EPA NEGOTIATIONS IN THE PACIFIC REGION:
SOME ISSUES OF CONCERN

SYNOPSIS

This Analytical Note explores some of the main challenges related to the EPA negotiations in the Pacific ACP region, particularly with respect to Market Access and regional integration, Agriculture, and trade in Services. This note highlights some of the region’s main concerns and explores some possible positive linkages between the EPAs and the WTO Doha Round of negotiations in an effort to increase negotiators’ understanding about the EPA developmental implications.

November, 2007
Geneva, Switzerland
EPA NEGOTIATIONS IN THE PACIFIC REGION: SOME ISSUES OF CONCERN

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<td>DG</td>
<td>Directorate General</td>
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<td>DWFN</td>
<td>Distant Water Fishing Nation</td>
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<td>EPA</td>
<td>Economic Partnership Agreement</td>
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<td>MSG</td>
<td>Melanesian Spearhead Group</td>
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<td>Negotiating Group</td>
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<td>PACER</td>
<td>Pacific Agreement On Closer Economic Relations</td>
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<td>PACP</td>
<td>Pacific African Caribbean Pacific Region</td>
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<td>Pacific Islands Countries</td>
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<td>Pacific Islands Countries Trade Agreement</td>
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<td>Pacific Islands Forum</td>
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<td>Pacific Islands Forum Secretariat</td>
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<td>PNG</td>
<td>Papua New Guinea</td>
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<td>REC</td>
<td>Regional Economic Community</td>
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<td>RNT</td>
<td>Regional Negotiating Team</td>
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<td>ROO</td>
<td>Rules Of Origin</td>
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<td>Regional Preparatory Task Force</td>
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<td>SP</td>
<td>Sugar Protocol</td>
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<td>SPARTECA</td>
<td>South Pacific Regional And Trade Agreement</td>
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<td>TAEG</td>
<td>Trade Experts Advisory Group</td>
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<td>World Trade Organization</td>
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EXECUTIVE SUMMARY

The Pacific African Caribbean and Pacific (PACP) region negotiating the Economic Partnership Agreement (EPA) with the EU comprises fourteen island states in the Western and Southern Pacific Ocean. These same fourteen countries are part to regional economic communities (RECs), the most important being the Pacific Islands Forum (PIF) and the Pacific Islands Countries Trade Agreement (PICTA). Membership to these RECs bears important consequences for the EPA negotiating process.

The PACP region set up a Regional Negotiating Team (RNT) mandated to carry out the EPA negotiations. Within the RTN, the Minister of Foreign Affairs and External Trade of Fiji and the Minister for Commerce, Industry and Labour of Samoa were appointed respectively as the chief negotiator (or Lead Spokesperson) and the alternate. In order to allow better coordination and coherence during the negotiations, the chief negotiators are assisted by the PIF Secretariat and by a Regional Preparatory Task Force (RPTF).

The economic profile of the region is heavily determined by the geographical features shared by all the fourteen PACP countries. These small islands are remarkably vulnerable to economic and natural impacts – factors that hinder wide economic diversification. Further, they are dispersed across a large portion of the Pacific Ocean which results in very high transportation costs. The region is heavily import-dependent: exports of trade and services account for 46.5% of regional GDP while the imports of good and services represent 60% of the regional GDP. The PACP countries trade mostly with Australia, New Zealand and other East Asian countries (Thailand, China). The EU is the destination market of around 11% of Pacific exports, while only 4% of the PACP imports originate in the European Union.

The region is still noticeably rural: subsistence agriculture is the main source of employment for most islands. The decline in agricultural productivity has led to a deterioration of the food security situation. Sugar, produced almost exclusively by Fiji, is the main exported agricultural product. Fisheries and fisheries-related activities and industries show the greatest potential for future exports increase, employment, development of local know-how and skills.

The services sector, in particular tourism, has grown remarkably in the last years, and now represent more than one third of the national GDP of almost all the PACP countries.

The remoteness of the region from the EU as well as the little volume of trade between the two region suggest that any impact of the EPA on the PACP country would be limited and trade diversion is rather unlikely. However, the conclusion of the EPA could represent a challenge for specifically vulnerable sectors (such as services and fish industry), could hamper the regional integration process, lead to considerable loss of policy space (trade regulations) and is likely to result in high costs of implementation.

For the EU-PACP EPA to result in a real pro-developmental outcome, regional integration enhancement tools must be designed (for instance, to overcome structural
competitiveness hindrances). Further, the implementation of instruments aimed at the strengthening sectors in which the PACP countries have a competitive advantage (tourism) and abundant resources (fisheries) but scarce capacity and skills is of the uttermost importance.
EPA NEGOTIATIONS IN THE PACIFIC REGION: SOME ISSUES OF CONCERN

I. INTRODUCTION

1. The Pacific region of the ACP group, also known with the acronym of PACP, negotiating an Economic Partnership Agreement (EPA) with the European Union (EU) is composed by 14 countries: the Cook Islands, Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Niue, Palau, Papua New Guinea (PNG), Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu.

2. Around 15.5 million people inhabit the 14 countries composing the region. These countries are all island states and, with the exception of Papua New Guinea and the Solomon Islands, are very small states spread across a large portion of the Central and South Pacific Ocean – a characteristic that is of the uttermost importance in the analysis of the challenges faced by the region and the trade opportunities that it may seize. The geographical features and the consequently high transport costs act as barriers to sustained economic growth and market expansion.

3. Fiji and Papua New Guinea are the two largest countries, in terms of population and size of the economy, and they account for 52% and 26% of the regional GDP respectively. With the exception of Kiribati, considerable amounts of labour force are employed in the agricultural sector, especially in Fiji. Services cover more than one third of the national GDP of almost all the PACP countries and offer employment to large portions of the population. Unlike other ACP regions, the EU is not the region’s main trading partner, but likewise other ACP regions, intraregional trade is highly marginal (0.2%).

4. This note describes the main trade and institutional patterns that characterise the region and explores some of the main trade challenges it faces in the EPA negotiations. It highlights the region’s interests in the EPAs and aims at increasing negotiators’ understanding about developmental implications that result from some of the interfaces between both processes.

II. IDENTITY OF THE EPA PACIFIC REGION

5. The PACP EPA negotiations were launched in September 2004 through the agreement on a joint Road Map for EPA negotiations delineating the guiding
principles, the timeframe and the negotiating structure. This section analyses the configuration of the PACP EPA region and its institutional organisation for the purposes of negotiating an EPA. It is completed by an overview of PACP countries' economic, trade and productive profile.

A. General Overview: overlapping membership

6. As with other ACP regions negotiating an EPA with the EU, the Pacific EPA region is composed of fourteen island countries participating to more than one regional economic community (REC). Membership to multiple RECs creates an institutional and trade regulatory overlap that constitutes a significant challenge for the negotiation and implementation of the EPA. This is particularly true when considering the Pacific Agreement on Closer Economic Relations (PACER) with Australia and New Zealand (see paragraph 10).

7. At the multilateral international level, it is noteworthy that only four out of the fourteen Pacific Islands Countries (PICs) are WTO members (Fiji, Papua New Guinea, Solomon Islands and Tonga) while two appear as observers (Samoa and Vanuatu). This fact bears consequences as far as one of the most direct motivations for concluding an EPA is to frame EU-ACP trade relations in a WTO compatible instrument. It also has consequences on the negotiating options. For instance, the EU suggestion that the PACP EPA dispute settlement system could utilise the dispute settlement mechanism of the WTO would disadvantage non-WTO member PACP countries in so far as they would need to rely on WTO members of the region to file and negotiate their disputes at the WTO.

8. At the regional level, the Pacific Islands Forum (PIF) binds these fourteen countries together with Australia and New Zealand. The PIF is an intergovernmental organization, created in 1972 and known as South Pacific Forum until October 2000, conceived as the “region’s premier political and economic policy organisation.” The Forum and its Secretariat, the Pacific Islands Forum Secretariat (PIFS), constitute an important channel of cooperation among the PICs to which it provides technical and administrative support. Particularly important is the PIF’s

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3 In the words of a 2001 UNCTAD study on the impact of regional trade agreements and developing countries, “The Pacific Islands Forum provides a vehicle for cooperation among the FICs themselves, and between the FICs and Australia and New Zealand as the two developed countries of the South Pacific. [...] The Forum Secretariat provides the FICs with technical and administrative support. For the FICs the Forum is both an expression of the social and cultural linkages extending far back into their history, and a means of renewing, strengthening and deepening those linkages, as well as building a foundation for closer
2004 Pacific Plan, a programme of cooperation and integration for the Pacific with the objective to achieve deeper political and economic integration within ten years from its inception.4

9. Two regional integration processes were initiated under the auspices of the PIF: the Pacific Islands Countries Trade Agreement (PICTA) and the already mentioned PACER. The membership of the former, a free trade agreement of the developing countries of the PIF, is identical to the current geographical configuration of the EPA PACP region. PICTA entered into force in April 2003 but the economic integration process has been rather slow.

10. PACER is the free trade agreement, encompassing all the PIF member countries, including New Zealand and Australia, intended to replace a preferential trade agreement (the South Pacific Regional and Trade Agreement – SPARTECA) which granted duty-free access to exports from the developing island countries of the Forum into New Zealand and Australia since 1980. According to article 5.1, negotiations for the establishment of reciprocal free trade arrangements between the Forum Island Countries and New Zealand are scheduled to start eight year after the entry into force of the PICTA agreement, i.e. in 2011.

11. However, by virtue of a third country MFN clause such negotiations may start even earlier in case any of the PICTA countries enters into trade liberalisation negotiations another developed non-Forum country. Consequently, if PICTA members signed the EPA at the end of 2007, they would automatically need to begin the negotiations to further open their markets to Australia and New Zealand four years before the expected date.5

12. An additional layer of complexity is given by the existence of three sub-regional groupings (Melanesia, Micronesia and Polynesia) constituted along ethnic, cultural and historical lines. This factor is particularly important when analyzing the decision-making process at the wider regional level, as the mentioned groupings not always converge on the priorities and issues at stake.

13. However, as far as the membership to formally constituted economic

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4 Among the measures envisaged to achieve deeper political and economic integration are: the pooling of scarce regional governance resources, reform of regional integration organizations and the aligning of policies to strengthen national capacities.

5 The third country MFN provision embodied in article 6.3 (a) decrees that if any Forum Island Country “commences formal negotiations for free trade arrangements which would include one or more developed non-Forum country, then that Forum Island Country shall offer to undertake consultations as soon as practicable with Australia and New Zealand, whether individually or jointly, with a view to the commencement of negotiation of free trade arrangements”.
communities is concerned, only the Melanesian countries (Fiji, Papua New Guinea, the Solomon Islands and Vanuatu) have started an economic integration process “that has shown considerable progress”\(^6\) under the Melanesian Spearhead Group (MSG) Agreement. It is noteworthy that the MSG not only comprises four of the largest economies in the region, but these same countries are also the largest EU trading partners among the PACP states.

### Figure 1 - Regional Economic Communities in the Pacific Region

**B. PACP institutional and policy making framework**

14. The 2004 Joint Roadmap agreed on by the PACP countries and the EC spells out the negotiating structure for both parties. At the Ministerial level, PACP States have set up a Regional Negotiating Team (RNT) composed of the Ministers for Trade from the Cook Islands, Papua New Guinea, the Republic of Marshall Islands, Palau, Samoa, Tonga and Tuvalu. The RTN is primarily responsible for what is called the Phase II of negotiations, i.e. the final negotiating rounds, the drafting of legal texts and the translation of the outcomes of negotiations into a finalised arrangement. Within the RTN, the Minister of Foreign Affairs and External Trade of Fiji and the Minister for Commerce, Industry and Labour of Samoa were appointed respectively as the chief negotiator (or Lead Spokesperson) and the alternate. Since the December

2006 Coup in Fiji, Minister Joachim Keil of Samoa has acted as the region’s Lead Spokesperson.

15. The RNT is supported by the Trade Experts Advisory Group (TEAG) provided under the aegis of the Pacific Islands Forum Secretariat (PIFS) and the guidance of the Pacific ACP ambassadors in Brussels. The RNT established Negotiating Groups (NGs) led by a senior Pacific trade officer and focusing on specific issues and subject areas.

16. This framework follows a hierarchical structure in which, Ministers, capital-based senior officials (typically PACP country’s director of trade at the Ministry of Trade and Industry), ambassadors in PACP missions in Brussels, and the PIF secretariat cooperate. The creation of the NGs was intended to provide, beside a more in-depth analysis of the PACP region sectoral priorities, the possibility for Non State Actors (NSA) - representatives of the civil society, academic institutions and the private sector - to contribute to the formulation of positions at the regional level.

17. Finally, the regional negotiating machinery is completed by a Regional Preparatory Task Force (RPTF), composed of development experts of the PIF Secretariat, PACP countries and the EC (DG Development). Its task, as in other ACP regions, is to provide a platform for the discussion of trade and development interfaces arising from the EPA negotiation. It assists the negotiating process by identifying EPA-related technical assistance needs and including such needs in the programming of future EU aid to the PACP region and countries.

18. It is worth noting that the PIFS plays a key role in the EPA negotiations, by providing the PICs with administrative support. It has also helped in facilitating and coordinating the EPA negotiations process at the regional level through its Secretariat, based in Suva. In particular, it must be acknowledged that the PIFS has proved to be significantly proactive in making proposals and a rather capable actor during the evolution of the negotiations. On the contrary, remarkable shortcomings characterize the ability of national governments engage in EPA negotiations.7

C. PACP economic, productive and export profile

19. The PACP region is composed of fourteen small islands geographically dispersed

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7 According to a study carried out by ECDPM, only few countries in the region can consistently articulate their positions and priorities as a result of the “serious lack of capacity and financial resources” common to the vast majority of PICs. Further, “scarce overall commitment by national governments to the EPA negotiations and the low profile of EPA in the political agenda” critically affected the chances for national government to effectively take part to the priorities-setting process.” Rampa F., “Implementation of article 37(4) of the Cotonou Agreement – Provision of technical support to assist the Pacific ACP Region in the review of the EPA negotiations.
across a large portion of the West and South Pacific Ocean. They are isolated, with resources constraints limiting economic diversification and remarkably vulnerable to natural phenomena, especially climate change and sea-level rise. The high transportation costs deriving from these geographical characteristics affect both imports and exports and translate into significant competitive disadvantage.  

20. The region has a cumulated market size of around 15.5 million people and an average annual population growth of 1.27% (2005). The regional GDP is US$ 10.9 billion with an average GDP per capita of US$ 3,833.

21. Generally speaking, it can be said that the Pacific region economy is still markedly rural as agriculture constitutes the source of employment of over 43% of the population. However, the sector accounts for only 21.4% of the region’s GDP. While industrial sector data (22% of GDP and 19.8% of employed population) shows a moderate industrial development, the services sector development is remarkable: services account for 56.4% of the regional GDP and 47.5% of regional employed labour force.

22. However, owing to the heterogeneity prevailing in the region, disaggregate data reveal interesting patterns.

23. Fiji, PNG and Solomon Islands are the countries with the biggest populations: 8.5 million, 5.8 million and 490 thousand people respectively. Five PACP countries (Cook Islands, Nauru, Niue, Palau and Tuvalu) have a population around or of less than 20 thousand people. Niue is the smallest country both in terms of territory (21 squared kilometres) and population (1,492 people). The region has, moreover, experienced a noticeable process of urbanisation (migration from rural to urban areas). Finally, migration, particularly emigration, plays an important role in most countries’ population dynamic, and explains the low population growth in most Micronesian and Polynesian countries.

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24. Not surprisingly, territorial and population factors explain that Fiji and PNG account for 52% and 26% of the regional GDP respectively, while Niue and Tuvalu account for less than 1%.

25. Excluding Fiji and PNG, the regional GDP is US$ 2.4 billion with an average regional GDP of US$ 202.4 million, and the distribution appears more balanced. Samoa and Solomon Islands are the biggest economies and the Cook Islands and Tonga revolve around the average.

26. The region’s average GDP per capita amounts to around US$ 3,833, but figures for the 14 countries vary considerably. Interestingly, the third biggest economy of the region, the Solomon Islands, shows the lowest GDP per capita value (US$ 600) – 15 times less than the Cook Islands and 12 times less than Palau. Solomon Islands and Palau show the highest annual growth economic rates (5.30% and 5.70% respectively). Tuvalu records among the lowest values of national and per capita GDP and Fiji the highest. Micronesia, with a national GDP of US$ 244.7, a close to zero population growth, and with negative growth rate value (-0.7), has the fourth lowest GDP per capita value. Five out of the twelve PACP countries (Kiribati, Samoa, Solomon Islands, Tuvalu and Vanuatu) are listed as least developed countries (LDCs).

27. Agriculture, including fishing, accounts for 21.4% of regional GDP but the agricultural component varies considerably when looking at each country. Figure 4 points out to the importance of the agricultural sector for the national GDP of the Solomon Islands (42%), PNG (35.7%) and Marshall Islands (31.7%). On the contrary, less than 9% of the national GDP is created through agricultural production in Fiji, Kiribati and Palau. However, a glance at the data concerning the labour force occupation by sector leads to somewhat different consideration (Figure 5).

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10 A brief comparison with the European Union shows that the smallest EU member state’s economy is Malta with a GDP of US$5.6 billion, more than twice the PACP minus Fiji and PNG’s GDP. Bulgaria is the European country with the lowest GDP per capita: US$ 3,990, slightly more than the average PACP GDP and more than six times the GDP per capita of the Solomon Islands – the PACP country with lowest GDP per capita value.

11 The Cook Islands and Niue are not UN members and therefore do not appear the UN-drafted list of LDCs.
28. With the exception of Kiribati, considerable amounts of labour force are employed in the agricultural sector, especially in Fiji. This suggests that agriculture production in these countries serves mainly subsistence purposes and is neither productive nor trade-oriented. In these three countries, more than 65% of the GDP comes from the services sector, especially in the case of Palau (81.8%).

29. Services cover indeed more than one third of the national GDP of all the PACP countries (with the exception of PNG and Samoa), and offer employment to large portions of the population, particularly in Kiribati (65.3%) and Marshall Islands (57.7%). Samoa is the only country whose GDP is generated chiefly through industrial production (58.4%). Samoa and PNG (37.1%) aside, industry constitutes less than a third of PACP countries’ GDP.12

12 Palm oil processing, plywood and wood chip production, mining of gold, silver, and copper and petroleum refining constitute the primary industrial activities and products of Papua New Guinea, while food processing (mostly fish processing) is the main industrial activity in Samoa.
At the regional level, merchandise trade stands at 78% of regional GDP. However, as the region is heavily import-dependent. While exports of trade and services account for 46.5% of regional GDP, imports of good and services account for over 60% of the regional GDP.

Overall, the PACP region exports for a total value of US$ 6.410 billion, while the imports account for US$8.411 billion. As far as the outgoing flows are concerned, the extraction of mineral fuels, the production of ships, boats and other floating structure and the trade in fish, crustaceans and molluscs account for 36% of all PACP exports. However, it is important to note that only the export of fish, crustaceans and molluscs appears in the first three most exported products for more than half of PACP countries. On the contrary, fuel’s exports characterize the economies of Fiji and PNG only. Similarly, ships and boats are exported to a large extent (88.6%) by Marshall Islands predominantly to the European Union (61.3%). Vanuatu (11.2%) and the Cook Islands (0.2%) contribute only marginally to exports of these items. It is worth noting the PNG alone exports mineral fuels and mining extraction products
for a value that amounts to 30% of the total regional exports.\textsuperscript{13}

32. The EU constitutes the destination market of around 11% of Pacific exports\textsuperscript{14} - behind Australia and New Zealand (ANZ) with a combined share of 12%. Intraregional PACP trade is remarkably underdeveloped (0.2%)\textsuperscript{15}, despite PICTA’s entry into force in 2003. Trade flows seem to be consolidated between Fiji, Tonga and Samoa only. Indeed Fiji is the recipient of almost all of the intra-PACP trade. It is important to acknowledge that Fiji acts as a regional hub: it imports merchandise (especially food) and re-exports it to the rest of the region. It is likewise the transit centre for the other PACP countries’ exports to international markets.

33. Imports are heavily concentrated on manufactures and mineral fuels (57.3% of the twelve largest imports) – in particular boats and ships (28.2%), machinery and engines (8.3%) and electrical and electronic equipment (5.4%). Only around 4% of imports originates in the European Union, while 10.1% is shipped from Australia and New Zealand. In particular, ANZ supply 37.3% of PACP countries oil demand. The commercial relationship with the EU appears to be of some importance for the supply of boats and ships (12.7%), although almost half of this market (48%) is actually covered by Korean exports.

III. SPECIFIC EPA-RELATED CHALLENGES AND OPPORTUNITIES

34. In this section, selected areas of relevance to the EPA negotiations are assessed.

A. Development dimension and regional integration

35. The definition of a development dimension is one of the most challenging and controversial issues regarding the EPA negotiations and conclusion. In fact, both parties to the EPA have a diverging understanding its possible developmental tools and contents. A common understanding about the developmental dimension is, nonetheless, crucial as EPAs should primarily serve as a development instrument.\textsuperscript{16} The necessity to shape the EPA contents through a developmental lens was confirmed again at the October 2007 joint EU-PACP Ministerial Meeting, where it was reiterated that liberalisation should advance competitiveness, to comply with

\textsuperscript{13} Gold constitutes 99.9% of the mining extraction products. Pearls and silver account for the remaining 0.1%.

\textsuperscript{14} The list of such main exports is based on the three main exports for each country composing the region.

\textsuperscript{15} Fiji exports various items of merchandise (food, beverages, textiles, metal products, electronic equipment…) to PNG and Solomon Islands most of all. The same items are exported from PNG to Solomon Islands too.

\textsuperscript{16} “Pacific ACP – EC EPA Negotiations. Joint Road Map”, see footnote 1.
WTO requirements and to foster development.17

36. At the broad level, most negotiators coincide on the basic developmental objectives of EPAs (e.g. enhancement of regional integration, economic diversification, etc.) but divergences emerge at the moment of drafting concrete EPA provisions. For instance, one important aspect being discussed (and opposing both sides) is how to incorporate financial assistance into the EPA, in order to ensure that resources are predictable, certain and appropriate.

37. The June 2006 Draft emphasized the need to put in place a comprehensive and detailed trade facilitation and trade promotion programme and a strategy aimed to the enhancement of agricultural productivity. The substantive measures envisaged in the 2007 draft do not strongly differ from the previous draft. The main difference is the introduction of a first part of the agreement stating the general principle according to which the EPA should serve the purpose of fostering and promoting the sustainable development of the PACP countries.

38. Regional integration and cooperation with other regional organisations, on the one hand, together with capacity building assistance in the areas of customs, biosecurity regulation and compliance with international standards, on the other, appear to be the two main pillars of the 2006 proposed trade facilitation and promotion programme.

39. On the agricultural side, the 2006 draft proposed the creation of a financial facility with the purpose of funding country-based Agricultural Development Strategies – strategies crafted to ensure both food security and an increase in the commercial production of agricultural products, coupled with precise attention to the compliance of Pacific products to sanitary and phitosanitary measures.

40. The geographical isolation and the lack of significant trade flows among Pacific developing countries strongly militate for an EPA that could contribute to increasing intra-regional trade flows, consolidating regional trade regulatory convergence and lowering trade and transport costs in the sub-region. These objectives would necessarily require the creation of new and the consolidation of existing productive capacity and the improvement of product quality. These objectives would also require the availability of appropriate financial assistance for trade-related infrastructure projects. These objectives could be translated, for instance, into trade facilitation and sectoral (e.g. fisheries, agriculture, manufacturing and value addition) EPA chapters that. Such objectives would be conceived as a tool to enhance

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17 Pacific-EC EPA Ministerial Meeting Joint Declaration Brussels, 2 October 2007
cooperation among the PIF countries.\(^{18}\)

B. Shift towards reciprocal trade

41. One of the best known challenges that ACP countries will face as a result of EPA reciprocity is the potential loss of fiscal revenue resulting from the elimination of tariffs on EU imports. Figure 6 shows the average effective tariff rate applied by twelve PACP countries, showing that Kiribati, Tonga, Tuvalu and Vanuatu apply the highest overall tariffs, while the Federated State of Micronesia and Palau apply low tariffs on most goods. It is important to note that the average figure conceals important features of individual countries’ tariff structures, for example in the case of PNG and, to some extent, of Fiji. Indeed, PNG and Fiji are the only two PACP countries to selectively use tariffs for protecting local industry.\(^{19}\)

42. Most of the PACP countries have started undertaking reforms aimed at identifying alternative sources of government revenue. Nonetheless, tariff revenues constitute an important part of government revenues in most PACP countries (Figure 6). Fiscal impacts deriving from the establishment of free trade arrangements are likely to be larger when high tariffs are in place. It is therefore important to take into consideration measures aimed at tackling the adjustment of fiscal revenues during the implementation of EPA tariff reductions. However, potential losses could be somewhat mitigated by the relatively little importance of EU in the region’s imports.

\(^{18}\) The Pacific Plan is the Pacific Islands Forum’s programme dealing with key-challenges in the region and to enhance cooperation among PIF countries. The Plan’s first pillar, Economic Growth, pursues the objectives of increasing sustainable trade, improving the efficiency of infrastructure and services delivery and augmenting private sector participation.

43. In addition to the impact of EPA on national revenues, an aspect of EPA reciprocity which is more difficult to predict is the extent to which a free trade agreement with the European Union will be more trade creating than trade diverting, i.e. whether lowering barriers on EU imports will increase the efficiency of local production or cause partners to shift their trade to cheaper EU imports. This is relevant as it relates directly to whether or not an EPA will enhance local production, support economic diversification and contribute to intra-regional Pacific trade.

44. Given that trade between the EU and PACP States as well as intra-PACP states is rather small, the overall effect of the EPA is likely to be small and any increase in Pacific ACP imports due to an EPA should also be relatively minor. It is quite undisputed that the data concerning trade between the EU and PACP States suggest that trade effects are likely to be slight even though no precise estimate of the general economic effect can be made. Some countries (Vanuatu, Kiribati, Tuvalu and Tonga) risk some trade diversion effect; but, at the regional level trade creation should outweigh trade diversion. Papua New Guinea and Fiji (the two PACP

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20 For a comment about the EPA trade creating or trade diverting effects, and for greater information about models regarding EPA impacts, please consult “Trade liberalisation and the difficult shift towards reciprocity in the EPAs”, South Centre EPA Fact Sheet N°3 (2007) at www.southcentre.org.

countries with greatest trade with the EU) are expected to maintain or maybe expand exports levels to the EU.

45. Last, it is worth noting, however, that the design of the PACP EPA will have an impact on possible trade benefits. In this sense, a possible positive trade effect could be enhanced through well-designed measures aimed at creating value added in strategic sectors presenting growth potential.

C. Agricultural trade and production

46. The geographical constraints characterizing the small Pacific Islands determine a limited resource base and production conditions. These in turn determine the region’s reliance on the export of few primary commodities. Furthermore, recent trends of declining food production and rural-urban migration aggravate the concerns over food security in the region. Thus, it is worth understanding the extent to which liberalisation under the EPA may undermine the rural livelihood of Pacific Islands. The importance of agriculture as a source of livelihood (income generation) is all the more important as, despite a modest contribution to national GDP, the sector (including fisheries) employ as much as 85% of the work force in PNG, 75% in Solomon Islands and 70% in Fiji. An assessment of the structural shortcomings affecting the agricultural production of the region can also help individuate more elements to add to the developmental dimension of the EPA.

i. Food security

47. A recent study on the food security position of five countries of the region\(^{22}\) found that per capita food production and per capita agriculture production\(^ {23}\) has declined in Fiji, PNG, Tonga and Vanuatu (1991-2002). The situation appears quite critical for Vanuatu, whose change in per capita food and agricultural production decreased of 28.8 per cent in the considered period (Table 2).

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\(^{23}\) Data in this section comprise both agricultural and fishing activities.
Table 2 - Food and Agriculture Production (Base 1989-91 = 100)

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<td><strong>% change 1997-99 to 2000-02</strong></td>
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<tr>
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<tr>
<td><strong>Total agriculture production</strong></td>
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<tr>
<td><strong>% change 2000-02</strong></td>
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<tr>
<td><strong>% change 1997-99 to 2000-02</strong></td>
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<tr>
<td><strong>Per capita food production</strong></td>
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<td><strong>% change 1997-99 to 2000-02</strong></td>
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<td><strong>Per capita agriculture production</strong></td>
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<td>96.7</td>
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<td>3.3</td>
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<td>67.3</td>
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<td>-28.8</td>
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</table>

48. Parallel to the decline in food and agricultural production are the decline in agricultural exports (which increased only in Solomon Islands) and the increase in the countries’ trade deficits. Consequently, PACP countries experienced surges in food imports to varying extents. The increase has affected Cook Islands, Samoa and Tonga especially – the three countries that rely entirely on imports for cereals, roots and tubers.

49. Interestingly, between 1991 and 2002, import dependency has increased in Solomon Islands too (91 to 95 per cent) notwithstanding the increased food and agricultural production. This may be due to the fact that Solomon Islands’ increase occurred in the fish products sector, possibly diverting resources from other products demanded by the local population.

50. Fiji appears to be the least import dependent country, although its reliance on food imports has increased from 79 to 90 per cent, chiefly due to a steep decline in rice production. Fiji plays an important role in the regional supply of food, as it imports cereals from overseas (mainly Australia, Thailand and USA) and re-exports them to other islands in the Pacific region (chiefly Vanuatu, Kiribati and Tuvalu).

51. The discrepancy between the employment by sector and the export and GDP contribution by sector data (see Figure 5) are an indicator of the dual system characterizing most of the Pacific Islands economies, with a small commercial agricultural sector and a large subsistence one. The latter contributes to “at least one third of the output of agriculture, fisheries and forestry sector.”24 Subsistence farming has been particularly important in guaranteeing food security in the rural areas. However, the sector’s contribution to food supplies is decreasing at the same

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24 Sharma K.L., see footnote 22.
rate as migration to urban areas increases.

Table 3 - Agricultural Products, Food and Cereals: Imports and Exports 2000-02

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<thead>
<tr>
<th></th>
<th>Cook Is.</th>
<th>Fiji</th>
<th>PNG</th>
<th>Samoa</th>
<th>Solomon Is.</th>
<th>Tonga</th>
<th>Vanuatu</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total agricultural</td>
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<td></td>
<td></td>
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<tr>
<td>products, incl. fish</td>
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<tr>
<td>products (US $100,000)</td>
<td>-113</td>
<td>636</td>
<td>-22</td>
<td>-192</td>
<td>311</td>
<td>-36</td>
<td>-53</td>
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<tr>
<td>Cereals</td>
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<tr>
<td>(in 100 metric tons)</td>
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<tr>
<td>Net exports</td>
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<td></td>
</tr>
<tr>
<td>Net imports</td>
<td>9</td>
<td>1609</td>
<td>3268</td>
<td>149</td>
<td>341</td>
<td>75</td>
<td>174</td>
</tr>
<tr>
<td>Import dependence (%)</td>
<td>100.0</td>
<td>91.5</td>
<td>96.5</td>
<td>100.0</td>
<td>87.2</td>
<td>100.0</td>
<td>94.6</td>
</tr>
</tbody>
</table>

52. To invert the degradation of food security in the Pacific, strategies need to be put into place. First, intervention and investments in rural infrastructure and appropriate incentives to farmers are required to increase agricultural production. In addition, buffer stocks of cereals and other food stuffs should be improved to cope with sudden and disrupting natural calamities.

*ii. The vulnerabilities related to the EU Sugar Protocol*

53. Food imports constitute between 9 and 29% of total PACP’s import expenditure – a figure that is expected to increase dramatically with global warming (sea-level rise, typhoons, etc.). High food import levels stress the need that Pacific countries have to generate enough export revenue to finance food bills. In this sense, threats to existing sources of export earnings could have a direct impact on food security. Fiji illustrates the vulnerability of the region in this respect.

54. In fact, Fiji has benefited from preferential access to the EU market by virtue of the EU Sugar Protocol (SP) 25. The bulk (75%) of Fiji’s sugar and sugar confectionary products - constituting the country’s second main export (20-25% of the country’s total exports) after mineral fuels – is sold on the EU market. Fiji SP allocation represents. 12.75% of the total EU import commitment from the ACP sugar producers.

55. The denunciation of the SP and liberalisation of sugar imports in the EU from 2009, is likely to bear consequences on Fiji’s capacity to sustain sugar exports and

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25 Under the sugar protocol, the European Union agreed to buy a fixed annual quantity of sugar from ACP producers at guaranteed prices aligned to European internal sugar prices and established annual quotas for sugar producers. MFN suppliers have limited access to the EU under specific quotas and an in-quota tariff rate of US$98 per ton, much higher than the zero rate applied to imports under the Protocol. Thus, ACP sugar producers receive a substantial preference over the MFN suppliers.
hence its export earnings. EU internal price for sugar will be 36% less the current price\textsuperscript{26} and Fiji’s losses may amount to 20,990,942 Euros during the phase-out period (i.e. until 2009).\textsuperscript{27} Hence, the decrease in export earnings risks deteriorating further Fiji’s already critical levels of self-reliance on food products. Moreover, around 100,000 people are employed in the sugar sector, increasing the threat of a disruptive impact on the country’s economy and society\textsuperscript{28}.

56. It must be noted, however, that while the liberalisation of the European sugar market is likely to impact Fiji’s sugar production detrimentally, the same process could benefit PNG. Papua New Guinea is a relatively small producer, with most of its production destined to the United States (under a small quota allocation) and to other Pacific island states. Pursuing the goal of increasing both agricultural production and exports, it was announced the intention of securing access to the EU. Duty-free access to the EU market under the new sugar arrangement is, therefore, an element adding value to PNG strategic choice to further expand the sugar sector.

\textit{iii. Rules of origin and Agricultural Sensitive Products}

57. Notwithstanding the region’s preferential access to the EU market, the rules of origin (ROO) currently applicable to PACP exports are seen as one of the greatest barriers to making the most of EU market access. This militates, thus, for an improvement of these rules under an EPA. The EC has agreed to review general ROO provisions with a view of facilitating greater PACP access to the EU market. In addition, the EC has proposed to improve sectoral rules of origin, including those applicable to agro-processing, textiles and fisheries.

58. The remoteness of the PACP countries from the EU is a major factor hampering more consistent food flows from the Pacific to the EU but also from the EU to the islands. Indeed, agricultural imports from the EU amount to negligible values, both in absolute and relative terms. Being food imports from the EU so negligible, the fear that lowering tariffs on such products might lead to a “flood of cheap food imports that would discourage local food production”\textsuperscript{29} does not appear likely.

59. However, given the importance of agricultural production in socio-economic terms for the Pacific Islands economy, it could be worth assessing the need to selectively protect some locally produced products. This could be done through the concept of sensitive product, which would allow wholly excluding certain products from the scope of an EPA. Indeed, the domestic food production tends to be

\begin{footnotesize}
\textsuperscript{26} Council regulation (EC) No. 318/2006, 20/02/2006, Title II, Chapter 1, Article 3.
\textsuperscript{27} South Centre calculations.
\textsuperscript{28} For a detailed analysis of the EU sugar reform and regime, refer to “The Reform of the EU Sugar Sector: Implications for ACP Countries and EPA Negotiations”, South Centre (2007), available at: www.southcentre.org
\textsuperscript{29} Scollay, 2002, see footnote 19.
\end{footnotesize}
concentrated on a narrow range of products that which represent a marginal amount of bilateral PACP-EU trade, thus respecting EPA’s “substantially all trade” liberalisation requirement.\textsuperscript{30}

D. Fisheries

60. Exports of fish, crustaceans and molluscs accounts for 7\% of the exports of PACP states, but the aggregate data does not reflect the overwhelming importance that fishing vests for several Pacific countries. Indeed, fish accounts for over 90\% of Palau and Micronesia’s total exports, 50\% of Cook Islands’ and Vanuatu’s, and 18.5\% of Kiribati’s.\textsuperscript{31} For the remaining countries, this sector accounts for more moderate shares of total exports, ranging from the 0\% in Niue and Tuvalu, to 13.9\% in Tonga. However, fishing represents a fundamentally important source of income and protein for a large portion of households in the region and a collapse of the fishing activity would have direct impact on the levels of poverty and malnutrition in the region.

\begin{table}[h]
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\begin{tabular}{lcccccc}
\hline
                    & Solomon Is. & Kiribati & Samoa & Marshall Is. & Tonga & Tuvalu & Micronesia \\
\hline
Fisheries as % of GDP & 12.80        & 11.78    & 7.99   & 7.40         & 7.13  & 4.77   & 4.70        \\
\% of population employed in the fisheries sector\textsuperscript{32} & 11\%            & 4.4\%    & 33\%   & 2.8\%        & 8.0\%  & 5.3\%   & 7.4\%        \\
\hline
\end{tabular}
\caption{The importance of fisheries for the PACP countries}
\end{table}

\begin{table}[h]
\centering
\begin{tabular}{lcccccc}
\hline
                    & Cook Is. & Palau & Fiji & Nauru & Niue & Vanuatu & PNG \\
\hline
Fisheries as % of GDP & 2.84      & 2.77  & 2.34  & 2.12  & 1.65 & 0.96   & 0.56        \\
% of population employed in the fisheries sector\textsuperscript{33} & 25\%            & 6.8\%  & 2.2\% & n.a.  & n.a. & 35\%   & 23\%        \\
\hline
\end{tabular}
\caption{The importance of fisheries for the Pacific}
\end{table}

61. It must be noted, moreover, that the potential of fisheries for the Pacific

\textsuperscript{30}The liberalisation of “substantially all trade” under the EPA results from the intention to conclude a WTO compatible agreement. For more information about the elements of WTO compatibility, refer to “Understanding the Economic Partnership Agreements (EPAs)”, South Centre EPA Fact Sheet N°1 (2006), available at www.southcentre.org

\textsuperscript{31}To exports of fresh fish, one must add processed and canned fish and seafood. Fiji, Solomon Islands and Papua New Guinea have been benefitting of EU Cotonou preferences for their canned tuna exports.

\textsuperscript{32}Ether formally of informally and either for commercial or subsistence purposes.

\textsuperscript{33}See footnote 32.
economies is best apprehended by considering the total value of the fish caught by foreign fleets. As a matter of fact, while the tuna fish stock surrounding PACP countries is the largest in the world, only about one-third of catch is landed in the region\textsuperscript{34} and only one tenth of the tuna fisheries revenue remains in the PACP countries. Indeed, owing to bilateral or multilateral agreements, Distant Water Fishing Nations (DWFNs)\textsuperscript{35} owned and operated vessels carry out between 80 and 90 percent of the tuna fishing.\textsuperscript{36} In return for the right to fish in the Pacific’s exclusive economic zones, DWFNs pay an access fee, generally around 4 to 6 percent of the gross revenue of the catch.\textsuperscript{37} These payments often constitute a crucially important source of revenue for Pacific governments.

62. In the light of article 178 of the Cotonou Agreement, fishing agreements between the EU and Pacific ACP states must take into consideration the developmental and environmental needs of the latter, including the conservation of fishery stocks, a commitment to take only ‘surplus’ stock, and the need to contribute to domestic economies, including the development of domestic industries, resources, and capacities. According to the European Commission’s DG Development, fisheries provide ‘the greatest potential for the expansion of exports from Pacific Island countries.’\textsuperscript{38}

63. EPAs provide a good opportunity to address the shortcomings that the PACP countries face in developing their export capacity. This would require an improvement of relevant ROO. Currently, a fish product must be ‘wholly obtained’ from a Pacific ACP state to be eligible for tariff-free access to the EU market.\textsuperscript{39} Because of the PACP countries limited fishing capacity, the EU’s Rules of Origin provide an incentive for Pacific canneries to buy the raw fish from EU-flagged vessels in order to gain tariff-free access to the EU market. Consequently, it can be argued that ROO requirement acts as form of “upstream subsidy to EU vessels” by providing an incentive for Pacific ACP states to sign EU access agreements in order

\textsuperscript{34} Forum Fisheries Agency, “GEF Support for Pacific Oceanic Fisheries Management: Background Information,” undated. Available at http://www.ffa.int/node/513
\textsuperscript{35} Currently, the EU has bilateral fisheries partnership agreements with Kiribati, the Federated States of Micronesia and the Solomon Islands. These agreements benefit mostly French, Portuguese, and Spanish fleets.
\textsuperscript{36} Kaliopate Tavola, “The Impact of WTO Agreements and the Current WTO and ACP-EU Negotiations on the Fisheries Sector”, undated, p. 3. Available at http://www.globefish.org/files/FisheriesSector1_331.doc
\textsuperscript{37} DG DEV/AIDCO estimated that this is well below market value, which could be as much as 13%. In “Fisheries in the Pacific: Coherence between Development and Commercial Objectives,” p. 3.
\textsuperscript{39} Cotonou Agreement, Article 3.
to ensure the supply of ‘originating’ fish to their canneries.40

64. A developmental fisheries agreement should include, aside from ROO improvements, capacity building measures in the domains of local industry development, sanitary and phytosanitary requirements. Indeed, the inclusion of a landing requirement for processing tuna onshore and creating value added for PACP countries exports must be coupled with a EU commitment to the funding and development assistance of new infrastructure and facilities, as well as to the creation of the required skills for a sustainable management of the marine resources. The creation of the necessary facilities to process tuna onshore would provide the PACP countries a possibility to increase the value added and the competitiveness of their exports to the EU market.

E. Industrial products

65. Significant manufacturing exists only in Fiji and PNG, and to a lesser extent in Samoa. According to Scollay’s extensive study on the impact of EPA on the PACP countries41, the countries with a manufacturing sector will to a large extent be able to maintain current levels of protection by designating selected products as “sensitive”. Sensitive designation would allow specific products to be entirely excluded from EPA tariff elimination commitments, thereby maintaining current levels of policy space (defined as the ability of utilising tariff protection for promoting these products42).

66. However, a difficult aspect of designating industrial sensitive products is that a truly developmental list would need to cover not only products currently produced which are vulnerable to increased imports, but also products the production of which is incipient or even inexistent. Some sectors may indeed present growth potential and would require pro-active promotion policies in the future. In other words, government would need to anticipate the potential for future development of specific manufacturing activities. This task is all the more difficult in the absence of well established national or regional industrial vision.

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42 For a discussion of the concept of “policy space”, please refer to “Policy Space for the development of the South”, South Centre Policy Brief N°1 (2005).
F. Services

67. Together with fisheries, services represent the most promising sector in terms of development potential in the Pacific ACP states. For the smaller islands with very limited resources to endow in the manufacturing and agricultural sectors, services, and especially tourism, are an asset of great value.

68. At the regional level, services contribute to the creation of 56% of the GDP. Such contribution to the regional economy is even more important when considering the limited potential for economic diversification in the agricultural and industrial sector. In particular, tourism appears the most important service and the one with the highest growing potential. Tourist arrivals increased by around 8% in 2004, with Fiji benefiting most.

69. As Table 5 shows, over 50% of the national GDP in all the PACP countries, with the exception of PNG and Samoa, is created by trade in services. Palau, Fiji and Cook Islands’ economies are clearly largely tributary to the services sector, especially tourism and to some extent offshore banking services. The main markets for the Pacific tourism industry are Australia, New Zealand and the US.

70. Some PACP countries are expanding and further investing in the sector, whose development in recent years has proved to be critical to finance much-needed projects. This is true especially for Cook Islands, Palau, Fiji, Vanuatu and Samoa. In these countries, the expansion of tourist arrivals catalyzed investments and encouraged lending by commercial banks for tourism-related projects. In Fiji, tourism has mitigated previous heavy dependence on sugar. In Marshall Islands, Micronesia and Kiribati, where the tourism industry is still underdeveloped, tourist numbers are expected to rise in the medium term, but growth is subject to the development of adequate supporting infrastructure.

71. The establishment and provision of offshore banking centres and services is a second major category of services in the Pacific Islands, involving especially Cook Islands, Samoa, Vanuatu. However, the management of the sector resulted quite problematic as other countries started to exert growing pressure because of the role

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of these centres in international money-laundering as well as tax competition.\textsuperscript{43}

72. Nonetheless, the geographical constraints that have hindered sustained economic growth risk affecting further flourishing of the services sector in the PACP countries. Remoteness and small size act as barriers to the inflow of adequate private sector investment into Pacific ACP states, even where an otherwise favourable economic environment has been created through “far-reaching programmes of economic reform and the adoption of sound economic policies and governance frameworks.”\textsuperscript{44}

73. The characteristics of the sector in the region, advocate for an EPA which assists the region in strengthening its capacity to properly regulate and promote various services sectors. This was reflected in the PACP countries’ proposed EPA chapter on services, which included a safeguard giving the region the right to delay implementing its commitments until it has an appropriate regulatory regime in place and the capacity to enforce the regulations. The proposed agreement also requires the EU to provide financial and technical assistance for strengthening regulation in the Pacific.

74. The region has also proposed to enhance the temporary movement of natural persons between the Pacific and the EU (mode IV of GATS). However, labour mobility as seen by the EU would only cover the movement of professionals and technicians, but not unskilled workers or most categories of semi-skilled workers\textsuperscript{45}. The EC considers the Pacific proposal to cover issues of migration, thus falling outside the Commissions’ competence on trade. As a result, Pacific ACPs are negotiating bilateral Memoranda of Understanding with individual EU member states. Key issues still to be negotiated are the definitions of which categories of professional and technical workers are included, how many people per year and whether the agreement is binding.

75. The human resources development scheme announced in the October 2007 Joint Declaration would couple the temporary movement of people with the opportunity for Pacific Islanders to access training and skills development programmes. However, it must be noted that such scheme represents the EC counterproposal to the Pacific request to include “Mode IV” provisions in the EPA. Moreover, no specific and detailed proposal for the mentioned scheme has been elaborated yet.

\textsuperscript{43} In Nauru, the attempt to establish the country as a centre for offshore banking aborted owing to poor management and the international pressure for failing to strengthen money-laundering legislation. (The Economist Intelligence Unit, “Nauru”, Country Profile 2005.)

\textsuperscript{44} Grynberg and Onguglo, “A Development Agenda for the Economic Partnership Agreement between the EU and the Pacific ACP (PACP)”, Concept Paper, 2002.

\textsuperscript{45} “key personnel, graduate trainees, business services sellers, contractual services suppliers and independent professionals” according to the August 2007 EPA draft text (Chapter 4, art. 17).
76. PACP countries should be very cautious when liberalising their services. The fundamental question for negotiators is why Pacific countries would sign up their service sectors under the restrictive frameworks, particularly since studies have shown that it is extremely unlikely that productive foreign investment would result from them doing so.\textsuperscript{46} Moreover, it is feared that non-sequenced or badly managed liberalization vis à vis the European Union could delay or hinder the development of local services providers, jeopardizing the regional integration process.

IV. CONCLUSION

77. The analysis of different sectors highlight, in fact, that a prerequisite for the EPA to effectively result in a development enhancing tool is the fostering of regional integration. The objective of enhancing regional integration highlights the importance of financial assistance to improve the physical integration of the region (trade facilitation) as well as measures to foster regional productive complementarities as well as regional self-reliance (e.g. agro-processing industries).

78. In addition, given the limited technical and financial capacity of most countries of the region, assistance from the EU could make a real contribution in several areas, such as: the implementation of fiscal reforms to counter the loss of government revenues, better regulatory capacity in trade in services, in particular tourism. This objective can be reached by putting in place the required regulatory measures for which skills development is fundamental.

79. Finally, the inclusion of a fisheries chapter in the EPA should have the objective of increasing the share of value added actives in the region and fostering economic diversification. Therefore, it should encompass capacity-building measures allowing PACP countries to comply with and demonstrate compliance with international technical standards. It should also include measures to promote onshore fish processing in order to enhance local skills and to augment the value added of PACP fish exports.

80. In sum, the effect of the Pacific region’s geographical features and limited economic diversification possibilities as well as the relatively low trade flows between the PACP countries and the EU mean that the main contribution of an EPA reside largely in its developmental promises rather than in its strict trade aspects.

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