and regional ties, which would also assist extra-regional trade, is the improvement of market access in all the PIDCs. Harmonisation and standardisation of administrative procedures are necessary in the areas of customs and quarantine, labelling and packaging, phytosanitary and other sanitary requirements, export/import controls, exchange controls and technical standards. These are issues which need to be addressed primarily at the national level.

(b) Regional cooperation in the South Pacific

137. The concept of regional cooperation in the South Pacific has been strong and on-going since 1947, when the oldest regional agency, the South Pacific Commission (SPC) was established. Since that time, a further seven regional agencies have evolved to cover a diverse range of areas:

1. The South Pacific Forum and Forum Secretariat

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[31] World Bank, 1995 - op cit.

[32] Thirlwall, Anthony. The Performance and Prospects of the Pacific Island Economies in the World Economy. Plenary address to the Third Pacific Islands Conference of Leaders. Pacific Island Development Program. Hawaii: East-West Center, 1990.

[33] World Bank, 1995 - op cit.

2. The South Pacific Commission

3. The Forum Fisheries Agency

4. The South Pacific Regional Environment Programme

5. The South Pacific Applied Geoscience Commission

6. The University of the South Pacific

7. Pacific Islands Development Program

8. Tourism Council of the South Pacific.

138. In an effort to ensure that decisions taken by the organisations' governing authorities are implemented effectively and with minimal duplication, the South Pacific Organisations Coordinating Committee (SPOCC) was formed in 1989. The government membership of all the regional organisations overlap, which makes it vital for each organisation to be keenly aware of the others' work programmes. SPOCC provides this opportunity and helps to avoid unproductive competition for scarce aid resources and thereby encourages more effective aid utilisation, a common request of aid donors.

139. South Pacific Forum member countries' trade and economic interests are considered and discussed at the bi-annual meeting of the Committee on Regional Economic Issues and Trade (CREIT). Participation by senior trade and economic officials from all Forum member countries, plus representatives of regional and international donors and economic agencies as observers, allows the CREIT to consider a diverse range of issues relating to trade and economic development in the South Pacific. The CREIT plays a critical role in the strategic direction of the Forum Secretariat's work programme activities relating to trade.

(c) Sub-regional cooperation and integration

140. Against the background noted above, and given the diversity and geographic spread of the South Pacific countries, it is perhaps not surprising that more progress has been made in the area of sub-regional cooperation than across the region as a whole. A number of specific cooperative efforts exemplify this point.

141. The Melanesian Spearhead Group (MSG) is the most significant sub-regional agreement in the South Pacific comprising Papua New Guinea, Solomon Islands and Vanuatu, with Fiji as an observer. The MSG countries have proceeded to develop their trade relationship through an initial positive list of three commodities. The MSG's objective is to promote a sub-region where trade will be conducted free of duty and where a sense of cooperation in areas of investment and technical cooperation will be promoted. The MSG aims to increase integration and cooperation not only through trade, but also through cultural interaction, shipping and communications, tourism, and investment promotion.

142. The first summit of the Heads of Government of the Republic of Kiribati, Republic of the Marshall Islands, Republic of Nauru and Tuvalu was held in Kiribati in March 1995. The meeting acknowledged and reaffirmed a desire to promote sub-regional cooperation in the areas of air transportation, shipping, trade, and immigration. While it is still early days for the grouping, it is anticipated that in the area of trade, efforts will be focused on providing a competitive and cost effective system of sub-regional trade.

143. The Leaders of the Small Island States (SIS) in the South Pacific - Cook Islands, Kiribati, Nauru, Niue, and Tuvalu have met on an annual basis since 1990. Past summits have focused on a diverse range of issues, with trade not being given a particularly high priority. The fifth summit, held in October 1995, reversed this trend with a number of significant outcomes relating to trade development cooperation. Of particular note was the decision to examine the possible establishment of bulk purchasing arrangements and supply services within

the SIS or at the broader regional or sub-regional level, particularly for pharmaceuticals.

144. Under the Regional Long Term Sugar Agreement (RSA) which recently entered its 20th year, Fiji supplies sugar on a cost-plus basis to a number of other PIDCs. Currently five PIDCs purchase sugar under the RSA - Kiribati, Solomon Islands, Tonga, Tuvalu and Western Samoa (which also supplies Tokelau). Sugar is a staple import for the PIDCs, and the RSA has proved to be an excellent example of South Pacific cooperation from which benefits are derived by all involved parties.

145. Philatelic exports are a significant export earner for a number of the PIDCs, particularly the small island states. In an effort to assess and maximise the potential benefits of economies of scale in the philatelic area, the Forum Secretariat has developed the concept of a regional network of cooperating PIDC philatelic agencies. The first meeting of the potential network was held in Suva in early November 1995, with representation by 12 of the 14 PIDC philatelic agencies.

146. Trade linkages between the PIDCs and the French Territories in the Pacific (New Caledonia, French Polynesia) are limited, with the exception of trade between Vanuatu and New Caledonia.

147. The Forum Secretariat will be undertaking a major programme of activity in 1996 (trade exhibitions, missions etc.) from the PIDCs to the French Territories - initially New Caledonia - to assist with the further development of PIDC trade with the Territories.

(d) Inter-regional fisheries cooperation

148. The vast exclusive economic zones (EEZs) of the South Pacific island countries contain a significant percentage of the world's fisheries resource which are the major economic resource of many of the smaller island states. The waters of the South Pacific are fished by some twenty distant water fishing nations (DWFN). Prior to the establishment of the Forum Fisheries Agency (FFA), the small island nations' negotiating position with DWFNs was weak. FFA provided the impetus and opportunity for member countries to pool information on their negotiations with DWFNs. It was clear that the DWFNs were presenting different information on the same fishery to various member countries and were trying to play one island off against the other. The close regional cooperation fostered by FFA outflanked this negotiating tactic.

149. In the South Pacific fisheries sector, standardisation of minimum terms and conditions of fisheries access through the region was one of the most significant results of regional cooperation. Perhaps the greatest achievement in access negotiations was the conclusion of the Multilateral Treaty on Fisheries with the USA. This highly complex treaty is regarded as a unique fisheries access agreement. It was pursued at the direction of the Forum and came into force in 1988. The treaty has become a benchmark for further multilateral negotiations with other major DWFNs - negotiations on similar agreements with Japan, Taiwan and Korea are currently the focus of considerable FFA activity.

(e) Regional tourism cooperation in the South Pacific

150. As noted previously, Fiji dominates the South Pacific tourism market. The Tourism Council of the South Pacific (TCSP) is the regional organisation with responsibility for tourism planning, development and marketing.

151. There is a strong awareness in the PIDCs that they “must market their unique shared Pacific identity and, within that framework, promote their own individual cultural identity and unique attractions. Only in this way can they

capitalise on the comparative advantage they have over other destinations and compensate for their remoteness”[34].

152. Many commentaries on the region, although commending the work of regional agencies such as TCSP, note the many and various difficulties of regional cooperation in tourism development. These are underpinned by differences in culture, tradition, degree of economic dependence and even the long history of rivalry between the various island communities and nations. ESCAP[35] has noted that the degree of fragmentation and independence of the PIDCs is "not conducive to cooperative and integrated (tourism) policy and strategy formulation."

153. While noting these conditions, the TCSP has nonetheless been successful in its activities as a regional agency, more so in the marketing and promotion of the South Pacific as a tourist destination in Europe and the USA, than in the area of strategy and planning. Tourist arrivals in the South Pacific continue to demonstrate strong growth, driven by regional and individual PIDC initiatives. The TCSP has to some extent been constrained by lack of funding to adequately cover the broad range of activities which it must undertake to increase market awareness and capture new opportunities - product development, investment attraction, human resource development, and marketing and promotion - across such a large number of countries.

(f) South Pacific cooperation in the wider regional environment

154. When considering regional cooperation for trade development in the South Pacific, it is important to note the success of regional cooperation in the region’s dealings with the international environment. The South Pacific Forum is a full member of the Pacific Economic Cooperation Council (PECC); is one of the three observers to Asia Pacific Economic Cooperation (APEC) and also attends meetings of the Pacific Basin Economic Council (PBEC) on an invitation basis. These three Asia Pacific regional groupings are focused on trade and investment liberalization and facilitation.

155. To promote export trade, attract foreign direct investment, source cost effective imports and facilitate industrial collaboration, the Forum Secretariat has established the South Pacific Trade Commission offices in Sydney and Auckland. Linkages with Asia are also being developed with proposals to establish a South Pacific Economic Exchange Support Centre in Tokyo, Japan, and possible South Pacific Trade offices in the People’s Republic of China, and Taiwan. Furthermore, the Forum Secretariat’s Trade and Investment Division undertakes a range of regional efforts focused on trade and investment development. Trade missions, participation in international trade fairs and exhibitions,and publication of a comprehensive *South Pacific Trade Directory* are examples of the Secretariat’s efforts to maximise the benefits of regional cooperation for trade development.

Chapter V

CONCLUSION AND RECOMMENDATIONS

156. The Pacific Island Developing Countries (PIDCs) are open trading economies. Because of their limited natural, human and capital resources, they are increasingly import-dependent. There appears to be a link, working through exports, between exogenous shocks, terms of trade changes and economic growth in PIDCs. Most PIDCs are dependent on overseas remittances and aid transfers.

157. The larger PIDCs (Fiji, Papua New Guinea and the Solomon Islands) show more potential for export growth than the small island States of the region (Palau, Federal States of Micronesia, Republic of Marshall Islands, Kiribati, Tuvalu,

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[34] United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) - Sustainable Tourism Development in Pacific Island Countries 1992.

[35] Ibid.

Niue). However, some PIDCs such as Tonga and Samoa have made significant attempts to diversify exports in niche markets in recent years. In the services sector, tourism offers the greatest potential for PIDC export growth.

158. As the global trading environment becomes increasingly integrated, the PIDCs face a number of challenges:

- how to deal with the adverse effects of the conclusion of the Uruguay Round, as preferential market access is being largely eroded for key PIDC exports;
- can the PIDCs afford the costs of joining the World Trade Organization and, conversely, can they afford the cost of not joining;
- how the limited regional economic integration among the PIDCs can be enhanced;
- what benefits can the PIDCs draw from the wider Asia Pacific region;
- how to diversify trade and develop niche markets in areas where PIDCs have a comparative advantage.

159. Potential exists for trade diversification in the PIDCs as a result of opportunities presented by trade liberalization and globalization. To take maximum advantage of such opportunities PIDCs must adopt a focused and strategic approach to identify products and sectors for possible future development.

160. Regional cooperation for trade development in the PIDCs has been limited compared with other regions in the world. While scope exists for further regional economic cooperation in specific areas, the PIDCs’ interests are most likely to be enhanced by more rapid development of linkages with the global trading environment, in particular the Asia-Pacific region.

161. The PIDCs must therefore take a holistic view to the issue of trade diversification based on the diverse range of factors which are part of, or impact on, trade and economic development. In this connection priority should be given to the following key issues:

- macro-economic and public sector reforms to create an environment conducive to economic growth, particularly with respect to small- and medium-size enterprises;
- implementation of international rules for trade and investment liberalization, which provides a more favourable climate for trade growth and diversification;
- regional economic cooperation that promotes key markets and taps new sources of investment capital, particularly in the Asia Pacific region;
- long-term strategic approaches to industry development based on key products and services of comparative advantage, targeted at selected niche markets (including "micro-niche" marketing);
- enhancing competitiveness of PIDC exports through improved quality control, and better access to new technologies that can improve production techniques and facilitate information flows;
- development of human resources through education, training and skills formation matched to present and future social and economic needs; and
- cost-effective procurement and management of imports to ensure foreign-exchange savings.

162. The speed of change in the international environment necessitates that PIDCs seek to address the above policy issues at enterprise, national and regional levels. These efforts will need to be supported by expanded aid flows, on concessional terms where appropriate, and provision of the required technical

assistance. In providing the above support, consideration should be given to other modalities to improve the quality of aid, such as priority to programme support and recurrent-costs financing where appropriate.