European Development Cooperation Strengthening Programme (EDCSP)

Beyond Fish and Coconuts:

Will the New EU Trade Policy Support Development in the Pacific Islands?

Nikunj Soni and Derek Brien

Simply put, the answer to the question above is probably no.

In January this year, the European Commission (EC) released its Communication on Trade, Growth and Development with the stated intention of 'tailoring trade and investment policy for those countries most in need'. There is much to be commended in the Communication, most notably the recognition that one-size-fits-all policy is less relevant (assuming of course such an approach was ever actually relevant) in today's rapidly changing economic landscape. From a Pacific perspective, however, there is concern with the focus on coupling aid and trade.

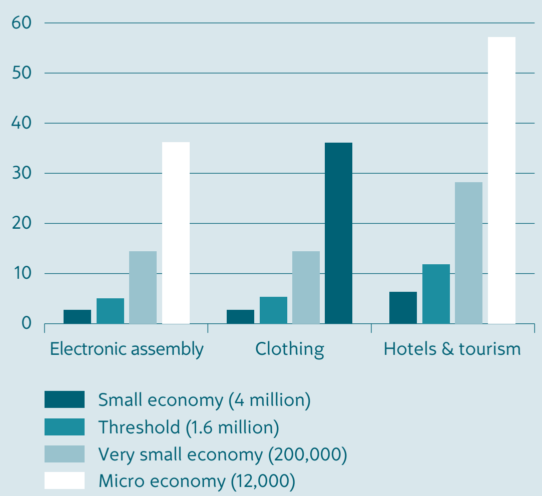
In our discussion paper (Pacific Institute of Public Policy, 2010), we suggest it was timely to rethink the language and assumptions of the prevailing aid-centric approach to development in the Pacific. We also know that the Pacific islands region is so small and isolated that it is almost impossible to trade internationally in goods and only marginally possible to trade in services. In this context, it seems cruel and unjust to link aid to trade instead of broad development needs or economic vulnerability.

There are exceptions of course – notably the two largest Pacific island countries, Papua New Guinea (PNG, population 6.5 million) and Fiji (population 860,000). PNG and Fiji were the only Pacific countries to sign up to an Economic Partnership Agreement (EPA) with the EU – in order to keep preferential access for sugar and tuna exports. These agreements now set a precedent for other Pacific countries should they wish to enter into EPAs in the future. Imports from Europe are small and diminishing, so this should not matter, except that under the most-favoured nation (MFN) clauses any trading rules and tariff rates would also apply to the region's nearest neighbours, Australia and New Zealand, which could lead to significant negative fiscal consequences.

The big difference is we are small and remote

As the following two figures show, the Pacific region is the most economically remote and as a result has the greatest comparative disadvantage when it comes to the production of goods. The small population size of most our nations (generally under 250,000) means the same also applies to services.

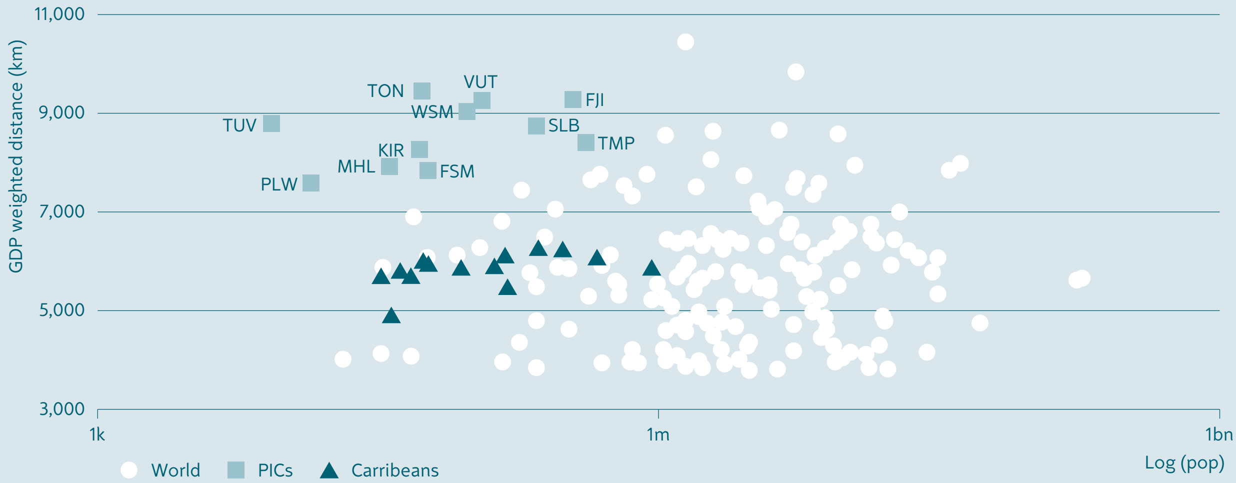
Additional costs of production (% of costs in median economy)



Source: Winters, in Haque (2011).

The Pacific often gets compared with the island states of the Caribbean, which also have small populations – but unlike the Caribbean, Pacific island states are the most geographically remote from any major economic hub.

Population versus GDP distance



Source: Haque (2011).

*The message is clear, but has been so often overlooked: unlike anywhere else in the world, the Pacific is **both** small and remote.*

Most Pacific island countries will not trade their way to self-reliance

In his thought-provoking paper, Francis Hezel suggests foreign aid may be not just a stopgap to achieve economic self-sufficiency but a permanent requirement for the Pacific island countries that will always come up short of this goal (Hezel, 2012).

Most Pacific economies are based on subsistence farming, with aid budgets accounting and therefore paying for a large component of each country's trade deficits – partly because of the demands of the aid industry and the lack of locally available products. So, given that most of the Pacific cannot trade their way out of poverty or hardship, linking aid to trade will hinder the prospects for good developmental outcomes from aid. Linking aid with trade in our region will make aid less effective.

The World Trade Organisation (WTO) has divided Aid for Trade (AfT) into six categories, namely trade policy and regulations; trade development; trade-related infrastructure; building productive capacity; trade-related adjustment; and other trade-related needs.

The EC Communication notes that tariff liberalisation alone is not enough to ensure benefits from international trade. This is something that has long been understood in the context of the Pacific region, where a host of supply-side bottlenecks are known to hinder economic performance. Indeed, recent discussions have argued that AfT should not be a substitute for, or compete with, other development aid, nor should it be seen as a substitute for trade liberalisation.

AfT is required to deepen structural economic reforms, enhance the productivity of the business sector and institute regulatory and institutional reforms to create an environment that is conducive to investment and the growth of exports.

Addressing supply-side constraints in the Pacific will need investment in key trade-supporting infrastructure sectors, such as education, health and the development of human resources. Further, as we point out in our discussion paper on regional migration (Opeskin, and MacDermott, 2010), the Polynesian and Micronesian countries of our region have generally benefited from migration for education and employment purposes – a development avenue still not widely available to the Melanesian countries.

Again the message is clear, but often missed: if aid programmes are well designed and implemented, we can, over time, improve trade. However, the converse is not necessarily true: simply removing barriers to trade will not improve developmental outcomes in the Pacific.

Taxing issues

Most of the countries in the Pacific still rely on international taxes to fund a significant portion of their recurrent budgets. Traditional tax theory suggests such taxes may be regressive or inefficient, but this holds true only if you are in economies with some depth in terms of numbers of producers and suppliers. In small island states, it is both costly and difficult to collect domestic taxes, given lack of capacity, remoteness and limited economic activity that tends to be concentrated in a few urban hubs – and as a result these hubs tend to be overtaxed and expensive. Pacific economies generally have little economic depth or value adding, so removing international taxes, which are the simplest and easiest form of tax, makes little fiscal sense: it simply results in a drastic reduction in revenue as the extra profits made by companies is too hard to collect.

Conclusion: our region is unique and merits separate treatment

The EC's shift in language and thinking in its recent Communication is generally to be welcomed, and we can see where the AfT focus can and should apply in the context of African and Caribbean countries. Even in the Pacific, trade has an important role to play in terms of reducing vulnerability, but it is not a panacea. Nor should it be the primary aid delivery mechanism. Aid should be directed at making nations, especially newly independent nations like we have in the Pacific, less and not more vulnerable. Simply reducing tariffs makes countries in our region more vulnerable and not less. The instability and fickleness of most aid programmes has a similar effect, and so linking aid and trade could make the plight of some of the most remote and vulnerable nations on earth – those in the Pacific – worse.

For the Pacific, a better solution would be to link aid to vulnerability. Pacific countries should also be given an opt-out of the EPA, such that they can retain preferential arrangements based on vulnerability alone. If aid can reduce vulnerability over time, and this can be demonstrated, it should trigger talks at a future stage – although the reality is that climate change and other factors may well mean the Pacific should be given indefinite preferential access by extending Everything but Arms (EBA) on the grounds of vulnerability.

Our region is unique and should merit separate treatment.

References

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edcsp@odi.org.uk

www.international-development.eu

EDCSP
Overseas Development Institute
111 Westminster Bridge Road, London, SE1 7JD