RESEARCH STUDY ON THE BENEFITS, CHALLENGES AND WAYS FORWARD FOR PACER PLUS

Final Report

Institute for International Trade

Members of the IIT Team

Andrew Stoler	Institute for International Trade
Biman Chand Prasad	University of the South Pacific
Nikunj Soni	Pacific Institute of Public Policy
Peter Gallagher	Inquit Australia
C. Michael Hathaway	Sandler, Travis & Rosenberg, P.A., USA
Heather Baigent	Pacific Trade Consult, NZ
Margaret Malua	Samoan Consultant
Victoria Donaldson	Visiting WTO Fellow, IIT
Wadan Nasey	University of the South Pacific
Jim Redden	Institute for International Trade

June 2008

TABLE OF CONTENTS

GLOSSARY

ACP	Africa, Pacific and Caribbean [countries who are parties to the Cotonou Agreement between the EU and the ACP states]
ADB	Asian Development Bank
ANZ	Australia-and New Zealand
ANZCER	Australia New Zealand Closer Economic Relations
ANZCERTA	Australia New Zealand Closer Economic Relations Trade Agreement
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
AUSAID	The Australian Government Overseas Aid Program
AUSFTA	Australia United States Free Trade Agreement
CARICOM	Caribbean Common Market
CGE	Computer-generated equilibrium
CIE	The Centre for International Economics
CNMI	Commonwealth of the Northern Mariana Islands
UN COMTRADE	United Nations Commodity Trade Statistics Database
CTH	Change of Tariff Heading
EC	European Community
EEC	European Economic Community
EEZ	Exclusive Economic Zone
EPA	Economic Partnership Agreement (between EU and PICs)
EU	European Union
FEA	Fiji Electricity Authority
FIC	Forum Island Country
FSANZ	Food Standards Australia-New Zealand
FSM	Federated States of Micronesia
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement of Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
GSP	Generalized System of Preferences
GST	Goods and Services Tax
HS	Harmonised System
IIT	Inter-Institutional Trade
IMF	International Monetary Fund
IP	Intellectual Property

LDC	Least Developed Country
MFN	Most Favoured Nation
MSG	Melanesian Spearhead Group Trade Agreement
NAMA	Non-Agricultural Market Access
NFF	National Farmer’s Federation
NGOs	Non-Government Organizations
OECD	Organisation for Economic Co-operation and Development
PACER	Pacific Agreement on Closer Economic Relations [between the Forum Island Countries and Australia and NZ]
PACP	Pacific, African, Caribbean Partners (Cotonou Agreement)
PATCRA	Agreement on Trade and Commercial Relations Between the Government of Australia and the Government of Papua New Guinea
PIC	Pacific Island Country
PICTA	Pacific Island Countries Trade Agreement
PIFS	Pacific Islands Forum Secretariat
PIPSO	Pacific Island Private Sector Organisation
PMV	Passenger Motor Vehicle
PNG	Papua New Guinea
PPP	Purchasing Power Parity
RERF	Revenue Equalisation Reserve Fund [specific to Kiribati]
RMI	Republic of the Marshall Islands
ROO	Rules of Origin
ROW	Rest of World
RTA	Regional Trade Agreement
SIS	Smaller Island States
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement
SPS	Sanitary and Phytosanitary Measures
TAFTA	Thailand Australia Free Trade Agreement
TBT	Technical Barriers to Trade
TCF	Textiles, Clothing and Footwear
TTF	Tuvalu Trust Fund
UK	United Kingdom [of Great Britain and Northern Ireland]
USA	United States of America
VAT	Value-added Tax
WTO	World Trade Organisation

1. Executive Summary

Context

PACER creates the framework for the gradual introduction of a regional free-trade area encompassing Australia, New Zealand and the Pacific Island Countries (PICs)[1]. The free-trade agreement will be complemented by other cooperation on trade facilitation and direct technical assistance to Pacific Island Countries.[2]

The free-trade area created by PACER Plus[3] will be the latest of several regional trade agreements, but it will be notable for requiring *reciprocal* liberalisation of Pacific Islands' trade with their largest regional neighbours. Part of our quantitative analysis (see Appendix I) suggests that there could be a significant increase in trade volumes (up to 30%) from the elimination of regional trade barriers and improved efficiencies, although that effect will be due to the aggregate impact of PACER Plus, SPARTECA, PICTA and the EPA with Europe.

PACER Plus could also be distinguished by the inclusion of a chapter or special section on the liberalisation of the temporary movement of skilled and unskilled labour within the region. Our consultations have shown that this would enjoy strong support from the Pacific community. The inclusion of broad labour market liberalisation provisions in the schedules of the Members would dramatically change the scale of the potential benefits, in particular if extended to unskilled labour.

The Institute for International Trade collaborated with well established Pacific partners in undertaking this overview report, which is based on desk research using existing quantifiable data and on initial consultations in the Pacific region. The Institute emphasised throughout the consultation process that the key aim of this overview report was to provide recommendations that would assist in identifying the most beneficial ways for PACER Plus to successfully move forward. From our discussions, it was clear that further consultation with both public and private sectors, along with further quantitative and qualitative analysis would be required in areas of mutual concern to progress PACER Plus negotiations.

The Institute for International Trade in Australia together with the University of the South Pacific in Fiji and the Pacific Institute of Public Policy in Vanuatu undertook much of the initial analysis and consultations with key private and public sector representatives available during May 2007. A list of those consulted can be found in 'Appendix A' but they included for example the Pacific Forum's Alternate Spokesperson on PACER Plus, (the Hon Lisiate 'Akolo), representatives from the Melanesian Spearhead Group (MSG), the Fiji-Australia Business Council, Pacific Island Private Sector Organisation (PIPSO) representatives and the Pacific Island Forum Secretariat. Consultations were also held with expert academics in the region and with trade officials from the New Zealand and Australian governments. A draft list of potential benefits and challenges (Appendix B) was given to those consulted to assist in facilitating their responses.

It is intended that further consultations, capacity building and research work will take place following this report. Nonetheless, given the calibre and credentials of those consulted to date, we believe the initial findings and the forty recommendations put forward in this report,

[1] Throughout this report, PICs refers to the following Pacific Island Countries who are members of the Pacific Island Forum: Cook Islands, Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu

[2] The Australian Government has made it clear that development aid negotiations should be separate to PACER Plus negotiations. *Pacific Partnership for Development* will focus on development assistance agreements with each PIC.

3 At some stage it may be worth considering an alternative name for PACER Plus for example the agreement on Pacific Australia New Zealand Economic Relations (PANZER) to reflect a new era of regional integration

provide considerable insight into how to successfully move PACER Plus forward and we trust will be of value to the respective governments of the Pacific Islands, Australia and New Zealand who will be party to this agreement.

Key outcomes from the initial consultations

Potential benefits

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

The major perceived benefit of PACER Plus was without doubt the potential of increased labour market access[4], particularly for low and unskilled Pacific workers into the Australian and New Zealand markets. In the body of this report there is a detailed analysis of how temporary labour market access might be dealt with in PACER Plus but put simply, we believe it should be part of the trade architecture and that, if carefully designed, could be created, with discriminatory quotas, in a way that is unlikely to raise concerns under the GATS or with Australia's other FTAs.

There was reserved support for a trade architecture of a general nature applying to the whole of the Pacific region but with specific schedules for each Pacific Island Country according to each PIC's particular circumstances, for example with respect to the phasing of tariff reduction or its capacity to embrace services liberalisation. However government officials consulted were keen to see further detail of how such an agreement might evolve.

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

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

A key aim of Pacific leaders is to build the job base at home and more than one of those consulted, put forward the idea of an upfront investment liberalisation agreement as a forerunner to PACER Plus to facilitate an increase in productive investment in the region. This however requires further analysis and would require an analysis of incentives, such as specific tax and other measures that could go beyond the realm of a traditional trade

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

agreement. Nevertheless, potential benefits were identified if a PACER trade agreement could facilitate the further development of niche overseas and tourist markets with Fiji Water being cited as a good example of a uniquely Pacific trade success story.

In general there was support for the potential of PACER Plus to assist with domestic reform by driving down the cost of protection to PIC consumers and by increasing competition and the quality of both goods and services in PIC markets. The PIC business community saw the potential benefits from promoting competitiveness within PICs, including what may be a long term benefit to domestic producers and suppliers who are also consumers of goods and services. There was a recognition by many of those consulted, that PICs must not be 'left behind' by economic globalisation and that closer integration into the region with its two developed country partners should assist in their long-term economic development.

Potential challenges

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

PNG officials, for example, were concerned about the lack of a level playing field and felt that they could be undercut or out-smarted by experienced ANZ negotiators. They also highlighted the need for the development of 'business infrastructure' and industry assistance that would allow them to gradually become more competitive in the future. Vanuatu officials emphasised the importance of strengthening institutions, especially their 'customs and revenue collecting' system.

Fear of lost revenue as a result of reduced import tariffs was, as expected, high on the list but we again discerned a shift in thinking which reflected a view about the inevitability of tariff revenue reduction. For example, two countries that could be among the worst affected, Tonga and Vanuatu, did not labour the point. Tonga is more interested in the development of successful temporary labour market schemes and both countries have already undertaken considerable measures to broaden their tax base away from dependence on tariff revenue. The hardest hit may be some of the smallest PICs and for them; in particular, ANZ governments might consider supporting a tariff revenue offset trust fund.

The equal and opposite reaction to the support expressed for services and investment liberalisation was the fear of being swamped by ANZ goods and services to the detriment of local businesses and local employment. PIC officials look to ANZ for much greater assistance to increasing the supply side competitive capacity of PICs, for example through the training and up-skilling of the Pacific workforce, through assistance to meet Australia's stringent quarantine requirements, through a more flexible application of rules of origin or through the harmonisation of regulatory requirements that wherever possible are consistent with those required by other developed nations such as the EU or the US. They also raised the complex problem of "fine tuning" the balance between *attracting* foreign investment while retaining or possibly introducing subsidies and other direct assistance to support local industries and sectors, particularly those with future export potential.

More than a few representatives from the private sector emphasised the value of technical assistance to identify how Pacific companies could better integrate with ANZ supply chains and on how to better market their products or services overseas. There was generally open acceptance of the value of liberalising mode 3 and mode 4 services if it could lead to greater joint investment and greater cross-fertilisation of business professionals and managers throughout the region. The importance of government and private business working closely together on PACER Plus was clearly identified, with the alternate spokesperson on the Pacific putting forward the need for a joint ad-hoc working group on PACER Plus.

An additional area of concern of both the PICs and ANZ was to ensure that the institutional and resource capability exists to respond to increased competition in authorized ways that promote economic and social goals. This can include, for example, education and training to enhance workforce resilience and flexibility, a social safety net that includes retraining and adjustment assistance programs and an institutional capacity that enables the proper use of WTO-consistent temporary safeguards or trade remedy measures.

Last but not least, one of the major challenges identified by those we interviewed was the need to inform and educate the general public, as well as the private sector, on the value of trade reform and its potential long-term benefits. Although such benefits may be marginal for some smaller PICs, reform will facilitate the most efficient allocation of resources, improve labour mobility options, increase investment inflows and assist in the development of competitive advantage for small niche markets. Tuvalu's 'TV' license revenue is a case in point of how one nation has benefited from 'being globally connected'. To this end, we have recommended joint work on media, training and education events which allow for honest and open debate on the benefits and the challenges of trade reform. Such events could include high profile visits of private sector investors to the Pacific, better marketing of Pacific goods through trade fairs in ANZ, public forums, joint media statements and opinion pieces on the benefits and challenges of trade reform and economic integration. It is also recommended that ANZ consider the provision of further training for Pacific officials across government departments, not just in trade and economic policy reform, but in building the technical skills to bring about necessary reform. Further consultation and technical support for the private sector, perhaps working closely through PIPSO, was also recommended as a useful way forward for developing the understanding and potential of PACER Plus.

Ways forward and recommendations

Some MSG officials and academics were of the view that PACER Plus should not focus too narrowly on tariffs and rules of origin, but much more on interconnectivity, communication, information, the harmonization and simplification of regulatory procedures, and more on research on each individual country's comparative advantage. A recent Pacific Economic Survey for example, points to a number of regionally based solutions for more efficient and integrated communications, aviation and shipping strategies.[5] By jumping straight into tariff line issues it was thought that negotiations would descend to, at best, marginal positives whereas much more could be had by looking broadly at the longer term potential benefits.

We agree that the cooperation agenda remains very important in building economic integration in the Pacific. However, Pacer Plus as we understand it will be far more than a simple trade agreement with a focus on tariffs and rules of origin. It is envisaged that this will be a broad and comprehensive trade agreement and understanding existing and potential comparative advantages will be an essential element of preparation for negotiations for PICs.

Nevertheless, the Pacific needs to move forward with due diligence and speed to avoid falling behind regions that are far advanced in integrating their economies. In particular, the Pacific Island Countries should be taking advantage of ANZ trade agreements with third countries, to avoid further marginalization. PACER Plus affords an opportunity for PICs to address the persistent high trade barriers that remain after decades of cooperation on trade, and to do so in a way that addresses their continuing, relatively poor economic performance which could well face further deterioration under demographic and, in some cases, environmental pressures. Regional economic analysis suggests that a reciprocal trade framework as outlined in PACER Plus would be a useful adjunct to regional cooperation. More open borders - among themselves as well as with their major regional trading partners - would bring more market discipline to macro and micro-economic management, would improve the accountability of government and would help to broaden the production and output base in some of the larger PICs. In addition, increasing economic resources in PICs would enable consideration of

[5] See the Pacific Economic Survey – connecting the region, Commonwealth of Australia, 2008

increased cooperation on other issues of importance, such as promoting rural and outer island development, environmental protection, fishery enforcement, gender equity, health and education, all of which have direct and indirect relationships to a broad trade agreement. PACER Plus could also be the platform for further significant liberalisation of ANZ market entry for the PICs, including in the domain of labour services.

The authors consider that PACER Plus will enhance the regional and global integration of the Pacific Island economies, especially if the conditions of reciprocity are respected. But there are narrow limits on the capacities of the Pacific Islands to plan, negotiate and implement a fully-fledged free-trade agreement. Australia and New Zealand will need to support a gradual process of regional consultation, capacity building and negotiation that avoids the mistakes made in the EPA negotiations, especially as some have argued, the failure to account for the diversity of Pacific Island economies and capacities.

Below is a summary of a number of specific recommendations, but perhaps the overall message at this stage is the need for sufficient preparatory work which delivers on trade related capacity building commitments while allowing time and political space for PICs to ascertain for themselves the challenges and potential long-term benefits of trade reform and regional integration. For Australia, concessions might include the winding out of some significant infrastructure expenditure through the Pacific Partnerships for Development program. From a trade perspective however, the big ticket item will no doubt be labour mobility for low and unskilled workers. If Australia pursues the piloting of temporary labour market schemes with the Pacific, this would send a clear signal of its commitment to greater regional integration – a key objective of PACER, and provide tangible evidence of the benefits of such integration. The promise of more to come through a trade agreement – once various sensitivities and complexities are dealt with – will help build momentum towards deeper integration through PACER Plus.

1.1 Recommendations

Our recommendations are divided into three categories:

A. Progress towards a PACER Plus agreement

B. Content of a PACER Plus agreement

C. Further work and research required

A. Progress towards a PACER Plus agreement

Progress toward PACER Plus is dependent on the ability of the negotiations to fashion a agreement that mitigates the cost of trade liberalization to the PICs while enabling the realization of benefits. It is well acknowledged that PICs lack adequate capacity when it comes to comprehensive trade negotiations. PICs often lack the capacity to take advantage of opportunities created by such agreements. Issues exist concerning trade related infrastructure, supply-side constraints, established private-public sector consultative mechanisms and public sector negotiating resources. To craft an effective integration program it will be important for Australia and New Zealand to remain cognisant of the diversity of PICs interests, their lack of capacities and their concerns about the potential for ANZ economies to dominate and reap most of the benefits of an ANZ FTA. Therefore we recommend that the Australian Government consider the following suggestions to ensure negotiations are conducted in a way that emphasizes the mutual advantage of a PACER Plus agreement and delivers closer regional economic integration among all members.

1. **Preparatory phase**: In order to ensure a gradual process that will provide time to engage PIC governments and business sectors in consideration of PACER Plus, a period of up to two years should be devoted to preparatory consultations and discussions in order to meet the challenge of constructing this new framework of regional integration.

2. **Financial support for preparatory and implementation phases**: Australia might consider how best to accelerate the provision of an appropriate level of bilateral funding to assist PICs through the preparation and implementation phases of PACER Plus.

3. **Implementation schedule:** The timetable to implement a WTO-compliant FTA is 'in general' ten years. The PACER FTA schedule should be consistent with WTO practice, but recognize the importance of not losing ground in the global competitive environment. The PACER schedule could also be 10 years, concluding implementation preferably after the completion of PICTA and coincident with the EPA implementation schedule. Because even the 'sensitive' PICTA products will have been liberalized by 2021, PACER could set all deadlines for the elimination of any barriers before this date, although the pace of liberalisation could be varied, if necessary, 'back-ending' the schedule of duty cuts to allow longer periods for adjustment .

4. **Architecture of PACER Plus:** In order to take account of the diversity of the PICs, and to ensure each schedule embodies region-wide obligations, the schedules of individual members of the FTA could be negotiated with all other Members; that is, not in a PICs-ANZ negotiation that would result in a 'hub-and-spokes' structure. Each schedule could contain a (possibly unique) progressive liberalisation commitment. Parties might wish to consider that a practical approach could be to use PICTA as the starting point for the goods schedules for each Member of PACER Plus, which would also assist in re-invigorating the regional integration objectives of PICTA and PACER Plus. (see section 5.7.2 of this report for further discussion.)

5. **Adjustment Programs**: PACER Plus will likely bring both welfare gains for the PICs, as well as terms-of-trade losses from the elimination of their import barriers. To help guard against the mal-distribution of the welfare gains, Australia and New Zealand from the outset might consider the generous funding of complementary programs (already foreseen in the original PACER agreement) to promote smooth adjustment rather than merely to compensate sector losses.

6. **Pilot labour market schemes**: Australia could consider the piloting of temporary labour market schemes with the Pacific, with a particular focus on market access for low to unskilled labour, with the pilot scheme involving at least one Melanesian, Polynesian and possibly a Micronesian country. A pilot scheme would contribute to the learning needed if a 'labour mobility' chapter of PACER Plus is developed.

7. **Vocational and technical training:** If pilot labour market schemes are introduced, Australia might consider contributing to the vocational and technical training needs of Pacific Islanders participating in these temporary labour market schemes particularly to the planning and funding of pre-departure briefings, on-the-job training, and assisting PICs in managing the 'rotation' and the re-integration of temporary labour.

8. **Support for Customs and Revenue Collection Reform:** Australia and New Zealand could consider an appropriate level of funding for customs and revenue related capacity building including the capital costs for equipment and funding for training and retention of customs and revenue officials as part of the preparation for PACER Plus negotiations

9. **Public sector capacity building:** It would be useful to increase the awareness of PACER Plus and the benefits/challenges of trade reform across government departments with in-country workshops and training exercises in ANZ and through the building of the negotiating capacity and skill development of current and future trade negotiators.

10. **Ongoing consultation and communications strategy**: In order to improve the capacity of the PICS to identify and contribute to the 'mutual advantage' that must underpin a successful regional integration (and to avoid the negative public perceptions that the EPA negotiations generated in many PICs), Australia could consider investing in private and public consultation, as well as education and media outreach that builds on the work and valuable feedback from these initial consultations. This consultative strategy could be divided into three specific but complementary areas:

    - the development of consultations and workshops on PACER Plus, organised jointly with the Pacific Island Private Sector Organisation (PIPSO), throughout the Pacific, with both an educative component and an investigatory component with respect to PICs' current trade capacity and barriers, including services barriers;
    - funding for each PIC for a media outreach and public consultation process with respect to the benefits and challenges of PACER Plus;
    - a collaborative and regionally organised series of events to promote civil society's awareness of the PACER Plus process, and of associated costs and benefits for each country. This could include such things as ANZ private sector delegations visiting PICs, trade fairs, joint media events, show-casing success stories and how others have dealt with the costs of trade reform.

11. **Private-Public Sector PACER Plus Working Group**: Australia could assist, as necessary, in the formation of a 'Pacific Private Sector-Government Ad Hoc Working Committee' to work together on PACER Plus preparations and negotiations.

B. Content of a PACER Plus agreement

12. **Tariff elimination and negative lists**: There should be no *a priori* exceptions to the elimination of tariffs. Schedules of obligations on commercial services trade should take the form of a negative list (as in ANZCER).

13. **Rules of Origin**: ANZ and PIC governments could undertake a preliminary examination of the benefits of implementing a simple CTH ROO supplemented where necessary by product-specific provisions. As their own FTA program expands to include other regional countries and MFN rates fall, Australia and New Zealand might also consider the possibility of accepting more flexible ROO including lower levels of regional transformation in PICs as sufficient to confer origin.

14. **Trade diversion:** PICs should consider taking steps to cut MFN duties as they cut preferential duties over the 10-year implementation period. This will make little difference to their import-competing industries (given the reduction in duties on imports from Australia and New Zealand), but will minimize the risk of PACER Plus creating trade diversion (PICs are likely to escape WTO obligations to cut MFN duties in the Doha Round of trade negotiations).

15. **Trade facilitation:** Noting the diversity, isolation and small size of many of the PICs, it is suggested that a tailor-made trade facilitation program for each PIC could be accommodated within a region-wide cooperative framework. Some of the main areas of need which we believe should come under prime consideration include:
    - Administration of borders and ports, including documentation and capital equipment;
    - Fiscal administration and public service efficiency;
    - Land transport and ports infrastructure and management;
    - Communications infrastructure and management.

16. **Food standards and SPS barriers:** Consideration could be given to the advantages of extending participation in FSANZ (Food Standards Australia-New Zealand, the Trans-Tasman food standards authority) to the PICs to facilitate their adoption of the same food standards as Australia and New Zealand. This could be a work program arising out of PACER Plus rather than a component of it. ANZ could also provide valuable technical assistance to PICs to assist in the development of SPS policy and administration that would enable PIC exporters to meet ANZ quarantine and SPS requirements.

17. **Investment liberalisation provisions or 'chapter':** Consideration should be given to PACER Plus containing obligations on region-wide cooperation on investment including liberalisation of investment regulations. These provisions would be in addition to the provisions of the services chapter on Mode 3 (establishment).

18. **Labour market liberalisation provisions or 'chapter':** Consideration should also be given to PACER Plus containing obligations on temporary movement of labour including for unskilled labour. The latter could be the most significant economic obligation and economic benefit in the agreement. It may be useful to complete the chapter on labour mobility after the entry-into-force of the head agreement and after considering the results of any pilot labour movement schemes.

19. **Binding labour market quotas:** The agreement could consider binding commitments in respect of the temporary entry of natural persons from PICs for work purposes, with different quotas for different PICs according to their individual situations. There are a number of possible options as to how this could be accomplished, such as through specific commitments in services annexes or through a separate chapter on the movement of natural persons. Regardless of how it is structured, we believe that a binding trade agreement is the appropriate vehicle for "locking in" commitments on labour mobility in a way that takes account of the heterogeneous needs of the PICs and is consistent with multilateral obligations under the GATS. However we believe that regional trade agreement on labour mobility will need to be supported by other cooperative agreements for example in areas of training, immigration and development.

20. **Commitment to services liberalisation.** PICs and ANZ should consider fully embracing a services liberalisation agreement given the potential benefits of greater supply and competition in sectors such as education, transport, communications and tourism. There is good reason to believe that a higher proportion of contestable services delivery in infrastructure could improve accountability, pricing and quality of these crucial services for business and consumers.

21. **Capacity building for services negotiations:** ANZ should also consider support for building the institutional capacity of PICs to implement necessary regulatory reforms that underpin equitable and non-discriminatory services liberalisation measures. Whether a negative or positive listing approach is used, the preparation of schedules for the individual PICS will benefit from extended consultation, cooperation and capacity building support from Australia and New Zealand, given the difficulty of preparing negotiations and writing the actual schedules.

22. **Harmonise regulatory requirements:** It would be useful for ANZ to harmonise where possible with other developed country regulations and requirements, for example on trade in services regulatory requirements, in order to simplify procedures for PICs.

23. **Broadening the tax base:** There are a few countries in the Pacific that do not have a consumption tax. These countries could be assisted to investigate the introduction of a consumption tax such as VAT or GST to mitigate the potential loss in tariff revenue as a result of their participation in the PACER Plus agreement. Others where a VAT/GST is established, could be assisted to further improve their revenue collection systems.

24. **Tariff Revenue Offset Fund**: ANZ should consider direct support to the smallest PICs in particular, in order to supplement revenues lost from tariff liberalisation and assist with adjustment costs through for example a well managed Tariff Revenue Offset Fund.

25. **Monitoring and evaluation:** It is recommended that consideration be given to the establishment of appropriate monitoring and review mechanisms for assessing both the preparatory and implementation phases of PACER Plus.

C. Further work and research required

26. **Industry competitiveness study**: It would be useful to develop a program for assisting PICS to identify and anticipate industry adjustment pressures flowing from the PACER Plus agreement. This could be followed by an assessment of the most appropriate forms of support to adjustment, taking account of the greater flexibility that a more open regional market should bring to the entry to, and exit of, firms and workers in each sector. ANZ should look to work with existing multilateral (e.g. ADB) programs in supporting these assessments and adjustment programs.

27. **Inventory of potential ANZ private sector investment in PICs:** Considerations should be given to undertaking consultations with ANZ companies with existing or prospective trade and investment interests in the Pacific in order to develop an inventory of current business ties, ascertain barriers to trade and investigate future potential for productive investment by ANZ companies in the Pacific.

28. **Technical assistance to PIC's agricultural, manufacturing and resources sectors**: As part of a program of assistance to adjustment in the PICS to the economic impacts of regional integration, further research could be undertaken to identify how, as part of PACER Plus, ANZ technical assistance and capacity building can best enhance the competitiveness of agricultural, manufacturing and resource firms in PICs. Particular attention should be given to strategies such as:
    - targeting niche markets not only in PACER Plus countries but internationally
    - targeting niche market programs of particular relevance to women
    - identifying how best to integrate PIC producers into ANZ supply and distribution chains
    - taking account of the limited marketing capacities of SME exporters in the Pacific

- identifying technical training for the up-skilling of management
- overcoming trade facilitation and logistic bottlenecks for the private sector
- assisting in prioritising infrastructure development for export
- supporting public sector capacity to remove red tape and barriers to doing business for domestic and foreign investors
- identifying specific industry assistance programs, for example to assist with the restructuring of manufacturing sectors or land reform programs within specific PICs

29. **Barriers to expanding services trade:** The above recommendation could include or be complemented by a study on the barriers to expanding services trade among PACER Plus signatories with recommendations on how to overcome or reduce these barriers in the future. This could focus on vital services sectors such as transport, telecommunications, professional services, education and tourism for example.

30. **Analysis of the impact of temporary labour market schemes on individual PICS:** The PACER Plus parties should consider undertaking - possibly in conjunction with the pilot labour movement program we recommend above - an evaluation of the costs and benefits of temporary labour market schemes so as to minimize misunderstandings about the limits that may be placed on any eventual access arrangements. Such a process would help to engage the attention of employers, employment service providers, trade unions and individual workers in a way that would make the implementation of an eventual agreement easier to manage. This process could include undertaking further research on each PICs labour market conditions, training needs and capacity to meet increased demand based on realistic assumptions such as likely ANZ demand for labour over the next 25 years.

31. **Remittances and transaction costs:** Remittances to the Pacific reached US$ 425 million in 2005, and at current trends are likely to overtake aid flows in value in 2009. Further research work could be undertaken on how PICs might better capture the benefits of remittances for savings and investment purpose using appropriate incentives. Further investigation could also be undertaken into the means for reducing transaction costs of remittances; solutions that are suitable for the Pacific.

32. **Local employment creation**: It would be useful to consider further research into the:
    - Economic management and accountability reforms designed to increase indigenous employment demand.
    - Liberalization of PICs investment and business regulations that might attract more investment in local employment-generation.
    - How best to align the training components of temporary labour market schemes with longer-term employment generation.

33. **Fisheries sector:** Further research is needed to examine the most cost effective ways for PACER Plus to assist in the trade related development of PICs fisheries industry and the enforcement of fishery agreements.

34. **Sustainable poverty reduction:** While the economic benefits of services liberalisation for low income consumers and the positive income effects of remittances are well documented generally, consideration should be given to further research on the most effective ways for PACER Plus to contribute specifically to sustainable poverty reduction of PICs - with particular attention to the interaction between services liberalisation, the role of remittances and agricultural productivity.

35. **Intellectual property:** Consideration should be given to investigating how PACER Plus might assist PICs in protecting intellectual property, traditional knowledge and cultural expressions/folklore and how the extension of geographical indicators might be of relevance to Pacific products. (This could be undertaken as part of the broader research into the relationship between PACER Plus and sustainable poverty reduction mentioned above.)

36. **Implications of previous FTAs for PACER Plus**: Further analysis would be useful on the nature of previous trade agreements (PICTA and EPA in particular, but also of PATCRA, SPARTECA and ANZCER) for their implications when considering the phasing in of obligations under PACER Plus, for example with respect to rules of origin, time-frames and tariff reduction schedules so as to take account of the differences among PICs in economic size and production profiles.

<u>Further Quantitative Analysis</u>

The University of the South Pacific's gravity model in Appendix I of this report predicts an increase of up to 30 percent in overall trade between ANZ and PICs. However as the text of this quantitative analysis points out, obtaining reliable economic and trade data sets from many Pacific Islands is not yet possible. The following recommendations are therefore put forward for consideration with respect to quantitative analysis and the implementation of PACER Plus.

37. **Further update existing data:** Update and consolidate existing available data (for example from USP, ADB, PIFS and other sources) and mirror data based on ANZ export and import data to the extent possible.

38. **Invest in statistical partnerships**: Invest in partnerships between a local economist/statistician in each PIC, on the one hand, and a major economics or accounting firm/practitioner in Australia or New Zealand, on the other, to develop the most accurate data available for purposes of modelling the impact of PACER.

39. **Social Accounting Matrix**: Contribute to a long-term effort, for example in collaboration with ADB and through PFTAC, to assist the PICS to improve their statistical data collections and to collect or reliably estimate the other data needed for a Social Accounting Matrix.

40. **Long-term trade and economic data capacity building project:** Invest in building the long-term capacity of individual PICs to more accurately record and analyse economic and trade data by the time PACER Plus comes into full effect. We are aware from PFTAC country notes that existing statistical advisors in several PICs have already started on, or established, some long-term work toward better data. It would make sense to accelerate/expand this work in order to build the database necessary for region-wide modelling of welfare impacts. This option would have the added advantage of investing-in and building the long-term capacity of individual PICs to more accurately record and analyse economic and trade data by the time PACER comes into full effect.

2. Introduction

The Australian Government is committed to working towards a comprehensive regional free trade agreement as envisaged by Forum Leaders under the Pacific Agreement on Closer Economic Relations, referred to in this study as 'PACER Plus'.

The Australian Government has made it clear that it wishes to encourage informed debate amongst Pacific Island Countries (PICs)[6] in their evaluation of appropriate trade liberalisation and trade reform policies which can assist in more equitable and sustainable economic growth for small island economies in the Pacific. Poor access to information on the benefits and the challenges of international trade has at times hindered PICs' uptake of trade reform policies and so with respect to PACER Plus, this study has been commissioned to provide an *initial assessment* of the major benefits and challenges of a free trade agreement between Australia, New Zealand and PICs.

The Institute for International Trade has collaborated with key partners in the Pacific in undertaking this overview report, based on desk research using existing quantifiable data and on initial consultations in the Pacific region. A key aim of this overview report is to provide recommendations that will assist in identifying the most beneficial ways for PACER Plus to move forward successfully. It is clear that further consultation, quantitative and qualitative analysis will be required in areas of mutual concern to progress these trade negotiations.

The Institute for International Trade in Australia together with the University of the South Pacific in Fiji and the Pacific Institute of Public Policy in Vanuatu undertook initial analysis and consultations with key figures who were available during May 2007. A list of those consulted is in Appendix A and includes important public and private sector representatives including the Pacific Forum's Alternate Spokesperson on PACER Plus, the Hon Lisiate 'Akolo, representatives from the Melanesian Spearhead Group (MSG), the Fiji-Australia Business Council, Pacific Island Private Sector Organisation (PIPSO) representatives and the Pacific Island Forum Secretariat. Consultations were also held with expert academics in the region and with trade officials from the New Zealand and Australian governments.

It is intended that further consultations will take place following this report but, given the calibre and credentials of those consulted to date, we believe the initial findings and recommendations in this report carry with them considerable insight into how to successfully move PACER Plus forward. Appendices D, E and F of this report may also be referred to for details of responses to the questionnaire used in our consultations.

Section 3 of this report contains a detailed analysis of the implications of PACER Plus for regional integration and describes the interaction and overlapping nature of recent trade agreements in the Pacific including SPARTECA, MSG arrangements, PICTA, Cotonou-EPA negotiations and of course PACER. This is followed by a short literature review before more detailed discussions of the potential benefits (section 5) and potential challenges (section 6) of PACER Plus across various sectors and trade areas of significance for PICs. The topics under sections 5 and 6 were somewhat arbitrarily selected based on initial views of those consulted about where the key benefits as distinct from challenges might lie. In reality both of these sections deal with benefits, challenges and suggestions for ways forward. Section 7 concludes with the key recommendation that sufficient time and flexibility be devoted to preparatory consultations and discussions in order to meet the challenge of constructing this new framework of regional integration. There is a significant amount of information in the various appendices on the consultation process and feedback as well as some detailed notes on quantitative analysis and PICs current statistical and data collection capacity.

[6] Throughout this report, PICs refers to the following Pacific Island Countries who are members of the Pacific Island Forum: Cook Islands, Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu

3. Background, structure and implications of PACER Plus for regional integration

3.1 Analytical approach

We first consider the *content of the PICTA and EPA agreements* to evaluate their implications for the structure, timing and content of a future PACER agreement. We then turn to the implications for PICs of the *sequence of agreements* from PICTA to PACER via the EPA. The background analysis concludes with a review of the existing literature on PACER.

3.2 Background

Most of the PICs have acceded to overlapping regional and international agreements on trade, technical assistance and investment.

- **Inter-PIC agreements**
  - MSG (Melanesian Spearhead Group Trade Agreement): PNG, Solomon Islands, Vanuatu and Fiji.
  - PICTA (Pacific Island Countries Trade Agreement): Now includes all of the PICs except Marshall Islands and Palau. Of the twelve signatories, only Micronesia has not ratified as at May 2008.

- **Regional agreements with non-PICs**
  - SPARTECA: All of the PICs benefit from qualified, non-reciprocal, duty-free access for their exports to Australia and New Zealand (ANZ).
  - Compacts of Free Association: the American trust territories of Federated States of Micronesia, Marshall Islands, and Palau enjoy certain funding benefits, access to some U.S. domestic education, health and infrastructure programs and qualified non-reciprocal duty-free treatment of exports to the United States.
  - PACER (Pacific Agreement on Closer Economic Relations): all PICs are members to this agreement focussed on regional integration objectives, trade facilitation and non-compulsory technical assistance. (see 3.3 below)
  - EPA (Economic Partnership Agreements with the EC): PNG and Fiji signed interim EPAs with the EC (European Communities) in December, 2007 that are to be finalized before the end of 2008. Other PICs are either beneficiaries of the EC's GSP program or of the EC's unilateral concession of free trade (with exceptions) to Least Developed Countries (Kiribati, Samoa, Solomon Islands, Tuvalu, and Vanuatu).

In addition, four countries are members of the WTO: Fiji, PNG, Solomon Islands and Tonga. Appendix G shows a listing of membership in the various agreements.

3.3 The objectives of PACER

PACER envisages the gradual development of a single regional market involving all 14 PICs and ANZ. It is a 'sequencing' arrangement intended to protect ANZ from the loss of 'most favoured' status in any PIC market[7]. But its strategic purpose is to provide 'stepping stones' (Article 3 - "Guiding Principles") to the closer economic integration of the Pacific region and of the PICs with the international economy. It contains some principles of non-discrimination, an endorsement of the importance of trade facilitation and some non-obligatory technical assistance provisions. But it does not contain any direct trade concessions.

3.3.1 Trigger for negotiations

Article 5 of the PACER agreement commits the Forum Island Countries (PICs – the same group as the PICs, along with French Polynesia, New Caledonia and Timor Leste as Observers) to "enter into negotiations" with a view to establishing a (reciprocal) FTA within 8 years of the entry-into-force of PICTA. That date, for the majority of the PICs is 13 April 2011.

Under Article 6.4 of the PACER agreement, upon commencement of any joint negotiations of an FTA with a non-ANZ developed country, the PICs are *jointly* obliged to consult with ANZ with a view to negotiating an FTA. Each PIC is also *individually* obliged by Article 6.3(b) to consult with Australia and New Zealand (ANZ) if it concludes an FTA with any other developed country, with a view to the negotiation of a (reciprocal) FTA.

Thus, the commencement of negotiations on a region-wide EPA by PICs with the EC - and the continuation of those joint negotiations - triggers PACER for all 14 PICs, while the conclusion of 'interim' EPA agreements by PNG and Fiji in December 2007 triggers the PACER obligation separately in their cases.

In practical terms, however, the trigger has few consequences for the future PACER agreement. Instead, it is the *pathway* from the PICTA and EPA agreements that will make the most difference to the timing, structure and scope of a future regional integration agreement under PACER.

3.3.2 Gradual economic integration

Although PACER is an economic treaty many of its provisions refer to future negotiations and agreements that will be concluded under the umbrella of PACER, including 'Arrangements among Forum Island Countries', a region wide FTA, and provisions on trade facilitation and financial and technical assistance. An important feature of these provisions is their reference to the 'gradual' economic integration of the PICs: a formula that is repeated in Article 2 ('Objectives') and Article 3 ('Guiding Principles').

3.4 PICTA to PACER

PICTA has been designed to encourage the expansion and diversification of trade in the Pacific region, by progressively eliminating tariffs and trade-distorting non-tariff barriers over a long period (up to 2021 or twenty years from the initial agreement), as well as to assist in building a single regional market among Pacific Island economies.

- **Scope of PICTA**: PICTA provides for the elimination of tariffs and non-tariff measures on all originating goods other than tobacco and alcohol, and for the (unscheduled) liberalisation of government procurement. In April 2007 the Parties agreed to commence negotiations of a Services protocol for PICTA. There are no provisions on investment, IP or other non-goods matters. "Originating goods" in PICTA are those that are wholly obtained within a PICTA Party or, in the case of a processed product, have a minimum of 40% of the value-added attributable to a PICTA party. Rules on the cumulation of origin for non-processed inputs allow the value of raw materials originating in any PICTA party to count toward the 40% threshold.

[7] The US Compact of Association Agreements impose a similar condition on PIC beneficiaries

- **Schedules of tariff reduction**: Ad valorem tariffs, other than those on goods in any Party's exception list are to be cut to a maximum of 25% by the end of 2008 and progressively eliminated in four steps over the 8-year period from 2008 to 2016 (i.e. zero duties by 1 January 2017). Non-ad valorem duties on these goods must be no more than 80% of the base tariff in 2009 and must be eliminated by January 1, 2017. Tariffs on "sensitive" goods on the exceptions list for any Party must be cut to a maximum of 50% by the end of 2011 and eliminated in ten equal steps over the following 10 years (i.e. by 1 January, 2021).
- **Schedules of elimination of non-tariff barriers**: All measures other than tariffs (and tariff-like charges) must be eliminated on entry into force of PICTA. No new non-tariff measures may be introduced.

Table 1:

PIC Export Markets (% total exports), most recent year

	Market 1		Market 2		Market 3		Market 4		Share 4 markets	Intra-regional share
Cook Is.	Japan	30.8	NZ	12.9	Australia	7.1			50.8	20
FSM	Japan	21.4	USA	20.9	Guam	3.4			45.7	0
Fiji	USA	19.1	Australia	16.5	UK	11.9			47.5	16.5
Kiribati	USA	26.2	Belgium	24.6	Japan	16.4	Australia	8.6	75.8	8.6
Nauru	S. Africa	56.7	India	15.4	Canada	5.9	Australia	1	79	1
Niue	N/A									0
RMI	N/A									0
Palau	USA	N/A	Japan	N/A	Singapore	N/A				0
PNG	Australia	29	Japan	8.7	China	5.4			43.1	29
Solomon	China	39.7	Korea	15.1	Thailand	6.7	Australia	1.3	62.8	1.3
Samoa	Australia	65.5	USA	8.2	A. Samoa	3.5			77.2	65.5
Tonga	Japan	33.3	USA	26.6	NZ	11.1	Australia	2	73	13.1
Tuvalu	Germany	62.1	Italy	20.7	Fiji	7	Australia	2.7	92.5	9.7
Vanuatu	Thailand	47	Malaysia	18.6	Poland	8.3	Australia	1.5	75.4	1.5
Average									65.71	15.11

Source: Nathan (2007)

3.4.1 Small scale of PICTA

The Parties' share of *merchandise* trade with other PICTA Parties is small. Only Tuvalu has a PICTA export market among its top four (Fiji takes 7% of its exports). Although five PICs count PICTA partners among their 4 largest import sources, it is the *same* source in every case (Fiji), undoubtedly because it is a regional transhipment hub. See Tables 1 and 2.

The share of services trade (particularly transport) is likely to be greater, but PICTA does not include services liberalisation at this stage and there is no available data on inter-PIC services trade or barriers.

For merchandise sectors, at least, this means that the potential welfare gains from PICTA are small. Economic adjustments implied by the PICTA schedules - and the potential impacts on their tariff revenues - are also likely to be small.

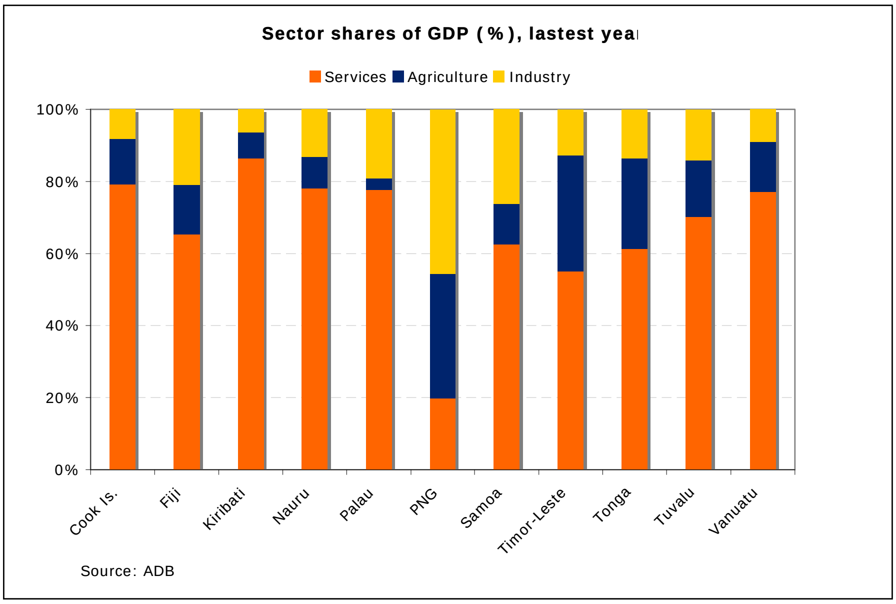
3.4.2 Significance of PICTA

It would be prudent not to jump to conclusions about the value of the PICTA treaty. Its long *gestation* period—it has taken more than 5 years for most Members to ratify the agreement and trading under PICTA preferences has barely begun – this suggests less than enthusiastic participation and in fact there is considerable rivalry between various PICs given the similarity of production. Changes that PICTA preferences will bring to commercial policies in the PICs are therefore likely to be small and, until trade in services is included and the agreement more fully embraced, will offer few "economic integration" incentives.

The current significance of PICTA, now that it has been ratified by all but three of the PICs, is that it constitutes the first[8] *region-wide*, reciprocal trade agreement with market integration objectives. That alone makes it an important step toward the bigger integration opportunity of PACER. Although the tariff impacts are small, the administrative experience gained from the negotiation, implementation and administration of a free trade agreement with other regional countries - in trade and customs agencies and in managing collaboration with the private sector - is likely to be valuable preparation for PACER Plus negotiations.

The inclusion of services trade in the PICTA framework will be an important addition to PICTA and significant for the future coverage of a PACER agreement. Services account for a very high proportion of PICs output/consumption and will be an essential component of a future regional integration agreement. One challenge for PICTA members in services will be compliance with Article V of GATS for those (larger) PICTA members who are also Members of WTO. Article V requires that an FTA in services have 'substantial' coverage of their commercial services sectors, however developing countries and therefore PICs may rely on some undefined flexibility in the definition of this coverage.

Figure 1: *Services output dominates most PIC economies*



Although some trade is already taking place under PICTA preferences, the 'free trade' experience will begin in earnest with the deadline for the first tariff-cuts at the start of 2009 (25% maximum ad valorem rate on non-sensitive items). It seems safe to predict that PICs governments will come under some domestic pressure to take advantage of the provisions in PICTA on:

- Safeguards;

[8] In contrast to the MSG Agreement, which is not region-wide and SPARTECA which is not reciprocal.

- The management of exceptions;
- Tariffication of non-tariff measures;
- The use of ‘general exceptions’; and
- ‘Protection of Developing Industries’ (i.e. ‘infant’ industry tariff measures, Article 14 of PICTA).

Table 2:

PIC Import Sources (% total imports), most recent year

	Source 1		Source 2		Source 3		Source 4		Share 4 sources	Intra-regional share
Cook Is.	NZ	79.3	Australia	6.3	Fiji	6			91.6	91.6
FSM	USA	36.1	Guam	13.9	Japan	11.5	H Kong	5.8	67.3	0
Fiji	Singapore	27.3	Australia	23.5	NZ	18.6			69.4	42.1
Kiribati	Australia	33.5	Fiji	27.5	Japan	18.4			79.4	61
Nauru	Australia	63	USA	10.3	Germany	7.5			80.8	63
Niue	NZ	97.6	Australia	0.3					97.9	97.9
RMI	USA	65.4	Australia	13.4	Japan	4.9			83.7	13.4
Palau	USA	45	Singapore	27.9	Japan	8	Philippines	6.5	87.4	0
PNG	Australia	55.7	Singapore	13.7	Japan	4.4			73.8	55.7
Solomon	Australia	25.5	Singapore	25	NZ	6			56.5	31.5
Samoa	NZ	21.8	Fiji	20.5	Singapore	12.2	Australia	8.8	63.3	51.1
Tonga	NZ	36.1	Fiji	26	Australia	10.2			72.3	72.3
Tuvalu	Fiji	45.8	Japan	18.8	China	18.1	Australia	7.7	90.4	53.5
Vanuatu	Australia	15.2	Japan	13.8	Singapore	12.1			41.1	15.2
							Average		75.35	46.31

Source: Nathan (2007)

PICs governments will have to develop capacity to evaluate demands for protection and to balance them against the benefits of adhering closely to the tariff reduction schedules. Learning to do so could prove especially difficult in the small and micro-economies of the PICs where alternative profit opportunities for trade-exposed business are hard to find and the influence of individual businesses on the political economy of trade can be large.

PICTA will also be the first opportunity for a number of PICs governments that are not members of WTO (See Appendix G) to experience the collective management of a plurilateral trade agreement. PICTA includes provisions relating to:

- Notification obligations;
- Consultation on disputes;
- Dispute Resolution;
- Review and extension of the agreement (e.g. to Services);
- Amendment to the agreement;
- Withdrawal;
- Delegation to the Pacific Forum Secretariat.

Each of these provisions is likely to have some analogue in a future PACER Plus agreement.

3.4.3 PICTA and PACER Schedules

Should the implementation of PACER (including a services chapter) be completed *before* the conclusion of the PICTA schedules? Without answering the question at this stage, it is possible, nevertheless, to identify one important consideration.

PACER and PICTA schedules would remain independent if the Rules of Origin (ROO) prevented liberalisation in one context from ‘leaking’ into the other. There are good reasons to consider very liberal rules of origin for a future PACER (see below) in order to ensure that a greater volume of PIC exports qualify for preferential access to the ANZ market. But the PACER Plus obligations would be region-wide, not limited to trade between PICs and ANZ. So if the PACER Plus ROOs are more liberal than those of PICTA (above) and the PACER schedules are complete before PICTA schedules they will have the effect of *advancing* the completion of PICTA.

Taking into account the ‘sensitive’ schedules in PICTA that allow reductions to be extended until 2021, and the probability of an even later completion date for services liberalisation, when the protocol is agreed, the members of PACER Plus will have to take into account the possibility that PACER Plus with liberal ROO could make the PICTA schedules *moot* in the last few years of the implementation period.

3.5 EPA to PACER

Although ten PICs engaged in negotiation with the EC on an EPA to replace the unilateral EC Cotonou preferences, only two PICs had signed by the 'deadline' of December 2007. Other PICs may, however, accede to the agreement during 2008.

The “Interim EPA” signed on November 29, 2007 by Papua New Guinea (PNG) and Fiji avoids the disruption of trade on their principal exports to Europe – processed tuna and raw sugar. Without an EPA, these two products would have faced significant tariff increases, from zero to €33.90/100kgs on sugar and from zero to 20.5 percent on processed tuna.

Table 3: *Schedule of EPA Tariff Reductions*

		2008	2010	2012	2013	2015	2017	2018	2022	2023	2033	total
Fiji	v.	24%			37%			78%		81.50%		81.50%
	t.	9%			22%			62%		80%		80%
Papua New Guinea	v.	88.10%										88.10%
	t.	82.10%										82.10%

v: cumulative value of imports from the EU, to be liberalised by the specified year
t: cumulative percentage of tariff lines, to be liberalised by the specified year
Source: ECDPM Trade Negotiations Insights Volume 6. Number 8 / December 2007 & January 2008

Although the Cotonou Sugar Protocol would have maintained Fiji’s quota and guaranteed price in the EC market until its termination in October 2009, it would not have protected the duty-free access. The higher GSP duty rate on sugar would have cut returns on a trade worth more than €95 million (more than a quarter of Fiji's total global exports). PNG, which also produces sugar (currently for domestic consumption) is not a Sugar Protocol signatory and thus could also stand to benefit from the new EPA arrangement. Reforms pending in the EC's sugar sector, however, are likely to erode, if not nullify, the value of the EPA preference rents in future.

On processed tuna, the interim EPA maintains duty-free access for PNG’s €40 million annual exports to the EC (10 percent of PNG's total exports to the EC), continuing a preference for PNG over producers from Thailand and the Philippines. PNG also gained a more generous rule of origin for processed tuna in place of the complex and burdensome Cotonou rules. In effect, as long as the fish is processed on-shore in a PACP EPA signatory country, it can be caught by anyone from anywhere in the world.

In exchange for these concessions—and the liberalisation of other EC import barriers on goods—Fiji and PNG agreed to liberalise import duties on substantially all imports from the

EU. The agreement provides for the liberalisation of 88 percent of the value of PNG's imports from Europe and 81.6 percent for Fiji over 15 years. See Table 3.

Ninety percent of all imports in PNG are already duty-free (see Table 4). Accordingly, all liberalisation in the EPA will take place in 2008. For Fiji, 23 percent of the value of EC imports will be liberalised on entry into force, however these products also already enter Fiji duty-free (Table 5).

Table 4: *Papua New Guinea, Frequency distribution of tariffs*

Distribution		Duty-free	0 <= 5	5 <= 10	10 <= 15	15 <= 25	25 <= 50	50 <= 100	> 100	NAV in %
		Tariff lines and import values (in %)								
Agricultural products										
Final bound		0	0.1	0.6	19.4	5.2	38.4	33.1	3.2	6
MFN applied	2006	48.4	1.2	0.2	13.7	25.2	8.7	1	1.6	5.2
Imports	2004	85.6	4.3	0	2.3	5.9	1.1	0	0.7	5.2
Non-agricultural products										
Final bound		0	0.1	0	29.5	0	59	11.4	0	0.1
MFN applied	2006	82.5	0	0	6.9	9.8	0.6	0	0	0
Imports	2004	94.1	0	0	3.3	2.5	0.1	0	0	0

Source: WTO

Under the "**regional liberalisation**" provisions of the EPA, any tariff concession made to the EC must also be extended to all regional signatories (only Fiji at present but potentially other PICs after 2008).

Table 5: *Fiji Frequency distribution of tariffs*

Distribution		Duty-free	0 <= 5	5 <= 10	10 <= 15	15 <= 25	25 <= 50	50 <= 100	> 100	NAV in %
Tariff lines and import values (in %)										
Agricultural products										
Final bound		0	0	0	0	0	97.3	0.6	2.1	2.2
MFN applied	2006	3	61.7	0	19	0.1	12.7	0.7	2.7	3.9
Imports										
Non-agricultural products										
Final bound		0	0	0	0	0	45	0	0	0
MFN applied	2006	11.2	64.9	0.1	8.5	0	14.8	0.3	0.1	1.2
Imports										

Source: WTO

The text of the Interim EPA agreement with PNG and Fiji is not yet available although some analysis based on late drafts is available (Stevens et al., 2008). According to this source and to the summary EC Commission 'staff paper' for the Council on the 'State of Play' (EC Commission, 2008), the Interim Agreement contains chapters on:

- **Trade in Goods**: the provisions include a prohibition of new export taxes with exceptions for environmental reasons or for infant industry purposes (subject to bilateral agreement), and a standstill provision with some product-level exceptions.
- **ROO**: Subject to review in 5 years. Interim EPA ROO appear to continue the Cotonou approach: that is, they are a mixture of 'Change of tariff heading' (CTH) and 'value-

added' (VA) rules with specific industry provisions as in the case of canned tuna. They allow regional cumulation of origin among EPA signatories in the region (implicitly subject to the 'regional liberalisation' clause).

- **Safeguards**: extensive safeguards are available to the PICs (for up to 10 years) with 200-day (maximum) 'pre-emptive' safeguards. PICs are exempted from the imposition of GATT Article XIX and WTO Agreement on Agriculture safeguards by the EC.
- **Customs and Trade Facilitation**: Includes a protocol on customs cooperation; a 'single administrative document' has been proposed for customs clearance but is yet to be negotiated.
- **TBS & SPS**: enhanced cooperation among national authorities and identification of 'priority products' for regional harmonization.
- **Dispute Settlement**: A panel of three arbitrators decides how to settle disputes; the decision is binding. A Joint Trade and Development Committee will establish rules of procedures and might review and amend provisions. Panels are to be drawn from a list of 15 arbitrators and 5 chairpersons to be agreed by the Joint Committee.
- **'Rendezvous Clause'**: Provides for on-going negotiations and for a Ministerial Declaration on the conclusion of a full EPA. Under this clause there may be further negotiations in 2008 on:
    - Fisheries;
    - Services and investment;
    - Trade related rules (competition, investment, sustainable development, IP, public procurement);
    - Development cooperation: There is no 'development chapter' in the Interim Agreement as there is in for example the full EPA with the CARICOM, where it provides, among other things, for funding of infrastructure related to trade through the EC's 'Aid for Trade' funding programs.

3.5.1 Implications of the 'Interim EPA'

The EPA negotiations have the distinction of being the first attempt at a region-wide reciprocal trade agreement with a significant trading partner. In that sense they pre-figure PACER Plus. The negotiations are not formally complete but they already hold an important lesson for PACER Plus: it is a mistake to try to fit all of the PICs into a monolithic trade agreement. Their interests and their capacities (especially) are probably too diverse to be accommodated in the standard form of an RTA in which all members subscribe to the same disciplines in return for the same benefits.

The majority of the PICs had little interest in the EPA once it was clear that the EC would negotiate on neither fisheries (for which the PICs themselves seemed unprepared) nor on labour mobility. Both PNG and Fiji were vulnerable to the loss of preferences and so had a compelling interest—albeit a *negative* interest—in the agreement. But even when the schedule of implementation is long and safeguards and 'development' exceptions are generous, it is difficult to identify economic incentives in a reciprocal trade agreement that will 'clinch' the deal for smaller PICs.

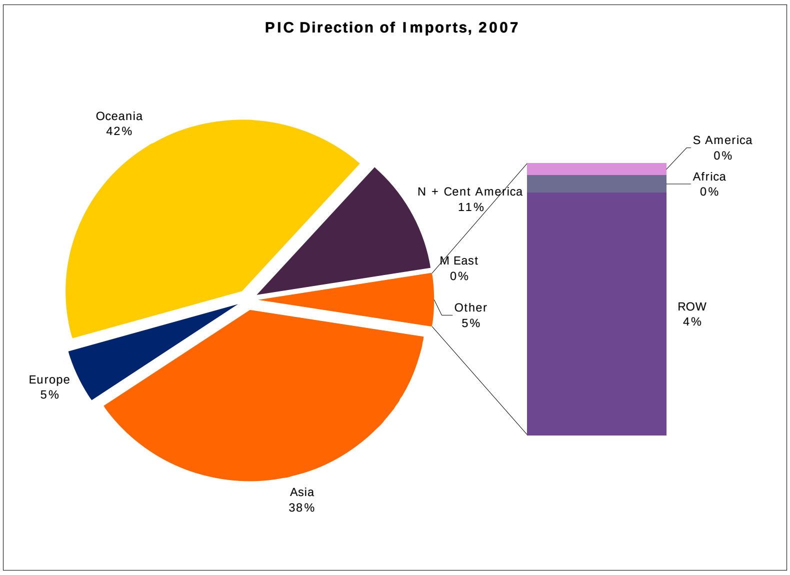
The 'Interim' EPA with PNG and Fiji comprises only a goods agreement with some ancillary provisions (safeguards, dispute settlement, some customs provisions, some standards provisions). It is nevertheless already a substantial 'FTA' framework that could have two implications for a future PACER Plus agreement if it were extended to the other PICs.

- **Displacement**: The EPA has the potential to overlap with or even to partly displace intra-regional trade frameworks among the PICs, such as PICTA or MSG, if the remaining PICs accede, because of its "**regional liberalisation**" provision. This clause requires the extension of any trade concession offered to the EC to all other regional EPA signatories - theoretically in return for the EC's acceptance of regional cumulation of origin for imports qualifying for duty-free and quota-free access to its market. If all PICs were EPA signatories without regional liberalisation, they would be only 'spokes' on the EC "hub". With the regional liberalisation clause, this link with the 'hub' is duplicated among the regional parties, building a 'rim' to the geometry. But the 'hub' remains a key component. Moreover, intra-regional trade relations are not advanced by the EPA as far, or as fast, as they would be by PICTA, for example, since PICTA provides for 100% free trade in goods while the EPA provides only for liberalisation of 'substantially all' trade by EPA developing countries[9]. PICTA also provides a deadline of 2021 for full liberalisation, two years earlier than the current EPA schedule for Fiji (Table 3). This potential displacement threat is further discussed in the section on the 'Sequencing of Agreements', below.

- **Diversion**: As an important FTA with a major extra-regional economy (potentially more significant on a *region-wide* basis than the US Compacts of Association) EPA has the potential to divert PICs imports from ANZ (whose exports may be still dutiable) to the EC (a 'substantial' proportion of whose exports will be duty-free). PATCRA (Agreement On Trade And Commercial Relations Between The Government of Australia and the Government Of Papua New Guinea) provides Australia with a better than-EPA-terms of access[10] to the PNG market, but not NZ. Neither Australia nor NZ has EPA-equivalent terms of access to the Fijian market.

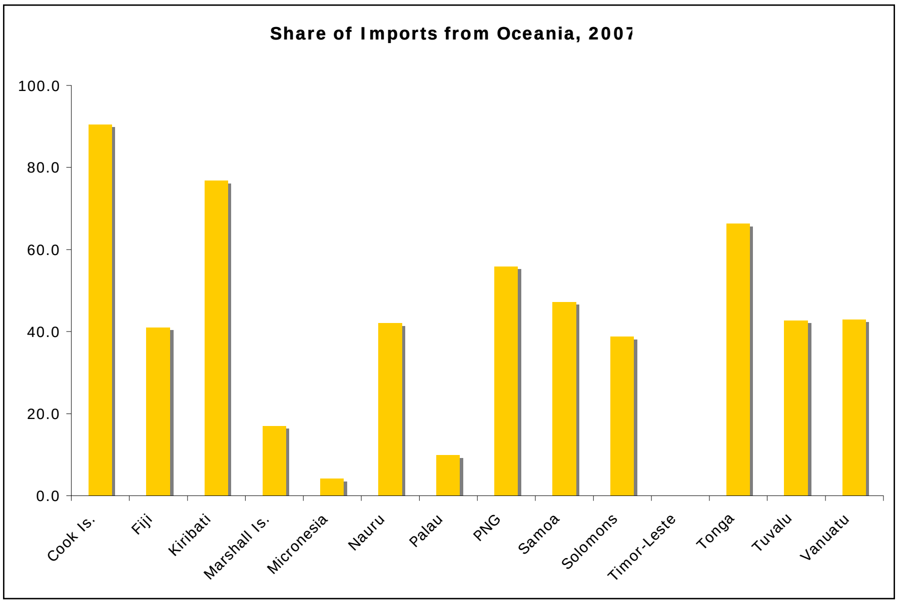
Perceptions within the region of the EPA negotiations - especially the final round in October, 2007 - could also have a lasting impact on **community support** for a future PACER Plus agreement. The negotiations received negative press coverage in the Pacific, and were described as EC 'bullying'. The implication that PNG and Fiji accepted the EC's terms only to 'save' the canned-tuna and sugar concessions may confirm the public perception that the EPA was one-sided. This negative assessment is also likely to taint perceptions of PACER Plus.

Figure 2: *Direction of PIC imports*



[9] Interpreted by the EC as liberalisation covering at least 80% of tariff lines in the EPA schedules.
[10] Subject to the exceptions in Schedule C of the Agreement

Figure 3: *Share of PIC imports from Oceania*



Source: ADB

3.5.2 Coverage

At present, the scope of the EPA is not much greater than the scope of PICTA (i.e. merchandise trade) although it does include customs collaboration, standards and provisions on trade remedies. The EC apparently intends to include (via the "Rendezvous clause") provisions on investment, IP, and competition policy. This would create a precedent for a similar breadth of scope in a future PACER Plus agreement, although it is uncertain whether the smaller PICs that seem unlikely to accede to the EPA would be able to integrate a PACER Plus agreement covering these policy domains into their municipal administration.

3.5.3 The economic 'integration' objectives

The 'joint 'roadmap' EPA document from September 2004 identifies the objectives for the EPA with the Pacific as contributing to development through 'gradual integration' into the global economy—terms that are very similar to those in the early clauses of PACER:

> …Both sides agree that the overall objectives of Pacific ACP-EC economic and trade cooperation will be the sustainable development of the Pacific ACP States, their smooth and gradual integration into the global economy and contributing to poverty eradication in the Pacific ACP States ("Joint Road Map" retrieved 30 April, 2008 from *http://trade.ec.europa.eu/doclib/docs/2004/october/tradoc_118922.pdf*)

But the 'Interim' results prompt doubts about whether the 'integration' objective will be achieved. So far, at least, the 'goods only' agreement signed by two PICs remains firmly in the 'trade-preferences-as-transfer' framework established by Cotonou (and Lomé) and suggests little progress towards 'economic integration' with the EC. The take-home message for PNG[11] and Fiji was that they had avoided disruption to the crucial preferential access to the EC markets for canned tuna and sugar, but not achieved much else. In some domains

[11] See this statement from the PNG Foreign Minister, for example, in **Pacific Magazine** (http://www.pacificmagazine.net/news/2008/04/30/png-defends-signing-of-economic-partnership-agreement)

where there was a prospect of stronger economic *liaison* with the EC through, for example, the physical movement of temporary workers between the markets, or the development of an EC-PIC-region fisheries treaty, the Commission declined to negotiate. (the Commission did not refuse to engage on mode 4, but tossed the 'hot potato' to the individual Member States to negotiate).

The Commission's report to the European Council (EC Commission, 2008) claims that the Pacific interim EPAs will favour *regional* 'integration' (under the 'regional liberalisation' clause) but this refers only to merchandise trade preferences and is hardly a significant gain for the PICs in the light of the more ambitious regional merchandise trade liberalisation already included in PICTA and MSG.

Without a more detailed account of the EPA negotiations it is impossible to identify the precise barriers to 'integration' with the EC that the CARICOM countries, for example, apparently managed to scale. But the prospect of bringing about economic integration between the EC and the Pacific through a trade agreement was dim from the outset for reasons that were never likely to be overcome by negotiation or the design of the agreements. The most obvious barriers were the distance between the European and Pacific regions and the narrow base and small volume of PIC merchandise trade. In addition the PICs are relatively unprepared to engage in meaningful collaboration on economic integration even in domains that are less affected by distance such as standards, professional and skills qualifications, financial and communications services.

The greatest challenge that the PICs face in any economic integration agreement is not due to distance or their small size but to the demands that integration would place on their economic management. Most of the PIC economies are *under-performers* compared to similar economies. Chand (2006), who draws un-favourable parallels between the larger PICs and the island states of Mauritius, Malta and Maldives, argues persuasively that this is due to, among other things, the use of anti-integrative growth strategies (autarchic industrialization, 'infant' industry protection).[12] He points to some encouraging recent signs of reform and to new prospects for growth, a trend that is reinforced by the recent Pacific Economic Survey which shows that regional growth is forecast to reach 4.5 per cent by 2008 particularly if the Pacific becomes better connected both internally and with the rest of the world.[13] But this growth varies considerably among PIC economies the majority of whom face a pressing need to establish and maintain a stable growth path and to build or re-build fundamental economic institutions. The majority therefore are not likely to be in a strong position in the near future to take on the challenges of cross-border integration.

Although the integration objective of PACER Plus may be less challenged by geographical factors and both the merchandise- and services-trade base is broader in ANZ-PIC trade (especially in the ANZ → PIC direction), the challenges remain substantial. The narrow base of the 'interim' EPAs indicates that integration will be a high hurdle for small island economies with some serious economic policy challenges at home, no matter how 'gradual' the implementation steps may be.

3.5.4 Implications for the pathway to PACER Plus

As previously mentioned the PICs have relatively open economies. Most have high levels of exports and imports relative to GDP (CIE, 2007 and IIT, 2008).

[12] See also Stoler (2005) on the Mauritius/Fiji comparison.

[13] Pacific Economic Survey: Connecting the Region, AusAID 2008.

Table 6: Trade share of GDP

Country	Trade Share of GDP (2000)
Cook Is.	74.0
Fiji	82.9
Kiribati	92.3
Marshall Is.	59.2
Micronesia	56.9
Nauru	166.9
Palau	115.7
PNG	79.9
Samoa	44.9
Solomon Is.	55.1
Tonga	53.7
Tuvalu	42.1
Vanuatu	47.4

Source: ADB

Simple MFN tariff averages in PIC economies are about average or a little less than the average for low-income developing countries. WTO data suggests that the average is less than 17% (WTO, 2007), while the World Bank's 'overall trade restrictiveness index' for tariffs and non-tariff measures (NTMs) in low-income developing countries is about 17.5% (World Bank, 2007). High tariffs (> 40% *ad valorem*), where they exist, apply mostly in fish products, horticulture, sugar, pork, wood products and pearls in Cook Islands, Kirbati, PNG and Vanuatu (Nathan, 2007, Table 7).

Table 7: *Tariff summary, selected PICs*

Summary	Total	Ag	Non-Ag	Ratio Ag to non-Ag
Fiji				
Simple average final bound	42.3	48.9	40.0	122%
Simple average MFN applied	10.2	25.7	7.8	329%
Kiribati				
Simple average final bound				
Simple average MFN applied	17.5	24.9	16.3	153%
Papua New Guinea				
Simple average final bound	32.5	48.3	30.1	160%
Simple average MFN applied	5.5	16.7	3.7	451%
Solomon Islands				
Simple average final bound	79.2	76.3	79.6	96%
Simple average MFN applied	14.5	17.5	14.1	124%
Tonga				
Simple average final bound				
Simple average MFN applied	17.0	25.3	15.8	160%
Vanuatu				
Simple average final bound				
Simple average MFN applied	16.3	33.2	13.8	241%

Source: WTO Tariff Profiles

This suggests that there is still considerable room in some PICs to open up markets for regional production. The PICTA agreement provides for this regional liberalisation, requiring all merchandise trade tariffs to be cut to zero by 2021. Since intra-PIC regional trade appears to be only a small component of their total trade (Tables 1 and 2), PICTA liberalisation appears to be a relatively modest step in terms of its coverage of existing trade. But it would target the ‘peaks’ in PIC tariffs that appear to protect against regional competition. If PICTA is extended to services, which comprise a much bigger proportion of total PIC output (see Figure 3), the liberalisation could be still more significant.

EPA concessions among PICS would likely be determined by the concessions made to the EC in the first place (because of the EPA 'regional liberalization rule'). These are not necessarily the most appropriate concessions among PICs, but PICs may be more interested in the EPA than in PICTA because the former is a compensated agreement.

In fact, it is easy to imagine that a regional EPA would become a more prominent framework for regional trade liberalisation than PICTA because, unlike PICTA, the EPA is a compensated trade agreement. The EC has not proposed direct compensation for terms-of-trade losses involved in the reciprocal exchange of the EPA, but it has offered access to substantial ‘Aid for Trade’ funding to the only region to adopt a full EPA so far; CARICOM. This funding is not, in a formal sense, direct compensation for terms-of-trade losses in the EPA. But, for practical purposes, the ‘Aid for Trade’ funding does have that character.

So far, the EC has withheld its ‘development funding’ concession in the ‘interim’ EPA with PNG and Fiji. It remains to be seen whether the EC will hold out that carrot in 2008 to encourage other PICs to accede to a full regional EPA.

The timetable for the progressive implementation of PICTA could also be overtaken by implementation of PACER Plus between the PICs and ANZ if the latter were negotiated before, say, 2013 and were designed to comply with the WTO expectation that FTAs will ‘generally’ be completed within a decade (Article XXIV). The impact on intra-PIC trade of a regional agreement that mirrors the scope of, say, the Australia-Thailand FTA, would certainly be greater than either PICTA or the EPA because the PICs trade more with ANZ than with any other region, including themselves (See Figure 2).

A future PACER Plus could also supplant PICTA as a framework for intra-regional trade. Unlike the EPA, PACER does not foreshadow a ‘regional liberalisation’ clause. But the obligations within PACER Plus need not be structured like the EPA as a ‘hub and spoke’ structure with *consequential* obligations shared among the spokes (the *rim).*

We instead recommend that consideration be given to building on the existing PICTA agreement to reinforce integration objectives and to rescue a flagging PICTA. (also see section 5.7 on regional integration). In order to take account of the diversity of the PICs, and to ensure each schedule embodies region-wide obligations, the schedules of individual members of the FTA could be negotiated with all other Members; that is, not in a PICs-ANZ negotiation that would result in a ‘hub-and-spokes’ structure. Each schedule could contain a (possibly unique) progressive liberalisation commitment. This would give PACER Plus a true *regional* integration character.

A PACER Plus agreement with extensive goods and services coverage would almost certainly reduce (or displace) the impact of the EPA on intra-regional trade policies, especially if few or no additional PICs accept the offer to join the current ‘interim’ EPA. The EPA would retain its importance for some PICs’ extra-regional trade, but its ‘regional liberalisation’ clause would have little relevance in view of the broader coverage and the direct (rather than *consequential*) nature of the intra-PIC obligations in both PICTA and PACER Plus.

3.5.5 The way forward

The lessons from the EPA and PICTA for a PACER Plus agreement are:

- Make it a principle of the negotiations that the agreement will be designed to accommodate the significant differences in the composition of output and the capacity for adjustment in the PIC economies, within a firm overall schedule for implementation, but without prejudging the scope of the agreement (no *a priori* exceptions).
- Appropriate 'aid-for-trade' assistance will be essential to accelerate the capacity of the PICs to take advantage of closer integration (e.g. in the labour market).
- Build on the existing inter-PIC obligations of PICTA to structure the FTA agreement as a true *regional* FTA with each member's schedule containing a single set of obligations extended to all other members (in contrast with the augmented 'hub and spokes' conformation of the EPA).
- Build in further analysis of the implications of the various trade agreements but in particular PICTA and EPAs (once finalised) for the nature and phasing in of obligations under PACER Plus.

4. Literature review of existing studies on PACER

There is much literature on the economic challenges facing the PICs and on the problems facing small and vulnerable economies generally that is relevant to the design of a PACER agreement. We have reviewed a broad selection of this literature in the course of preparing this preliminary report including those cited in the text and listed in the bibliography.

The studies most relevant to PACER are three of the most recent ones, namely:

> Nathan Associates, (2007). "Pacific Regional Trade and Economic Cooperation Joint Baseline and Gap Analysis", Report to the Pacific Islands Forum Secretariat
>
> Institute for International Trade and Pacific Trade Consult, (2007). *The Potential Impact of PICTA on Smaller Forum Island Nations*, Final Report to the Pacific Forum Secretariat

Robertson, R (2005). "Regionalism in The Pacific: A New Development Strategy". University of South Pacific, Fiji.

4.1 Nathan Associates (2007)

This study provides an overview of some of the key gaps in the trade capacity of Pacific Island Countries with some observations on the potential benefits and issues a PACER Plus agreement might create.

The study notes that PICs currently have a limited market for exports in ANZ; Australia is the primary export market for only two of the 14 PICs: PNG and Samoa. Japan and the United States are each the primary export markets for three PICs. However ANZ is an important source of imports for most PICs, with either Australia or New Zealand ranking first among import suppliers for 10 of the 14 PICs. The PICs, collectively, have a goods trade deficit with ANZ.

Services comprise a majority of the GDP of all PICs except PNG, dominated by tourism. Other FIC services exports are very limited – in part constrained by Australian and New Zealand restrictions on the movement of natural persons. Australia provides no preferences for Pacific Islanders in their entry; New Zealand has a new but small program under which temporary workers may enter to meet seasonal agricultural needs.

Had it been possible for the PICs to sequence their trade negotiations optimally, they might have opted to start by liberalizing with regional partners, then expanding trade relationships to extra-regional parties. This retrospective view was strongly supported by those consulted in the region. In fact, the sequence placed the EPA negotiations first, raising the risk that PIC concessions made in the EPA negotiations will form the basis for PACER Plus concessions to ANZ by the PICs. For this reason, the Nathan report argues that it is essential for the PICs to consider how reductions in PIC tariffs, or commitments made in relation to services made in the context of EPA negotiations, could affect imports from ANZ at a future date under PACER Plus. While this is no doubt important, the actual nature of the two agreements can differ substantially on a range of issues including on ROO, time-frames and tariff reduction schedules, particularly given the quite different volume and range of products that PICs import from the EU as compared to ANZ.

Nevertheless the Nathan study argues that Australia and New Zealand are engaged in an ambitious FTA program that has three implications for the scope and coverage of a future PACER Plus agreement:

- The PICs are excluded from the most successful regional FTA - ANZCERTA. PACER Plus is of course intended to address this issue;
- The more FTAs that ANZ agree, the more the value of PIC preferences in the ANZ market will be eroded;

- FTAs by Australia or NZ with China will raise the competitive threshold for PICs in the ANZ market on goods (light manufactures, horticulture) in which PICs are interested.

Some of these points are debatable given regional integration and the proximity of the Pacific to ANZ, but there is no doubt about the impact of multilateral and regional agreements on preference erosion, an issue PICs will need to face in the near future.

The Nathan report makes other assumptions which may not necessarily hold true. For example, the report argues that current ANZ FTAs with the USA, Thailand, Singapore indicate the likely content of PACER Plus, namely:

- Unlikely to include free labour mobility (indications are that this will not be the case);
- Likely to include an investment chapter with implications for PIC investment and land-holding policies;
- May include a 'negative list' approach to services (like ANZCERTA) with exceptions for transport services (like ANZCERTA) that could impact PIC interests;
- Significant challenges for PICs in managing differences with ANZ on matters such as ROO, quarantine, IP, safeguards, trade remedies and exceptions for sub-national governments.

Overall the report argues that as small, resource-constrained economies the PICs face threats from trade liberalisation as well as benefits.

4.1.1 Benefits

The report anticipates the standard gains from regional liberalisation (contribution to macroeconomic growth and consumer welfare) but is unable to quantify them owing to deficiencies in the data. It notes that although multilateral trade liberalisation is likely to be optimal for most economies, their small size, the volatility of their income growth, the lack of natural resources and high trade-transaction costs, support the view that regional trade liberalisation may be a more practical and rewarding route to more open markets in the PICs. The report acknowledges that a regional trade-liberalizing framework is more likely, too, to allow for the institutional shortcomings of small and isolated economies leading to more appropriate and better-adapted programs that take account of regional diversity and embody sufficient flexibility to allow successful adjustment (that is 'policy space').

4.1.2. Costs

- Revenue losses. The report suggests that Fiji, PNG, Samoa, and Vanuatu each stand to lose upwards of $10 million annually in tariff revenues currently collected on imports from ANZ. Perhaps more significantly, however, the report believes that a number of PICs will lose tariff revenues on imports from Australia and New Zealand that currently account for more than 10% of their overall revenues: the Cook Islands (12.2%), Kiribati (14.3%), Samoa (14.0%), Tonga (17.2%), and Vanuatu (17.2%);
- Costs of negotiations will be significant for PICs' government services.

The analysis identifies a number of crucial gaps or weaknesses related to the formulation of PIC's trade strategy and participation in trade negotiations and processes; and to the private sector's ability to respond to the opportunities of increased trade liberalisation. Key gaps in current PICs capacity include:

- Trade Policy Coordination at the National Level. All PICs lack mechanisms to ensure balanced input to the trade policy-making process from other government ministries and agencies, and from the private sector and civil society;
- Staffing and Expertise. PICs have insufficient numbers of staff in trade ministries to participate substantively in the full range of negotiations currently underway;

- Enforcement/Compliance capacity;
- Public Outreach and Communications. Stakeholders lack an understanding of how they may benefit – or avoid harm – from new trade obligations.

In our own recommendations we have put forward some resourcing and consultation options to address the lack of public understanding and outreach issues.

4.2 Institute for International Trade (2007)

4.2.1 Benefits of PICTA

The study by the Institute in 2007 points out that Forum Island Countries (PICs) will implement PICTA on a gradual basis to allow time for institutional and policy reform, along with regular evaluation. This progressive implementation means, however, that a number of significant import tariff lines will not reach zero until 2017 and, for some excepted goods, not until 2021.

Overall, the impact of tariff loss on total revenue is assessed to be relatively minor, while lower tariffs will mean lower prices for some essential consumer products. Alcohol and tobacco tariffs remain in place and may be increased, preserving revenue from these items. Built-in safeguards and special and differential treatment will assist the adjustment to lower tariff revenues. Smaller PICs have introduced or are moving toward a more diverse revenue-raising base – most have introduced consumption taxation – resulting in reduced reliance on import taxation.

The expanding services sector in most PICs reduces their dependence on import tariffs and increases benefits from services liberalisation. Importantly, PICTA provides strong incentives for:

- A more integrated regional market;
- More efficient and transparent tax collection and long-term improvement in tariff compliance;
- Customs reform, increased transparency and less corruption;
- Integrated trade related capacity building plan;
- Consolidated aid commitments based on reform;
- Potential increases in remittances;
- Development of the private sector to increase sustainability and diversify exports;
- Adjustment and re-evaluation as trading proceeds.

In addition, longer-term benefits will flow from embracing more sustainable processes of open, transparent trading systems, such as the achievement of better standards and practices and lower prices for consumer goods. The report concludes that PICTA should be seen as a first step in an almost inevitable process that becomes more costly and disruptive the longer it is delayed.

4.2.2 Challenges

Although some PICs will experience significant tariff loss due to PICTA reforms, others will not. Kiribati, Tuvalu and Tonga will lose less than one and half per cent of total government revenue over the next five to six years.

The initial impact of PICTA implementation when tariff cuts first take effect needs to be monitored. The study suggests a ‘Tariff Revenue Offset Fund’ where necessary and regular evaluation, a view also supported by this study.

There exists the potential for some trade diversion and, while not seen as a major issue, this should also be carefully researched and monitored.

The necessary reforms to embrace and enhance the implementation of PICTA will take time and political conviction.

4.3 Robertson, R (2005)

The outcome of the EC's EPA with the Pacific region will shape the nature of PACER. PICs will be reluctant to agree to free trade with Australia and New Zealand and incur high transaction costs if they receive fewer benefits than achieved in EPA negotiations.

There are four conditions of success for a regional integration strategy:

- A successful regional strategy must directly address fundamental challenges facing the region. In the Pacific this means addressing capacity constraints and increasing economic opportunities.
- Deeper links among economies than can be forged by cooperation alone. Cooperation among PICs will always be insufficient to overcome constraints of smallness and isolation. Other governance, economic, social development and security strengthening proposals are also required such as harmonizing standards and extending policies on information access and dissemination; harmonizing approaches to health; developing and implementing policies and plans for dealing with national disasters, waste management, urbanization and biosecurity issues; and strengthening law enforcement training by focusing on domestic, gender and sexual violence, drug abuse, and accountability mechanisms.
- Participation of significant economies in the regional agreement. Regional integration of small or relatively similar markets can only make a small contribution to economic growth. With a combined output of only \$20 billion, the costs of integration will quickly overwhelm the benefits of regionalism in the Pacific. Australia and New Zealand – with a combined market of over US\$700 billion must be integral components of Pacific Regionalism. Without their stimulus to growth, regional members will have little incentive to work closely together.
- Progressive implementation must address a broad range of policy domains to create early potential rewards for 'governance' improvements. Integration need not start first with goods and then move progressively to include services, investments, and finally labour, particularly if the overriding goal is to provide states the incentive to stay the pace and deepen regionalism. In order to stimulate change, a regional strategy for good governance must address the problem that the benefits of good governance are shared by many but the costs are imposed on a few who are often well organized, vocal and can oppose reforms. One solution is to strengthen the benefits immediately available to citizens through the liberalisation of services and the movement of people. Severely restricted access of unskilled FIC labour to Australia and New Zealand combined with relatively unrestricted and permanent movement of skilled labour is a worse case scenario for FIC welfare.

A number of the points raised in the review of the three papers above find their way into the analysis and overall recommendations contained in this report. The next section tends to focus more on how PACER Plus might proceed to deliver potential benefits to PICs while section six discusses some of the major challenges to be overcome.

5. Benefits and opportunities of PACER Plus

The benefits offered by an FTA that covers goods and services are the same, in principle, as are offered by a multilateral trade agreement. They are narrower and smaller to the extent that they represent the results of discriminatory liberalisation of only some imports. They comprise, chiefly, a possible increase in overall demand in the FTA *region* due to reduced consumer prices (but this demand increase *leaks* outside the region, too) and improvements in productivity that flow from more efficient allocation of resources; that is, an opportunity to exploit specialization. Reduced taxes on imports are a benefit to consumers but not a net benefit to the economy as a whole since the duty reduction is simply a transfer from government to consumers *and* to foreign exporters from the FTA partners in the case of discriminatory liberalisation where a high tariff remains on imports from the rest of the world.

Some of the most important benefits of an FTA may flow from the liberalisation of investment policies, the liberalisation of services and from trade facilitation measures such as facilitated customs administration and harmonization of standards. There may also be *intangible* benefits due to 'head-turning' impacts on investment plans, but these are impossible to forecast and difficult to measure.

5.0.1 Benefits to PICs

In an FTA where the *starting point* is already low tariffs (zero, in the case of PIC→ANZ trade but still high in the ANZ→PIC direction) and where (as in the case of intra-PIC trade) FTA partners are not important suppliers or markets, the demand and productivity-enhancing benefits from tariff reductions are likely to be small.

Since, under SPARTECA, all PICs benefit from quota-free and duty-free access to the Australian and NZ markets, subject to the SPARTECA rules of origin, the PICs will probably gain little merchandise trade benefit from PACER Plus trade preferences in ANZ. However if there is liberalisation of the SPARTECA/PACER Plus rules of origin and/or provisions that facilitate trade by reducing non-tariff barriers in ANZ, for example by increasing the capacity of PICs to meet Australian quarantine barriers, then there is scope for some benefit for PICs in trade in goods.

However, PICs would gain much more from a services agreement that provides for greater services liberalisation and competition generally and *preferential* access to the ANZ markets especially on the temporary movement of un-skilled or semi-skilled labour.

Either PACER Plus or PICTA FTA provisions may improve prospects for exports to other PICs, but these benefits will be in proportion to the value of intra-PIC trade in goods and services. This may again mean there will be greater benefits in services (transportation, communications) than in goods.

Accordingly, the greatest gains for the PICs from a merchandise and services FTA as part of PACER Plus are likely to flow from the **gains from liberalisation of their own import regimes and from a services agreement with emphasis on improving access for PIC unskilled and semi-skilled labour.** These gains may comprise both productivity gains due to improvements in the allocation of resources and other *behind-the-border* improvements, such as in market competition[14] and better administration of trade flowing from the cooperative and trade-facilitation aspects of an agreement. The services gains will result in increased competition in the provision of services with both direct and indirect gains for consumers as

[14] For example, elimination of monopolistic or collusive activities made possible by high trade barriers or simply improved customer-focus by local businesses facing new foreign entrants. See Nathan (2007), p. 68ff.

well as direct income effects as a result of remittances to specific communities and through multiplier effects to the economy generally.

5.1 Agriculture

The PICs' agriculture sectors are in poor shape. Overall output is shrinking and productivity has been falling across the region (Reddy and Duncan, 2006). As Table 8 shows, the value-added in agriculture as a proportion of GDP has fallen in all of the PICs for which we have data over the decade to 2005, by amounts between 15% and 65%. Yet most of the PICs have ample resources for agricultural production and some have achieved good growth in the livestock and horticulture sectors.

Table 8: *World Development Indicators: Percent change 1995-2005*

		Agricultural land (% of land area)	Agriculture, value added (% of GDP)	Exports of goods and services (% of GDP)	GDP (current US$)	Industry, value added (% of GDP)	Merchandise trade (% of GDP)	Services, etc., value added (% of GDP)
Fiji	1995	25.18	20.05	59.29	1,970.34	24.31	76.69	55.63
Fiji	2005	25.18	14.31	55.01	2,997.89	21.91	77.09	63.78
Fiji	Δ%	0.00	-28.63	-7.22	52.15	-9.88	0.52	14.64
Kiribati	1995	45.68	20.85	14.50	46.00	5.09	92.87	74.06
Kiribati	2005	45.68	7.19		66.37	7.09	116.96	85.72
Kiribati	Δ%	0.00	-65.52		44.27	39.35	25.94	15.74
Marshall Islands	1995	72.22	15.96		105.24	16.10	92.88	67.93
Marshall Islands	2005	77.78			144.36		77.19	
Marshall Islands	Δ%	7.69			37.17		-16.89	
Micronesia	1995	44.29			213.60		51.42	
Micronesia	2005	44.29			237.00		58.05	
Micronesia	Δ%	0.00			10.96		12.90	
Palau	1995	19.57	5.77	14.56	95.24	9.29		83.51
Palau	2005	19.57	3.13	77.61	144.66	19.00	71.94	76.87
Palau	Δ%	0.00	-45.70	432.97	51.90	104.44		-7.95
PNG	1995	2.08		62.40	4,601.03		89.24	
PNG	2005	2.35			4,945.03		101.79	
PNG	Δ%	12.82			7.48		14.06	
Samoa	1995	32.51	18.52	34.62	200.36	29.57	51.91	51.90
Samoa	2005	32.86	13.57		403.92	27.35	49.27	59.09
Samoa	Δ%	1.09	-26.75		101.60	-7.52	-5.08	13.84
Solomon Is.	1995	2.72		62.49	327.23		98.40	
Solomon Is.	2005	3.04			299.98		96.18	
Solomon Is.	Δ%	11.84			-8.33		-2.26	
Tonga	1995	45.83	30.28	8.73	162.36	18.41	56.05	51.31
Tonga	2005	41.67			214.77		60.93	
Tonga	Δ%	-9.09			32.28		8.71	
Vanuatu	1995	11.89	16.62	45.82	227.90	11.52	53.97	71.85
Vanuatu	2005	12.06	14.10	39.81	367.98	8.87	48.64	77.50
Vanuatu	Δ%	1.38	-15.18	-13.13	61.47	-23.04	-9.87	7.86

Source: World Bank World Development Indicators database

The PICs may benefit from an opportunity to expand their agricultural and food exports to Australia and New Zealand under PACER if the agreement provides for cooperation or standards harmonization that reduces the protective impact of quarantine measures (in Australia, especially).

According to the Nathan Baseline report, [15] processed food products account for about a quarter (about $US17million or 26.1%) of agriculturally based goods exported to ANZ from the PICs. But these exports are concentrated in a few individual products, particularly, Fijian pasta and baked goods. Samoa and the Cook Islands have established a nascent market for fruit juices with export values of approximately US$325,000 c.i.f. in 2005.

Cassava exports (for animal feed) amounted to $US11 million, while copra and coconut exports added up to about $US5m. Potentially higher value horticultural crops accounted for only $US2.6 million in 2005. The Nathan report identifies transport time horizons and cold store availability as one of the principal barriers to the expansion of this trade, although quarantine measures are also a 'formidable barrier'.

Meat and livestock products are a significant potential export to Australia and New Zealand. Fiji exported US$1.16 million in cured meats to New Zealand in 2005 while Vanuatu exported US$ 425,000 in fresh beef to Australia.

5.1.1 The way forward

The main challenge that the PICs face in exploiting the export potential of their agricultural industries is that, in order to offset transport and logistics costs (that also affect NAMA, see below) they must have low production costs. Reddy and Duncan (2006) indicate that there is a willingness to take up new technologies in the Pacific, but that the misallocation of resources in agriculture due to subsidies and to protection is a barrier to economically more efficient production. The data on the levels of applied duties in agriculture relative to duties on non-agricultural products (Table 8) tend to confirm this: average applied agricultural tariffs in the PICs are between 125% (Solomon Islands) and 451% (PNG) of applied non-agricultural tariffs. Although this suggests high levels of effective assistance to agriculture, it may well be going to the wrong places.

On the other hand, there are exemplary success stories such as with Fiji Water or Mahen Export. These firms to date, have managed to overcome either transport or quarantine barriers, to prove the point that with appropriate technical assistance and private-public sector cooperation, both of which PACER Plus can facilitate, then a more productive export oriented agricultural sector is possible. The case-study below demonstrates the successful efforts of Mahen Exports to overcome quarantine barriers and increase its market share of horticultural exports abroad.

[15] The most recent data available PICs trade with ANZ trade is a mix of original data (mostly 2005) and 'mirror' data using COMTRADE statistics for imports of Australia and New Zealand. The data in the annexes to the Nathan Baseline report (late 2007) is still the most recent available. It is expressed in $US as a 'common' denominator for all currencies.

Mahen Exports

Mahen Exports is located at Bilalevu in Sigatoka[16] (nicknamed the "Salad Bowl of Fiji"). The business started way back in 1982. It started on a very small scale where the company used to send only 1 shipment (weighing around ½ a tonne) per week. However, it now sends 2 shipments per week. On average, each shipment now weighs around 50 tonnes. Currently, the company earns around F$4 to F$5 million per year. The company is trying to increase its export earnings by targeting the cassava market, which will then enable it to earn around F$6 million per year.

Some of the products exported to the two major importers, Canada and New Zealand, are taros, dalo, eggplants, chillies, pawpaws, mangoes, okras, beans, plaster beans and leafy vegetables. Out of all the exports, the company gets relatively higher returns for okra, chillies, eggplant and dalo.

The company works closely with the Extension Research and Quarantine departments of the Ministry of Agriculture and Primary Industries. Through the help of these departments and with some external technical assistances, the company is able to export quality products and get good prices in return. The major problem faced by this business is poor road conditions, which not only hinders the transportation of the export products but also damages them, resulting in these products getting rejected in the export market.

Apart from export earnings, the company is also important, as it employs 27 permanent workers, who receive an aggregate sum of $10,000 per week. In addition, the company contributes about $17,000 per week to the Taveuni (an island on the Northern side of Fiji) economy, as payment for the dalo that is purchased from there. One of the major future plans of the company is to expand its export markets in New Zealand, Australia and the U.S.

PACER Plus can assist in facilitating increased investment in small and medium enterprises such as with Mahen Exports, while providing necessary technical assistance for meeting ANZ quarantine and SPS requirements. In addition, by providing the PICs with a framework that requires progressive elimination of their barriers to trade with each other and with ANZ, PACER Plus can help the PICs move towards transparent, more predictable and less distorting policies. It will, however, create a need for subsidies and capacity building support in the agriculture sector to assist with adjustment to new competitive conditions.

5.2 NAMA products

Manufacturing products, fuels and mining products, fish and fish products, and forestry products comprise the WTO's NAMA category. Different PICs have significant production capacity in all of these categories. Apart from some manufactures (PMV and textiles/clothing in Australia), however, they already face low or zero duties on their exports to Australia and New Zealand either under MFN tariffs or, on qualifying goods, under SPARTECA.

In manufactures including garments, the PICs have so far been unable to convert the preferential margin into a sustained advantage over other suppliers (China, other Asian countries) to the Australian market. This challenge for the PICs will be still more acute in future following the NZ agreement on an FTA with China and an Australia-China FTA in the wings.

[16] Sigatoka is situated on the western side of Viti Levu, the biggest island in Fiji.

The PICs do however have a more secure comparative advantage in forestry, fisheries and minerals. Here the main challenges are not duties or even third-country competition (*relative* duties), but transport and, to some extent, *before the border* export costs. The following provides a snap-shot of PIC trade in NAMA products before examining how best to move forward in relation to PACER Plus.

5.2.1 Textiles

Duties on imports into Australia are 17.5%, 10%, 5% and zero. Textiles that meet SPARTECA's 50% regional-value-adding rule-of-origin test enter duty-free but, according to submissions to the Productivity Commission's 2003 inquiry into TCF industry assistance, have difficulty competing with Chinese and other Asian competitors in the Australian market, whose products enter under MFN duties. Amendments to the SPARTECA-TCF scheme provide a method of reducing the 50% SPARTECA value-added threshold to 35% to increase the volume of duty-free access. But textile and garment trade between Australia and Fiji (the main PIC garment producer) continues to decline.[17] According to the Productivity Commission "...the benefits for most firms from duty free access to the Australian market for finished clothing products from Fiji are not sufficient to outweigh the additional freight and logistical costs of this sort of operation" (Productivity Commission, 2003).

Removing the remaining ROO restrictions through PACER Plus is not likely to be of much value to Fijian producers without significant industry reform and the identification of niche markets, a point we return to in *ways forward*.

5.2.2 Other manufactured products

The limited success of PICs in the supply of manufactures to the ANZ market under the SPARTECA provisions suggests that even with a relaxation of rules-of-origin under PACER, most products in this sector will face the same problems as textiles; lack of competitiveness against China and Asian suppliers. This challenge for the PICs will be still more acute if Australia and China agree an FTA in the next few years.

5.2.3 Fish and fish products

Probably the largest under-valued resource in the Pacific region (other than people) is the Pacific fishery. PIC export of fish and fish products to ANZ had a cumulative export value of approximately US$4.3 million in 2005 with fresh fish accounting for US$1.35 million. Fiji alone exported US$1.2 worth of fish and fish products, or more than 20% of the total. Other fish and fish product exports include Papua New Guinea's exports of rock lobster to Australia, which were valued at US$2.2 million in 2005.[18]

5.2.4 Forest products

Fiji, Papua New Guinea, Solomon Islands, and Vanuatu export timber and wood products to ANZ (US$16.4 million worth of logs, lumber, wood chips and plywood in 2005). PNG timber and wood accounts for 62 percent of the total, or US$10.2 million. PNG exports logs, lumber and plywood. Fijian wood products account for 20 percent of the total while Solomon Islands hold a 13.5 percent of the FIC total, valued at US$ 2.2 million. Vanuatu exports mainly wood chips accounting for US$ 653,000 or just under 4 percent of the total timber and wood exports to ANZ from the PICs.

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[17] DFAT Country Brief, 2008. Retrieved 5 May, 2008 from http://www.dfat.gov.au/GEO/fiji/fiji_brief.html

[18] Data from Nathan, 2007

5.2.5 Mineral products

PNG's spending on mining exploration has increased significantly with a number of new mining projects already underway including a US$450 million gold mining project and the planning of a US$10 billion project to build and operate a liquefied natural gas plant. These along with other projects coming on line, will present a significant boost to PNG's mineral export capacity well into the future.

5.2.6 Ways Forward

As noted earlier, PICs have a more secure comparative advantage in forestry, fisheries and minerals and PACER Plus should seek wherever possible to support productivity reforms and build the capacity of these sectors.

Manufacturing industries, for example in clothing, textiles or crafts sectors of SVEs, can survive and even flourish through the identification of niche markets and productivity gains. Recent studies[19] on the textiles and clothing in Fiji for example, have called for a number of steps to be put in place to assist in the survival and transition of the textile and clothing sector.

The steps include the exit of uncompetitive firms, retraining of displaced workers, improvements in trade facilitation to assist remaining firms consolidate, the development of niche markets and integration into regional supply chains. The study also points to the need for ongoing political stability. While many of these relate to domestic reform, PACER Plus can assist in capacity building and technical assistance in a number of these areas in particular with improvements in trade facilitation and in the identification and support the development of niche markets in ANZ.

But perhaps no area better illustrates the potential of SVEs than the fisheries sector. The revenue potential of fish and processed fish product exports is a high priority for PICs and along with the revenue from access license fees from foreign fishing countries, can provide an important, sustainable source of income for PIC communities. For many PIC communities fishing constitutes a basic way of life and subsistence income and nutrition for many in the region. So the challenge of competing globally needs to be carefully integrated with up-skilling, capacity building, and ongoing sustainability of the fishing environment, especially for small-scale fishers.

While some measures need to be resolved at the multilateral level such as the role of disciplines on fishing subsidies, PACER Plus can assist in developing regional cooperation and capacity building support to promotes domestic fisheries and value added fish products of PICs. We would highlight the importance of the following:

- support for incentives for domestic and foreign private investment in small-scale fisheries for example as a result of investment liberalisation measures;
- support for small-scale aquaculture technologies with the objectives of improving the sustainability and profitability of the fishery resources of artisanal fishers;
- capacity building support for transparency and notification procedures, given the importance of compliance and statistical analysis for future reform;
- support for national and regional efforts to foster effective fisheries management regimes in order to preserve fish stocks.
- identification of niche markets and how PICs can meet TBT and SPS standards of developed countries.

These strategies will require close domestic and regional cooperation if SVEs are to successfully build more competitive fisheries industries, while maintaining significant

[19] Prasad, Ram and Marr, 'Future of the Fiji garment industry', Trade and Poverty Reduction in the Asia-Pacific Region, soon to be published volume of case-studies supported by AusAID and the WTO.

revenue from access fees. We recommend that further research be undertaken to examine the most cost effective ways for PACER Plus to assist in the trade related development of PICs fisheries industry, cognisant of outcomes at the multilateral level and the capacity building commitments of other developed nations in this sector.

The mineral or forestry resource capacity of various PICs including PNG, the Solomon Islands, Fiji, Vanuatu and Nauru can also be supported by regional initiatives through PACER Plus. The most obvious is the potential of investment liberalisation to increase foreign direct investment (FDI) into these industries. PACER Plus will include support for trade facilitation reform and if services reform is embraced, will increase competition into the vital areas of transport and communications vital for improving the efficiency of resource exporting firms. ANZ can support institutional reform and the development of PICs regulative capacity in support of sustainability objectives and the welfare of local communities.

Overall this study makes no pretence about the difficult challenges both agricultural and manufacturing exporters from PICs will face, given increased competition from low cost Asian products into ANZ economies. Resource exports will remain in high demand but there are a number of behind-the-border obstacles that can be more efficiently managed in the interest of PICs. Notwithstanding these challenges, there is room for cautious optimism which builds on the success of those PIC firms that are already flourishing in the current trade environment. PACER Plus can play an important role in facilitating a conducive environment for investment and competitiveness as well as providing valuable technical assistance and capacity building in the private sector.

We recommend that further research be focussed on how, as part of PACER Plus, ANZ technical assistance and capacity building can best assist the competitiveness of agricultural, manufacturing and resource firms in PICs with particular attention to strategies which take account of:

- targeting niche markets not only in PACER Plus countries but internationally
- the need to identify how best to integrate into ANZ supply and distribution chains
- the limited marketing capacities of SME exporters in the Pacific
- identify technical training for the up-skilling of management
- overcoming trade facilitation and logistic bottlenecks for the private sector
- assist in prioritising infrastructural development for export
- support public sector capacity to remove red tape and barriers to the ease of doing business for domestic and foreign investors

5.3 Services

Evidence of good services performance following commercial entry

- The Fiji Electricity Authority (FEA) became one of the best performing electricity utilities in the Pacific, following the appointment in 2001 of a Board with significant private business experience and a mandate to run the utility as a commercial entity. FEA has improved efficiency, reduced production costs and system losses, improved labor productivity, become financially self-sufficient, and introduced private sector participation in power generation.
- Vanuatu’s privately owned electricity and water operator, UNELCO, performs better than any of the other Pacific utilities we reviewed, on measures of quality and efficiency in water and electricity. The utility recovers all operating and capital costs, as well as the costs of loss-making rural electrification, through its tariff.
- Apia Port in Samoa and Lae and Port Moresby in Papua New Guinea have some of the highest TEU throughput rates. They also have relatively low port charges. All of these ports are profitable.
- Tonga’s mobile penetration levels have increased significantly since competition was introduced. Within a year of introducing competition for mobile services, the tariff for almost all services dropped by more than 20% and the numbers of mobile subscribers and internet users both doubled. The result of competition has been that “telephones are easier to get, cheaper to buy and communication is faster”. It has also resulted in the two competing companies upgrading their infrastructures for further use in communications and broadcasting.
- In Papua New Guinea, competition between ISPs has reduced internet tariffs. In Samoa, the introduction of competing ISPs resulted in a price reduction of 50% in the incumbent ISP and an increase in internet traffic of over 100%.

Source: World Bank, 2006

In all PICs but PNG, the services sector dominates the economy (see Figure 1) and tourism exports make an important contribution to external earnings. But infrastructure services that are essential to successful trade (and economic growth) such as transport, telecommunications, port services and, in some cases, water and power generation and distribution services are generally weak and prices are sometimes inappropriately high e.g. in telecommunications, or low, for example in water reticulation (World Bank, 2007a).

5.3.1 Transport

The PICs are highly dependent on transport services but some have relatively high-cost surface and aviation services. Maritime freight is costly in the region. Long distances between islands combined with small trade volumes increase the unit costs to transport goods. The World Bank’s Doing Business survey reports that seven of the ten survey PICs surveyed have per-container shipment costs in excess of US$1,000 for at least one direction (import or export). Nevertheless Palau, Solomon Islands and Tonga all maintain shipment costs below the OECD average of US$883.0 for both incoming and outbound containers.

Intra-island transport is particularly weak in most PICs, effectively isolating outlying parts of their territories and limiting their ability to mobilize national resources. Furthermore, port infrastructure limits the size of ship that can call and affects turn-around time in port. Port clearances exceed two days in Fiji and four days in PNG.

Airfreight services are also limited, even in the larger PICs such as Fiji and PNG. The limited availability of airfreight precludes markets in fresh or perishable goods for many of the smaller PICs and crucially impacts on their ability to service the ANZ (or other regional) markets.

5.3.2 Tourism

Tourism makes an important contribution to the PIC economies; the estimated contribution of tourism to Pacific economies varies from around 47 per cent in Cook Islands to around 3 per cent in Solomon Islands and Niue (CIE, 2007). But the costs are high and marketing is often inferior. The quality of the service is often less than in competitive (e.g. Asian) venues due to high levels of import in resort supplies and poorly trained staff, (Harrison, 2004). Communal land tenure raises the challenges and costs of establishment and tourism revenues frequently 'leak' offshore through excessive investment incentives and offshore package sales.

Tourist numbers in the PICs are not large; in 1990 they accounted for 0.15% of total world 'arrivals': in 2000 they accounted for only 0.14% (Harrison, 2004). Fiji is by far the largest market, accounting for about 500,000 tourists in 2005—almost 40 percent of the PIC region total (CIE, 29007). Most tourist arrivals are from ANZ, but overall tourist numbers have declined since the 2000 coup in Fiji.

5.3.3 Potential trade liberalisation benefits

Although it is not always clear to what extent regulatory barriers to entry of commercial suppliers are responsible for the high costs and poor quality of infrastructure services in the PICs, the World Bank argues that where competition has been introduced it has been effective in improving supply and pricing despite the small scale of the market.

Some PICs maintain industry reservation policies that prohibit foreign entry or investment in local services supply (PNG prohibits foreign ownership of land transportation; Fiji discourages foreign investors from taking a controlling interest in local businesses).

There is good reason to believe that a higher proportion of contestable services delivery in infrastructure where commercial providers have significant experience elsewhere including telecommunications, ports, water etc. could improve accountability, pricing and quality of these crucial services. In cases where private entrants have been encouraged to compete to supply, accountability for service supply has also improved (See text box).

5.3.4 Why a negative list in services?

A negative list is the ANZ-CER approach. The closer that PACER comes to reproducing the ANZ-CER the more likely it is to bringing about closer PIC-ANZ economic integration.

A negative list negotiation is easier to prepare and conduct and a negative list agreement is easier to implement than a positive list. The biggest challenge of a services agreement is the inherent complexity of the sector. A negative list agreement focuses on a much shorter and more easily specified list of commercial services where governments want to maintain protection or equity provisions.

To ease PICs into a negative list approach, ANZ could consider offering a 'claw-back' provision after (say) 5 years, subject to reciprocity.

5.4 Labour mobility and employment issues

Possibly the greatest economic, social and development challenge facing the PICs is unemployment and under-employment. Hughes and Sodhi (2006) estimate that there are nearly 1.4 million people in the labour force in PICs who are un-employed or under-employed, about 13 per cent of the total population.

The causes of unemployment are, typically, some mixture of weak demand for production and services on the one hand and rigidities in the labour markets on the other hand. In any economy, higher demand and more flexible labour markets will tend to reduce the problem with unemployment. We can be confident that the PICs would have a smaller unemployment problem if their economies performed at—to use Chand's comparisons—the levels of Malta, Mauritius or the Maldives. Since better economic performance has many other benefits, the priority policies for addressing unemployment should be those that reduce impediments to better, more stable and more transparent macroeconomic management.

Finding an opportunity to trade labour services with another economy that values PIC labour more highly than it is valued at home is certainly one option for better employment of labour. But it can be a complex and costly means of raising *average* employment levels may not be well adapted to addressing the *root causes* of unemployment within PICs.

Nonetheless, many PIC governments, regional institutions, academics and NGOs have argued that greater labour mobility—by which they mean, chiefly, increased access to the ANZ labour market, but also to EC and Japanese markets—is crucial in the Pacific region to deal with the demographic pressures from high rates of population growth, a falling median-age profile, and high levels of unemployment and under-employment, particularly among youth. Advocacy for, and opposition to, the idea of temporary movement of PICs workers into the ANZ market tends quickly to reach hyperbolic levels. It has variously been described as a "make-or-break issue" for future regional relations and a *litmus test* of Australia and New Zealand commitment to PICs economic development (Kelsey, 2004).

Recently, given historically low levels of unemployment in Australia and an impending recovery of activity in the drought-affected agricultural sector, the National Farmers' Federation has restated its view that the sector will be unable to satisfy its demand for an estimated 100,000 workers from domestic supply. The Federation has called, especially, for opening up temporary entry for 'entry level', that is for low and unskilled workers from the PICs to fill an unspecified number (possibly 70,000) of those expected jobs in industries such as horticulture (NFF, 2008).

5.4.1 A case for opening the ANZ market

The debate on the value of greater labour mobility is complex, engaging issues that cannot be fully dealt with through economic analysis alone. The economic impacts of greater labour mobility are, themselves, difficult to sort out, posing significant challenges to analysts attempting to project welfare gains and losses (for example the impact of so-called 'brain-drain' issues) on each side of an exchange. Many factors have a bearing on the identification of the 'baseline' case (today) and the projected gains and losses for the PICs and for ANZ of labour mobility schemes of different kinds and duration.

A recent, widely quoted, ADB/World Bank report (Asian Development Bank, 2005) provides some help with the economic analysis. It includes the results of a detailed model (Walsmley et al., 2005) of a specific scheme chosen to represent a *plausible* temporary labour agreement between the PICs and ANZ. The model assumes that ANZ create a PICs labour-quota equal to one-percent of their labour force that is open to temporary workers from PIC countries on 3- to 5-year stays (without specific consideration of whether the same workers could rotate more than once through the quota).

The projected economic welfare changes in the short term (3 years) reflect the complexity of the choices—with gains and losses for the home and foreign economies, for the temporary workers and for the permanent employees in each home and foreign economy and in the rest of the world. Overall however, the gains are large.

Table 9: *Net welfare gains for PICs*

Scenario		Net welfare gains for PICs+ANZ+ROW ($USm)	Net welfare gains for PICs only ($USm)	PIC share in global gains (%)
1	1% increase in quotas for both skilled and unskilled labour	1,303.44	1,066.14	82%
2	1% increase in quotas for unskilled labour only	1,031.02	901.21	87%
3	1% increase in quotas for skilled labour only	272.42	164.93	61%

Source: Asian Development Bank, 2005. ROW is Rest of the World

This analysis is compelling and its conclusions (and limitations) deserve extended consideration. For the present purpose, however, we note it suggests that, to maximize economic-welfare throughout the region, Australia and New Zealand should consider a labour mobility agreement that includes *unskilled* labour.

The size of the projected gains differs significantly for the PICs between, on one hand, the scenarios that include unskilled labour and, on the other hand, the scenario that excludes unskilled labour. The underlying explanation for the difference in benefit to the PICs lies not so much in the gains to the PIC workers (which are similar in scenarios 2 and 3) but in the impact on the PIC economies of the loss of their own skilled workforce to temporary employment in ANZ. The study assumes that the quotas are filled in every case (wages and demand in ANZ are assumed to be sufficient) so that scenario 1 takes only 21% of the PICs skilled workforce, but scenario 3 takes most of them.

This analysis suggests, too, that current migration policies in ANZ—that allow permanent migration of skilled workers only—is likely to be a 'worst case' scenario for the PICs since it is likely to be similar to scenario 3 with remittances but without the return of the skilled workers to the home country.

The strength of these messages has to be balanced by reference to some important *simplifications* in the model scenarios. For example, the size the impacts may be due to the size of the quotas modelled. One-percent of the work force in ANZ is approximately 233,000 people or three times the levels of temporary entrants that the NFF (2008), for example, considers are 'needed' in agriculture. However ANZ are also examining the possibility of opening up non-agricultural sectors for example in construction services, mining, hospitality and aged care. The question arises here as to the extent of demand for unskilled labour as distinct from skilled labour, but it is fair to assume that a proportion of the demand in these sectors would be for low and unskilled particularly if formal and on-the-job training is a component of these labour mobility programs.

Now assuming sufficient demand (and sufficiently high wages) is reasonable and the quota is filled each year, absorbing this number of temporary workers may have many other *frictional* effects that the study does not evaluate. These include, for example, the cost of hiring, training, transporting, finding accommodation for, and supporting the internal movement of, scores of thousands of temporary unskilled workers—many of whom will have no experience in managing these things for themselves. These related training and social issues will need to be factored into negotiations.

Assuming for the present, however, that the model accurately represents the *scale* of the economic benefits from opening the ANZ labour market to the PICs, it prompts important questions relevant to the design of such a scheme such as:

- **Skilled or unskilled** temporary workers or a mix? There are significant differences in the economic impacts in both the home and foreign countries depending on this choice.

Can we profile actual ANZ demand as the NFF has done by reference to historical employment levels for unskilled workers? Or is this data (as Hughes and Sodhi suggest) inferred mostly from anecdotes, poor information on actual underemployment and participation rates in rural areas and an assumption that *productivity* levels in agriculture will be the same in the future as they were in the past.

- If unskilled temporary workers, **what kind of unskilled temporary workers?** Consideration would have to be be given as to whether mobility could encompass all types of unskilled workers (possibly subject to overall quotas), or specific categories of low or unskilled workers, such as seasonal agricultural workers, domestic workers, hotel/restaurant workers, etc.
- **What length of stay would be "temporary"?** Temporary employment stays typically range from three months to five years, but the maximum time that would be appropriate may also be a function of the type of labour at issue (three months may be appropriate for agricultural workers, but too little for domestic workers, hotel/restaurant workers, or workers receiving on-the-job training).
- **Rotation** of guest worker cohorts? Assuming 'temporary' means a short period of time relative to the expected working life of an individual—say less than 5 years—will the same temporary workers be permitted to return regularly to the foreign market? Or will there be a quota of rotations (to prevent overstays and to maintain high remittance levels)? What will the impact of a quota of rotations (possibly a quota of 1) be on the skills of individual workers? How will this affect economic gains in the home and foreign markets? Would rotation quotas reduce the impact on unemployment levels in the home market? Of note the New Zealand -Tonga 'Registered Seasonal Employer' (RSE) scheme between Tonga and New Zealand does not have any restrictions on allowing employers to contract the same workers if they wish to return.
- The **participation rates** in the home and foreign market. The economic assessments depend on assumptions about participation rates as well as raw 'looking for work' rates in each market. But it is very difficult to find adequate data on PICs unemployment levels (the World Bank 'key indicators' for even the largest PICs draw a blank on this point), let alone on labour-force participation rates.
- Likely **wage rates** of migrant workers in the foreign market relative to home market wages. Will bargaining set wages or will they be set by minimum wage rates in the developed nation? Will the bargains be regulated in the Agreement? For example, the NFF suggests a special visa category whose conditions would include Australian 'award' rate salaries for PICs workers. This may be politically necessary but it assumes that PIC workers are more-or-less perfect substitutes for unskilled ANZ workers (the ADB model assumes this, too). If they are not, will the wage differentials be determined by bargaining? Will unskilled employees be able to bargain effectively on their own behalf? In which jurisdiction will disputes be resolved? Notably the RSE program has been developed in close liaison with trade unions in New Zealand to monitor fair and reasonable wage outcomes for PIC workers in their horticultural sector and this is a useful model to follow
- **Remittances**. The model assumes the foreign workers remit a fixed proportion of wages. What differences would it make to the welfare outcomes if the model included changes in the remittance proportions over time (on average, and in relation to the number of times a guest worker returns to the foreign market)? What impact will high levels of remittances have on the structure of production in the PICs and the productivity of important sectors such as agriculture that formerly employed unskilled labour? Much concern has also been raised about the high cost of sending remittances with both New Zealand and Australian governments approaching major banks and financial agents to explore ways to reduce the transaction cost of remitting.

<u>Mobile phones and remittances in Africa</u>

In Africa, where there are twice as many people with mobile phones as there are with formal bank accounts,[20] mobile phones have become low-cost vehicles for remittance transfers. Safaricom Kenya, a leading mobile phone operator with around 5 million customers, has introduced a service which enables subscribers to send and receive money in an instant transaction costing, on average, US$1. A pin code-protected SIM card with a money transfer menu lets the user manage funds between accounts. Although mobile phone banking has not yet reached the Pacific, there are over 9 million potential customers, most of whom currently have no access to formal banking products.

- **Demand for labour** in the foreign market. How would the market operate efficiently to convey demand information between ANZ and the PICs about seasonal demand for unskilled labour in a time frame that would allow for recruitment, training and transfers?
- **Locus of coordination.** Would responsibility for matching migrant labour with employers be left to the market or coordinated through the public sector? In the receiving country, the sending country, or both?
- **Income allocations and non-wage benefits**. Do temporary workers acquire any flows other than wages? This is what the model assumes. To what extent will temporary workers be eligible for / subject to equitable non-wage terms of employment, including such issues as health care benefits, workplace heath and safety insurance, social security and pension contributions? How will these be established, through regulation and/or in employment contracts? To what extent will the terms of individual contracts be mandated under a mobility scheme?
- **Reintegration**. It would be naïve not to expect problems with overstays and illegal immigration. But reintegration of temporary workers into the PICs labour force will be a significant issue, too, especially if nothing is done to address those *underlying* reasons for unemployment and under-employment in the PICs that are susceptible to policy remedy. This issue is discussed in some detail in a case-study to be released soon by the Institute for International Trade on 'Labour mobility and poverty reduction in Tonga'[21]
- **Training**. Training and education programs should be considered as integral components of labour mobility schemes particularly for low and unskilled labour. Appropriate training will increase the skills of domestic labour on their return home and can increase individual capacity to start and manage new small and medium enterprises in their local communities. Pre-departure and reintegration programs should seek to identify training and vocational priorities for individuals. Questions arise with regards to the funding and coordination of such training, mutual recognition of training qualifications by the all members to a PACER plus agreement and the matching of training needs to local employment creation.

[20] Department for International Development (DFID), "Money sent home to poor countries hits all time high, new technology offers potential for further growth", press release 13 November 2006.
[21] The Institute for International Trade has just completed a soon to be published volume of research papers and case-studies on the relationship between trade and poverty in the Asia Pacific region with one case-study focussing on the significance of labour mobility for the Tongan economy including an early evaluation of the RSE scheme – the book is sponsored by AusAID and the WTO.

All of these issues require careful consideration but none should be seen as major obstacles. The RSE scheme, while still in its early days, would appear to have successfully dealt with a number of the issues mentioned above so there is no reason why these challenges, with careful consultation and negotiation with all parties concerned, cannot be dealt with.

5.4.2 Considerations for a trade agreement

For purposes of the next part of our analysis we assume that labour movement provisions would be considered as part of a PACER Plus trade agreement. Based on the strong desire that was conveyed to us in our consultations with Pacific Island officials to ensure that PACER Plus includes a meaningful labour mobility component, we believe that "locking in" commitments on labour mobility in a binding trade agreement would send an important signal to our PIC neighbours that Australia and New Zealand are serious about creating a mutually beneficial agreement. We do note however that for a few PICs, such as the Cook Islands or Niue, labour mobility will be of little interest and their focus will be on other benefits.

There are a variety of ways in which labour mobility commitments could be structured in PACER Plus. To a large degree, selecting amongst available options will be a function of the answers to some of the questions posed above. But other considerations, such as the relationship that labour mobility in PACER Plus may have with existing or future multilateral or bilateral agreements, are also relevant factors to be taken into account in identifying the desired shape and scope of the PACER Plus package. It is also useful to look to some existing FTAs which include labour mobility components in order to see different examples of how other trading partners have approached the task.

Turning first to the multilateral context, we consider whether the inclusion of labour mobility in PACER Plus would present any issues *via á vis* Australia's obligations under the WTO. In order for PACER Plus partners to give each other preferential treatment in their trade in goods and services, PACER Plus must satisfy the conditions set out in Article XXIV of the GATT (for trade in goods) and Article V of the GATS (for trade in services). Provided that their agreement satisfies those conditions, PACER Plus partners who are WTO members are exempt from the otherwise applicable MFN obligation to apply any concession made in respect of trade in goods or services to *all* WTO Members.

It is Australia's WTO obligations under the GATS, that will be the most pertinent to labour mobility issues. It should be possible to structure arrangements on labour mobility in a way that will not present problems of compatibility with the GATS and, in particular, with Article V. This is all the more so given, as outlined below, the limited scope of the GATS, significant uncertainty concerning the conditions that free trade agreements must satisfy in order to be GATS-consistent, and the express authorization of flexible treatment for developing countries in regional trade agreements. The view that labour mobility may be treated in regional trade agreements without compromising GATS commitments is arguably further supported by the practice of certain other WTO Members that have included limited labour mobility components in their FTAs.

GATS Article V ("Regional Integration"), which is expressly referred to in PACER, authorizes the discriminatory extension of access rights to bilateral or regional trading partners. In the absence of this Article V exemption (or a situation falling within one of the General Exceptions in GATS Article XXIV), Australia may not deny MFN treatment on to its other trading partners within the WTO once it has extended a relevant concession to the PICS.

Assuming that PACER Plus would contain some labour mobility concessions falling within the scope of mode 4 of the GATS, but would not provide for complete labour market mobility[22], then it would need to comply with the conditions of Article V. Article V seeks to ensure that, in order to be allowed to derogate from otherwise applicable GATS MFN

[22] Article V *bis* exempts agreements establishing full integration of labour markets from the scope of the GATS.

provisions, Members forming a preferential trade agreement engage to "real" liberalization amongst themselves, and do not raise barriers to trade in services in their trade with third parties. This takes the form of several conditions that any preferential agreement must satisfy, the most significant of which are that it must have "substantial sectoral coverage", and that it must provide for the elimination of substantially all discrimination—in the sense of Article XVII (National Treatment)—among the parties. The scope and meaning of these conditions is not at all clear within the WTO and, neither has been tested through dispute settlement. In addition, the well-known difficulties associated with measuring trade in services would complicate any quantitative analysis of compliance with them.

With respect to the “substantial sectoral coverage” criterion, a footnote clarifies this is to be understood in terms of the number of services sectors, volume of affected services trade, and modes of supply, and that no mode of supply may be a priori excluded from liberalization. Thus, the greater coverage PACER Plus has in all services sectors, and in all modes of supply, including mode 4, the more likely it is to comply with this condition, but universal coverage is not required.

The scope and meaning of the second requirement in Article V are arguably even less clear than the first. By naming discrimination “in the sense of Article XVII” (National Treatment) as the type of discrimination to be eliminated, Article V1.(b) seems by negative implication to authorize the maintenance of market access discrimination among trading partners. And even for national treatment, it is not all discrimination that must be eliminated, only “substantially all”. Further qualifying language in Article V(2) and (3) adds that, in evaluating whether sufficient discrimination has been eliminated, “consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization among the countries concerned”, and that when developing countries are a party to the agreement, additional flexibility is to be provided in meeting this condition, “in accordance with the level of development of the countries concerned”. Thus, the uncertain and highly qualified nature of the requirement to eliminate substantially all national treatment discrimination suggest that ANZ may retain some discrimination even when opening up parts of their labour markets to PIC labour, and that the ways in which this is done should take account of, and be designed in relation to, the level of development of the PICs concerned.

Overall, then, if the Australian government decides that it wishes to limit a particular mode 4 concession to the PICS, a GATS-compliant regional agreement would enable it do so without granting the same concessions to its multilateral trading partners, and the GATS seems to afford a fair amount of flexibility in terms of how such an agreement should be structured.

A second issue, however, is whether Australia has any other international trade obligations that would be triggered by the adoption of commitments to liberalize mode 4 service supply in PACER Plus. Specifically, would such action entitle any existing bilateral trading partners to claim similar access to Australia’s labour markets by virtue of MFN obligations in bilateral agreements? Upon first examination, this does not appear to be the case. Australia’s FTA with Singapore does not contain any MFN obligation. Article 1907 of the Australia-Thailand Free Trade Agreement excludes a requirement to match preferences extended to other trading partners except in three cases not relevant to labour movement. Although Article 10.3 of the Australia-US Free Trade Agreement (AUSFTA) imposes a broad MFN obligation on Australia to accord to the US service suppliers the same treatment it accords to service suppliers from any other country, this only applies to service suppliers in “like circumstances”. More importantly, Australia has scheduled an exception to this MFN and other obligations under the AUSFTA in respect of the supply of services by natural persons. Australia’s reservation limits its commitments to the US under mode 4 to what it has committed under Article XVI (market access) of the GATS. We presume that Australia’s most recent FTA, with Chile, contains a similar reservation, although the legal text is not yet publicly available.[23]

In considering different ways in which labour mobility could be included in PACER Plus, it is useful to look at some existing examples of trade agreements. In general, in the WTO and in bilateral and regional trade agreements, mode 4-type commitments tend to be very limited, typically allowing temporary entry relating to mode 3 commercial presence (e.g. intracorporate transferees) or in limited, highly skilled sectors (e.g. accountants, engineers).

The scope of commitments made has been increasing, but generally remains very modest, and limited to skilled workers. Although an in-depth survey of FTAs beyond the scope of this paper, a few examples are worth citing. Under the NAFTA, the US agreed to accept highly skilled workers from Canada and Mexico who have US job offers in specified occupations for renewable one-year periods. Although the US originally imposed a maximum quota of 5500 Mexican nationals per year under this commitment, this quota expired in 2004, so that there are now no restrictions on the number of qualifying Canadians and Mexicans who can enter. Japan has recently made commitments in respect of nurses and care givers in its FTAs with the Philippines and Indonesia (although the latter agreement is not yet in force), which are not subject to quotas, but which do subject qualified Filipino and Indonesian persons to undergo mandatory additional training while in Japan. Australia made commitments to accept (unlimited numbers of qualified) Thai chefs under the TAFTA, and, in its agreement with China, New Zealand made commitments to accept qualified practitioners of traditional Chinese medicine, chefs, mandarin teaching aides, martial arts coaches and tour guides from China. Each of these categories is subject to a maximum quota. New Zealand also agreed to accept up to 1000 skilled workers in specified occupations in which New Zealand has an identified skills shortage, no more than 100 of which can be in any one profession.[24] The sectors to which this commitment applies are to be set out in an exchange of letters between the parties and reviewed every five years.

Some countries, among which Canada and, more recently, New Zealand, are prominent examples, have chosen to implement seasonal agricultural worker programs independently of trade agreements. Germany maintains a contract worker scheme, which consists of a series of bilateral labour agreements with Central and eastern European countries.[25] These include country-specific quotas which are adjusted to the labour market situation in Germany. Some of these programs may not be covered by GATS (to the extent that the workers concerned are employees rather than service providers), but the way in which they are structured and the experiences of the countries involved could nonetheless provide useful insight in the design of any labour mobility component of PACER Plus.

One final consideration is that PACER Plus and its schedules and any associated documents will need to be structured so that the schedules or other documents do not contravene the terms of PACER Plus itself. If, for example, PACER Plus includes a market access provision equivalent to Article XVI of the GATS (which requires that, in sectors where commitments are taken, any limit on those commitments must take a specific form and must be entered in

[23] New Zealand's existing FTA commitments—particularly the relevant clauses of the FTA it recently signed with China—would also need to be checked to see if it has MFN obligations that could be triggered by mode 4 commitments in PACER Plus.

[24] The current list of the occupations that may enter under this category (each has attached qualification and experience requirements) is as follows: computer application engineer, senior test analyst, structural engineer, veterinarian, fitter and turner, registered nurse, fitter welder, university or higher education lecturer, early childhood education teacher, design engineer - electronics/ product engineer, auditor, electronics technician, medical diagnostic radiographer, medical radiation therapist, nuclear medicine technologist, boat-builder, film animator, electrician, plumber, automotive electrician, diesel mechanic, motor mechanic..

[25] "Background Paper", IOM/World Bank/WTO Trade and Migration Seminar, Geneva 4/5 October 2004, available at http://www.wto.org/english/tratop_e/serv_e/sem_oct04_e/background_paper_e.pdf

the individual country's schedule) then numerical quotas, for example, would need to included in each country's schedule.

All of the above suggests a number of issues that will need to be addressed in determining how to structure labour mobility commitments in PACER Plus. First, what type of labour will be covered by the commitments: skilled, unskilled and/or 'semi-skilled' (task-specific, or 'on-the-job' training)? Should the commitment(s) be made in terms of broad categories of workers (unskilled workers), or narrower categories (agricultural workers, restaurant workers, etc.)? Can/should quotas be used and, if so, should they be attached to specific, narrow categories, or should a single global quota apply for each country from which labour is received? How can they be structured so as to minimize "discrimination" among PACER Plus partners and thereby enhance the consistency of PACER Plus with Article V GATS? Can a mechanism for adjusting the quotas be included?

Without coming to a definitive view at this preliminary stage, the Institute for International Trade offers a few observations on some of these issues. As regards the possible use of differentiated quotas for different PICS, we recall that Article V of the GATS provides that when developing countries are party to an integration agreement, additional flexibility shall be provided for regarding compliance with the conditions for GATS-consistent FTAs, particularly the need to eliminate discrimination, "in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors."

Relying on this provision, ANZ could craft a suitably differentiated framework of PICS labour quotas by:

(1) Structuring the quotas according to criteria that are somehow tied to the different beneficiary countries' level of development (either overall or in specific areas), and not excluding any country a priori from the right to have an assigned quota;

(2) Including the quotas or some description of the criteria that will be used to fix or adjust them in the AU/NZ schedules (or possibly in a separate annex/schedule to the Chapter on Movement of Natural Persons).

The identification and application of criteria in a complex domain such as 'development' inevitably has an artificial aspect, however the treatment recommended above provides a structure for establishing quotas that are compatible within the FTA trade framework.

That said, the test of their contribution to the integration objectives of PACER is not whether they are GATS compliant but whether they also have *market validity* in the sense of being responsive to demand. This means that economic and administrative considerations will also have to be taken into account in deciding how to structure the commitments and how much information to put in the Schedules to the agreement. Even if the parties do not want to put the quotas themselves in the schedules, it might be useful to specify the nature of the work that temporary entry will be allowed for (for example, seasonal harvest of agricultural products, aged care for registered nursing homes or whatever) and some of the criteria that will be employed in fixing the quotas – for example tied to level of development.

5.4.3 Other trade related considerations

There are other issues the trade framework for negotiations on labour market that ANZ and the PICS will need to work through (and around) before the negotiations commence:

- A PACER agreement on mode 4 temporary movement of labour should not, be limited to the liberalization of access only to the ANZ market. PNG, for example, has the economic size and opportunities to generate its own employment (Chand, 2006) but Vanuatu—which, however, already makes a success of training seamen for service on foreign-owned vessels—probably does not. Exxon for example is planning to develop its natural gas operations in PNG and will require an estimated 7,000 workers both skilled and unskilled and while this will contribute significantly to using local labour wherever possible it will also be an opportunity for workers from other PICs to be involved. Some of the smallest PICS that depend on foreign transfers for a high proportion of national revenues (Niue, Nauru) will probably never be able to generate sufficient domestic employment and may need continuing access for a high proportion of their potential workforce to external labour markets. Between the two extremes there are workforces with different opportunities and levels of average educational achievements. Prasad argues (2007) that PNG and Solomon Islands could even face skilled-labour shortages themselves if they achieve planned growth rates and that shortages could also occur in Fiji, Samoa and Tonga if current migration levels continue. Intra-PIC mode 4 arrangements would help to alleviate any shortages. Given the complexity and novelty of the proposed ANZ labour-movement provisions, the Agreement could commit the parties to return to this subject at a later date, for example after a review of the PIC—ANZ labour movement arrangements.

- As noted before, a trade agreement that creates a temporary outlet for some labour does not address the *economic causes* of the high levels of PIC unemployment that have given rise to the demand for an agreement on labour mobility. Nor does it address the demographic issues. Over generational spans of time, wealth, lifetime-income expectations and population growth are inversely related in ways that many surveys attest. Creating an outlet for the currently unemployed is expected to raise their income levels and may therefore contribute to improvements in demographic indicators over time. But that contribution may continue to depend on the income from remittances. A more direct approach to the solution would be to raise the level of indigenous economic activity in the short term by means of economic and governance reforms.

- A trade agreement alone will be insufficient to make all the arrangements on the temporary movement of labour work successful. Labour markets have unique characteristics; they are full of frictions that do not occur in goods markets concerning the physical movement of workers, their welfare, their social relations, their different abilities to discover and use information about prices and non-price conditions of the labour contract, etc. Problems that occur even when workers move temporarily across a border between contiguous states become magnified when the market is made at a distance. Any provisions in a PACER-FTA on the movement of labour will have to be bolstered by complementary agreements on skills training (especially for 'unskilled' labour), visa terms, technical assistance on immigration and possibly regulations on recruitment.

- The 'micro' impacts of a labour movement agreement based on quotas will depend crucially (as in quotas on merchandise trade access) on aspects of the administration of the quotas. The design of the quotas should take account of the distribution of rents arising from quota entitlement; the 'life' of a quota entitlement; the transparency of the rules of quota administration; the time period between application for an entitlement and the distribution of access rights.

- A trade agreement between ANZ and the PICS that included extensive labour movement provisions would be the first such regional trade agreement between developed and developing countries. As such it is very likely to require more extensive consultation with business and civil society communities and take longer to draft and to negotiate than the other chapters of an FTA with the PICS that will cover more familiar ground. There is a slight danger of holding the agreement *hostage* to the completion of the labour movement chapter, intensifying the focus on its provisions with possibly disruptive effect for other positive aspects of the economic integration objective.

5.4.4 PIC objectives and ways forward

The Hon Lisiate ‘Akolo, Tongan Minister for Labour, Commerce and Industries, who has been appointed the Pacific Alternate Spokesperson for PACER Plus negotiations told us that labour mobility would be the number one issue for many of the PICs.

‘Akolo said that the PICs placed a higher priority on access to the Australian market because it offered higher wages, more diverse opportunities and a climate that PIC workers preferred. PICs governments would be seeking opportunities in semi-skilled activities other than fruit picking and agriculture, including support for manufacturing and services, particularly aged care, transport and hospitality services. He would like to see the Agreement place more emphasis on skills training for low-income workers, before, during and after temporary work schemes – skills that could be harnessed at home for local development purposes.

While there is a growing consensus among the more informed in the Australian community on the potential ‘win-win’ of temporary labour mobility schemes, there are still strong opinions in various directions in ANZ and in the PICs not only on the issue of temporary access but also on increased permanent migration from the PICs. Although there is evidence from the ADB modelling of significant economic benefits for both ANZ and the PICs flowing from a suitable scheme, there are a number of non-trade concerns that have yet to be resolved.

Overall then, we would want to put the following recommendations forward as useful ways to progress temporary labour movement schemes as a part of PACER Plus.

A binding trade agreement: The agreement could consider binding commitments in respect of the temporary entry of natural persons from PICs for work purposes, with different quotas for different PICs according to their individual situations. There are a number of possible options as to how this could be accomplished, such as through specific commitments in services annexes or a separate chapter and/or annex on the movement of natural persons. Regardless of how it is structured, we believe that a binding trade agreement is the appropriate vehicle for "locking in" commitments on labour mobility in a way that takes account of the heterogeneous needs of the PICs and is consistent with multilateral obligations under the GATS.

Economic integration objective: We consider - subject to the concerns we have indicated about the robustness of the ADB model projections and navigating through the trade agreement framework - that the proposal for a mode 4 agreement providing substantial levels of temporary access for *unskilled work* deserves sympathetic treatment for the sake of the contribution it would make to the economic integration objectives of PACER Plus.

Time for consultation and analysis: We would recommend that all parties to PACER Plus allow sufficient time be allocated for a transparent, public process of considering the costs, challenges and benefits in order to expose all the considerations relevant to the decision and minimize misunderstandings about the limits that may be placed on any eventual access arrangements. Such a process would help, too, to engage the attention of employers, employment service providers, unions and individual workers in a way that would make the implementation of an eventual agreement easier to manage.

Research on each PICs labour market needs: It would be ideal if specific research could undertaken in each specific PIC to assess current labour market conditions and the likely benefits and costs for them as a result of increased labour market access into ANZ based on realistic assumptions such as likely ANZ demand for labour over the next 10 – 25 years. PICs themselves need to undertake further analysis on the sectors and occupations where they currently have comparative advantage with a view to a broad training needs analysis

Pilot Program: Given the successful introduction of the RSE scheme between Tonga and New Zealand, Australia might consider undertaking a similar pilot project, one that would ideally target low to unskilled labour given the potential welfare benefits for PICs and one that invites the involvement of at least one Melanesian, Polynesian and possibly a

Micronesian state. The latter would assist in testing and designing schemes for the future that take cognisance of the differing employment and labour market needs of various cultures and countries within the region.

Training: We would recommend that Australia pay particular attention to the vocational and technical training needs of Pacific Island labour participating in these temporary labour market schemes particularly to the planning and funding of pre-departure briefings, on-the-job training and training on return - all of which will assist not only in the successful implementation of such schemes but in aligning individual training needs with the longer term employment and development needs of the PICs. The presentation of the initial ANZ approach to the PICs should be accompanied by some developed ideas on the ancillary provisions including possible responses to the training needs of the PICs.

Use of remittances and transaction costs: Remittances to the Pacific reached US$ 425 million in 2005,[26] and at current trends are likely to overtake aid flows in value in 2009. Clearly further work could be undertaken on how PICs might better capture the benefits of remittances for savings and investment purpose using appropriate incentives. It would also be useful to further investigate means for reducing transaction costs of remittances suitable for the Pacific.

Local employment creation: While covered in other areas of this report, this section reinforces the need for further research into:

- Economic management and accountability reforms designed to increase indigenous employment demand
- Liberalization of PICs investment and business regulations that might attract more investment in local employment-generation
- How best to align the training components of temporary labour market schemes with longer-term employment generation

5.5 Competition policies

We would expect to see some competition benefits from PACER as a direct consequence of the liberalisation of entry for foreign competitors in goods and services markets and as a consequence of the provision of national treatment for goods and services from ANZ and from other PICs. But we do not recommend an attempt to include explicit competition provisions in the agreement.

Although only ANZCER and EC have substantive, region-wide rules of competition, other agreements have some disciplines relating to competition (NAFTA), and several FTAs have chapters providing for cooperation in competition matters. However a high degree of institutional similarity (or at least *assimilability*) is required for a successful cross-border competition policy agreement and given the size of PIC markets and stage of development, competition policy may not yet be of the highest priority.

5.6 Private sector capacities

A PACER trade agreement may contribute directly to enhanced private sector capacities through technical assistance and improved trade facilitation procedures. It is also likely to affect the incentives for import-competing firms to improve their customer-focus, internal organization, knowledge of prices, marketing and planning in order to compete better with new entrants following trade liberalisation. Import-competing firms that maximize profits while cutting final prices will have to reduce their own costs; but with supply prices fixed in

[26] Christopher Browne and Aiko Mineshima, "Remittances in the Pacific Region", IMF Working Paper 07/35, 2007

the short term (particularly for non-tradeable supplies such as land, labour) this means improvements in efficiency.

The negotiation of an economic integration agreement with a dominant trading partner (ANZ) is a crucible for public-private collaboration on trade and economic policy in each PIC. If that collaboration does not work well, PIC governments will find it difficult to define commercially valuable objectives in the negotiations because they will lack the market knowledge to do so. A business community that has not collaborated with government in planning for an integration agreement will have difficulty planning investments and sales and will face higher adjustment costs and a longer period of disruption due to changes in the commercial environment.

Based on our experience in working with the business communities on public-private collaboration on trade agreements in many economies in the Asia-Pacific region, we believe that sustained and detailed engagement between public and private sectors will be essential.

5.6.1 Engaging the private sector

There is persuasive evidence of the importance of private-sector consultation on trade agreements in the history of Vanuatu's failed attempt to accede to WTO (Gallagher et al. 2005).

The integration objective of PACER cannot succeed without close and informed consultation between governments and the private sector because private transactions are the chief vector of economic integration, and;

- Private valuations of the costs and benefits—translated into business and household plans—will determine whether the economy adjusts smoothly or with difficulty to the new competitive conditions. For smooth adjustment, it is paramount that the private sector has the information to make appropriate plans and that policies, once adopted, remain stable.
- Policy stability in a democratic framework depends on consultations with the owners of productive resources (private property for the most part) in advance of policy changes and on transparent agreements (if any) to compensate private losses out of the gains from liberalisation.[27]
- Transparent consultation with the private sector representatives a national level (as opposed to collaboration between government decision-makers and individual firms) promotes accountability in government and can reduce the opportunity for corruption.

Without close collaboration between the government and private sectors on the reforms that PACER will bring, the identification of new economic opportunities that make integration worthwhile will lag and adjustment to new competitive conditions will be slower and more costly.

There are also, especially in the smaller PICs, non-economic reasons for giving priority to collaboration with community leaders whose attitude to—and involvement in—economic plans can make a big difference to their practical implementation.

Ways forward

The authors would therefore recommend the following initiatives:

[27] Non-transparent subsidies are a significant risk in small economies where individual firms often have market power. The World Bank records the case of the Samoa Electric Power Corporation that has apparently compensated its customers for the introduction of the GST by withholding dividends to the government (thus defeating the purpose of the tax as well as denying government the revenue).

- Australia could assist, as necessary, in the formation of a 'Pacific Private Sector-Government Ad Hoc Working Committee' to work together on PACER Plus preparations and negotiations.
- It would be very useful for consultations and workshops organised jointly with the Pacific Island Private Sector Organisation (PIPSO) to be held throughout the Pacific on PACER Plus with both an educative component and an investigatory component with respect to current capacity and barriers to trade.
- Further analysis should be considered of the cost structure/competitiveness of individual industries in PICs to see which industries are likely to benefit and which industries are like to lose from the possible trade liberalisation that PACER Plus would entail.
- Further consultation could be undertaken with ANZ companies with existing or prospective trade and investment interests in the Pacific in order to develop an inventory of current business ties, ascertain barriers to trade and investigate future potential for productive investment into the Pacific.
- The above recommendation could include or be complemented by a study on the barriers to expanding services trade among PACER Plus signatories with recommendations on how to overcome or reduce these barriers in the future.

5.7 Regional/global integration

A PACER agreement will contribute directly and substantially to the regional economic integration of the PICs and indirectly to their global integration. The value of the proposed PACER in comparison to PICTA and to the EPA will depend on coverage and enforcement.

PACER is likely to tie the PICs in general more closely to the ANZ economy. We judge that the PACER agreement will raise the volume of regional trade—see the next section for a summary of a quantitative analysis that cannot, however, show us the distribution of volume increases—but that it is unlikely to change ANZ merchandise trade *shares* or commodity *composition* by much. There may be better prospects for increased ANZ shares of PICs services markets and, if temporary movement of labour is included in the agreement, a significant prospect for much closer economic integration through PICs shares of the ANZ services market. In any case, closer institutional cooperation on standards, customs and trade facilitation and on other governance functions will help to bind the whole.

PACER could also improve the integration of the PICs as a region. Although PICTA (and MSA) are intended to achieve that goal, some analysts (Narsey, 2008) consider that PICTA obligations are already fraying as the level of preferential access mounts. Given the relatively small trade coverage of PICTA (due to the small share of inter-PIC trade in the overall trade of most PICs) governments may be less punctilious about compliance. But PACER is likely to have much more trade significance, especially if labour movements are also covered.

Global integration of the PICs will be advanced by PACER and by other external trade treaties. The larger PICs (Fiji, PNG) will retain substantial external economic links, including to Europe through the EPA. Marshall Islands, Micronesia and Palau will maintain closer relations with USA. Also, taking recent trends as a guide, most PICs will probably see a rise in the levels of imports from Asia and closer Asian and extra-regional interest in fisheries, forestry, minerals and, to a smaller extent, tourism.

The biggest *threat* to closer integrative under PACER will be rules of origin (see separate section).

5.7.1 An open-skies policy for the PACER region

Chand (2006) and others have noted the apparent success of the 'open-skies' policy of Vanuatu. The Pacific International Air Services Agreement was intended to liberalize regional air traffic but has had little impact. The World Bank's *Pacific Infrastructure Challenge* report (World Bank, 2006) argued that a multilateral air services agreement based on 'open-skies' would encourage competition, providing more choice and lower fares for passengers. This is likely to benefit the tourist trade in Pacific countries despite challenges of isolation and small scale. PACER could be a 'stepping stone' to multilateral open-skies by creating a region-wide air services agreement that would transform into a multilateral 'open skies' policy within a defined time frame.

The biggest impediment to a multilateral open-skies agreement would be the restrictive policies of ANZ. The recent Australia-USA open skies agreement may help to break down this barrier. Australia and NZ have had an open skies agreement since 2000.

5.7.2 The way forward

A plurilateral economic integration agreement involving two high-income regional economies and many small and isolated economies is almost unprecedented. The way forward is likely to be long and should be travelled at a deliberate pace in order to retain the commitment of all parties and to ensure the preparation of an agreement that serves the interests of all of them. There are some difficult decisions to be made on the scope of PACER Plus that need careful preliminary discussion to ensure that all parties understand the implications of including or not including a sector (e.g. air transport, fisheries) in the agreement. There are also important questions of structure; especially the structure of the schedules of commitments that - on account of the diversity of the PICS - could take some time to negotiate.

The schedules of commitments of PACER Plus will somehow have to take account of the differences among the PICS in economic size and production profiles and of the complexities introduced by the overlapping existing commitments of the PACER Plus parties under PICTA, EPA, PATCRA, SPARTECA and ANZCER. It will probably be necessary to negotiate separate PACER Plus schedules for each PIC and for Australia and New Zealand, within an overall framework concerning maximum periods, safeguards and exceptions etc. Each party to PACER Plus could have a (possibly unique) set of obligations concerning the timing of tariff reductions or the implementation of services commitments.

The most practical approach might be to use PICTA (described above at section 3.4) as the starting point for the goods schedules for each Member of PACER Plus. Negotiations would extend the provisions of the implementation schedule to include preferences for imports from ANZ implemented at the same time as preferences for other PICTA members. But modifications may be needed to make the PICTA schedules acceptable to ANZ. For example, using the PICTA schedules as a basis for PACER Plus, NZ would have less favourable treatment in PNG than the EC, which has secured liberalization of more than 85% of goods trade with PNG in the first year of the EPA implementation schedule (Australia already enjoys duty-free treatment in PNG under PATCRA). Also, the addition of ANZ to the schedule would probably lead several PICs to move more products to the 'sensitive' list for later liberalization under PICTA.

In spite of these complications, the use of PICTA as the starting point for PACER Plus schedules could have some benefits. There are some signs that the PICTA schedules are being evaded or ignored in some of the PICS, suggesting that a 'fresh installation' of the PICTA schedules in the PACER Plus Agreement could help with compliance.

The schedules for services liberalization would be simplified by a 'negative list' approach, but whether negative or positive, the preparation of schedules for the individual PICS will require extended consultation, cooperation and capacity building support from Australia and New

Zealand. Services negotiations are difficult to prepare and the schedules are very difficult to write in a manner that is precise and durable (witness the difficulties of the United States as revealed in the On-line Gambling case).

In our view, the first steps by the parties toward PACER Plus might well be to take the time to review the options in depth and more than once so that officials and the stakeholder communities in ANZ and in the PICs has an opportunity to reach an understanding of the *requirements* for the negotiation of a mutually beneficial agreement on integration. ANZ, especially, could adopt a schedule for this preliminary work that recognizes that none of the PICS is able to draw, as ANZ are able to draw, on four decades of WTO and OECD membership to guide them on these requirements and the implications of the treaties that are likely to comprise PACER Plus. They will need time and assistance to be able to define their own interests in economic integration and to recognize the facility that the PACER Plus agreements can offer them in the pursuit of those interests.

5.8 Welfare gains/losses

A key *policy* insight of the standard theory of trade is that in small economies - that have no capacity to manipulate their terms of trade by means of an 'optimum' tariff - the gains from trade liberalisation accrue chiefly from liberalizing import barriers. This promotes the specialization of production, enables some economies of scale and an increase in output possibilities. Of course, unilateral liberalisation of import barriers in the face of unchanged protection abroad results in a *terms-of-trade loss* that cuts the welfare gains from lower import barriers and induces governments to maintain protection at higher than optimum levels (encouraged by political economy pressures).

This is where *reciprocal* trade agreements play a useful role. They minimize the terms-of-trade effects of liberalisation by linking own-barrier tariff cuts to foreign-barrier tariff cuts. They also address the political-economy problem by providing evidence of new profit opportunities for formerly protected domestic industries in foreign markets. Consequently, reciprocal agreements (MFN and preferential) have played an important part in the progressive opening of global markets in the past sixty years.

Non-discriminatory agreements provide the greatest breadth of opportunity. All of the PICs, including those not members of WTO enjoy—*de facto* or by WTO rights—access to MFN treatment in global markets. But regional, discriminatory agreements also offer important trade opportunities, despite their discriminatory character, for the practical reason that they usually have a higher *momentum* than multilateral agreements. This momentum - due to foreign-policy motivations that are absent from the multilateral sphere - encourages a broader and deeper liberalisation of barriers than it has proved possible to negotiate on a multilateral basis.

The welfare gains from discriminatory regional trade liberalisation are likely to be smaller than those from a multilateral agreement. In part, this is due to the more restricted trade coverage (few members, less than 100% of the tariff) of regional trade agreements. Also there is a higher risk that the net welfare impacts could be small or negative if one regional partner is much larger than the others (terms-of-trade losses) or initial tariffs are high (some of the tariff revenue becomes a 'transfer' to the regional trading partner). Finally, the classic gains from trade (due to specialization) may be reduced for very small economies in an RTA because the opportunity for gain depends on regional liberalisation exposing a complementarity of the partners' economies. There is less prospect of two economies being 'complementary' if one is much smaller than the other, resource-constrained, and geographically isolated.

However to examine the more specific welfare implications of a comprehensive PACER Plus for each PIC will require further quite difficult research and below we discuss some of the options for quantitative analysis on revenue and welfare impacts. However is also worth recalling that in previous sections we have recommended the consideration of two other studies which will assist in assessing future welfare benefits. We put forward the possibility of a PIC industry competitiveness study which would undertake an analysis of the cost structure and competitiveness of individual industries in PICs to see which industries are likely to benefit and which industries are like to lose from the possible trade liberalisation under PACER Plus; and in the section on labour mobility we proposed a cost/benefit analysis of value of temporary labour market schemes for each individual PIC**.**

5.8.1 Quantitative analysis

Overall, the lack of consistent and/or recent data on the trade and tariffs of the PICs makes quantitative analysis of the proposed PACER hazardous. Although a 'work-around' approach can often be found for some missing data - typically by using mirror trade data and barrier proxies - there is a danger that the summary of results might be used for policy decision-making in ways that are not justified by the robustness of the model results.

The Institute for International Trade commissioned Professor Biman Chand Prasad, Professor of Economics and Dean of the Faculty of Business and Economics at The University of the South Pacific, to model the potential impacts of a PACER agreement. His conclusions are that PACER, like other RTAs, could be expected to have a significant impact on the volume of regional trade.

> [T]his study has shown, using the Gravity model approach that if one of the countries in a given country pair is part of this agreement, it will generate additional bi-lateral trade flows of 13 percent than would be the case otherwise. On the other hand, if both countries in a given country pair are part of this agreement, then bi-lateral trade will increase by an additional 30 percent than would be the case otherwise. [28]

The gravity model does not show the distribution of that increase in trade among the members of PACER but Professor Prasad considers "it would make some sense to say that increase in trade flows is likely to be mutually beneficial."

These results are clearly encouraging. But they must be considered preliminary. Professor Prasad adds two important qualifications

> Firstly, even though we had 6 digits tariff data using the Harmonized System of Tariff Classification (HS), we were not able to get imports data which were consistent with the 6-digits HS classification. This prevented our ability to do a more rigorous analysis whereby we could have lowered the tariff rates on various prohibitive and protective products and seen the resulting loss in tariff revenue. Secondly, even though we know what would be the potential benefits and costs of this agreement in theory, it is hard to quantify these benefits and costs at this early stage due to the unavailability of relevant data. It would require further research and analysis of data available at the country level.

The costs of PACER Plus for the PICs, estimated as tariff revenue losses, are further discussed in the next section along with some of the key challenges of PACER Plus.

[28] See Appendix I for Professor Prasad's full report

6. Challenges of PACER Plus

The expected gains from trade liberalisation may not occur or not be significant in a few smaller PIC economies. In some PICs, distance, market-size and limited resources are very likely to be a bigger barrier to market efficiency than regulatory impediments so that no amount of 'liberalisation' would lead to significant (or even noticeable) improvements in trade performance or growth.[29] Small economies are less able to adjust smoothly to changes in the terms of market entry and offer much more limited alternative uses for productive factors. Due to their isolation, information on prices is more costly and disseminates less rapidly. Geography also imposes physical limits on the responsiveness of supply to demand, which can create thresholds and discontinuities in market-clearing operations not seen in efficient markets.

There may be an argument, too, for the maintenance of import protection for resource-based industries that have plausible prospects of future competitive supply (at free-trade prices). Import protection may allow these industries the opportunity to develop and capture local learning and innovation (including that embodied in a trained local workforce) while being protected from the *leakage* of these assets to foreign competition. But it would always be more economically efficient to directly subsidize these industries given the usual risk of an *infant industry* strategy (that the 'infant' will never mature into an export competitor).

6.1 Implications of trade preferences for revenue, services regulation

The revenue implications of PACER are of concern to PIC governments. They have recently been examined in some depth by the Nathan Baseline report for the Forum Secretariat that concluded that the consequences—*if no alternate tax measures were implemented*—would be serious, including a loss of more than 10% of *current* revenues at the end of the implementation period.

Table 10: *PIC Tariff Revenues*

	% of Total Revenues	ANZ, % of Total Revenues	Tariff Revenues from ANZ, USD
Tonga	33.3	17.2	9,845,417
Vanuatu	27.1	17.2	12,398,316
Samoa	25.0	14.0	15,041,762
Kiribati	23.0	14.3	7,917,941
Marshall Islands	21.3	2.2	718,881
FSM	17.7	0.6	267,186
Fiji	17.4	4.9	35,173,983
Cook Islands	15.1	12.2	6,460,122
Solomon Islands	9.0	3.7	3,072,816
PNG	3.6	1.4	17,735,890
Niue	2.9	2.8	399,982

Source: Nathan (2007) based on Forum Secretariat data

[29] Hummels (2001) estimated an average rule-of-thumb that every additional day spent in shipping is equivalent to almost a 1% ad valorem tariff. There have been many subsequent elaborations of these ideas, showing similar results. Nathan (2007 — using estimates by Hummels among others), table 2-6, estimates the ad valorem equivalent impact of *before the border* delays in the PICs on their current 'basket' of exports between 1% (Kiribati) and 69% (PNG).

The tariff revenue concern certainly needs to be addressed. But the first step must be to put it into context.

- **Free trade is more than a decade away**: PACER Plus is likely to have a lengthy implementation period: probably at least the 10 years considered appropriate (but not necessarily enforced) by WTO's Article XXIV. It is unlikely to enter into force for at least 3 to 5 years. That means that the full revenue impacts may not be felt until 2023, when the PICTA and EPA cuts will also be fully implemented. This should provide ample time to consider and implement other revenue programs.

- **Tariff revenue cuts will be progressive and, possibly, 'back-ended'**: The typical tariff reduction schedule in an FTA (e.g. AUSFTA, TAFTA) takes place on a schedule that usually provides progressive cuts and sometimes postponed cuts on those items where duties are high, effectively 'back-ending' the nominal revenue impacts. So, for example, the AUSFTA Agreement provides for five formal *staged* categories of tariff reductions that the US schedule spins out to nine categories plus pages of product-specific schedules that extend the duty elimination, in some cases, to 18 years. The Notes to the US Schedule specify, for example, that

> "…Duties on goods provided for in the items in staging category G shall remain at base rates during years one through six. Duties on these goods shall be reduced by 5.6 percent of the base rate on January 1 of year seven and by an additional 5.6 percent of the base rate on January 1 of each year thereafter through year twelve. Beginning January 1 of year thirteen, duties on these goods shall be reduced by an additional 11.1 percent of the base rate annually through year eighteen and shall be duty-free effective January 1 year eighteen."

Although this extended period cannot be considered 'best practice' in an FTA, some form of staging is common practice and is likely to apply in PACER Plus to accommodate the bunching of peak rates that we observe in the WTO tariff profiles for many of the PICs. The inclusion of temporary exclusion lists in PICTA makes this outcome all the more likely.

The effect of progressive implementation and possible 'back-ending' is to cushion the revenue impacts.

- **Tariff revenue cuts will occur even without PACER Plus**: Over the next decade or so, it is very likely that MFN duties in the PICs will decline, due to WTO agreements or on an autonomous basis. Furthermore, PICTA and EPA will also play a part in cutting tariff revenues. Even without PACER Plus, it would be prudent for PICs to look to diversifying their revenue base away from the import tariff and several have done so: Cook Islands, Fiji and Samoa already have a VAT. Others are in the process of doing so. In its report on the potential impact of PICTA, IIT notes that even Tonga (which leads the PICs in the proportion of revenues from tariffs: (see the Table above) has reduced its dependence on tariff revenues following the 2005 introduction of a broad-based consumption tax (IIT, 2007).

- **The tariff share of revenue may decline even without PACER Plus**: Even if the tariff is untouched and the import share of GDP remains constant or even rises, progressive income tax schedules, growing worker remittances, royalties from mineral exploitation, and other foreign transfers may see the tariff share of future revenues decline.

- **Some PICs have low dependence on tariff revenue**: PNG, Solomon Islands, and Fiji each collect less than 5% of current tariff revenues from ANZ imports. They do not face a major challenge in finding alternative revenue sources over the next decade or so.

- **The smallest PICs have low reliance on tariffs or other taxes**: Tariff losses will have little impact on the economies of Marshall Islands, FSM, Nauru, and Niue that are more grant-driven (Noni et al. 2007).

Table 11: *Imports and tariff revenues for the PICs: 2000-2005*

Year	Fiji ($M)	PNG (KM)	Solomon Is ($M)
2000	1647.7	2778.9	468.2
2001	1769.1	3160.0	475.0
2002	1749.4	4196.8	452.2
2003	2017.5	4231.0	622.9
2004	2228.6	4703.0	636.2
2005	2471.8	4665.1	1393.0
2006	2839.4	6064.3	1597.9
Average Imports	2105.4	4257.0	806.5
Av. Tariff Rate (%)	7	6	22
Tariff Revenue	147.4	255.4	177.4

Source: Prasad (2008), using IMF International Financial Statistics

6.1.1 Quantitative assessment

In his assessment of the quantitative impacts of PACER Plus for IIT, Professor Prasad (2008) examines the available data on the tariff revenue collections of the three largest PICs (Table 11). His data shows the loss due to the elimination of *all* tariff revenue based on average collections in 2000-2005: that is, revenues from collections on imports from all sources not just from ANZ or other PICs. The numbers, as expected are substantial but, he concludes, the losses are manageable:

> …[Although] this study has shown that there would be a significant loss in tariff revenues, this does not in any way imply that there would be a drastic fall in total Government revenue for these three countries. This is due to the fact that the loss in tariff revenue would be partly offset by the increase in import VAT/GST revenue and a possible increase in income tax revenue. At this stage, it is also important to mention that there are a few countries in the Pacific that do not have a consumption tax like VAT or GST. Therefore, if these countries are seriously considering being part of this proposed agreement, they will have to introduce a consumption tax such as VAT or GST to mitigate the potential loss in tariff revenue as a result of their participation in this agreement. (Prasad, 2008)

6.1.2 The way forward

Considering the potential size of cuts to the revenues of some PIC governments, observations about the progressive nature of the impacts cannot be completely reassuring. More data is needed to support the kind of studies that would allow us to estimate the actual impacts over time (especially, import elasticity studies and complete tariff schedules for the non-WTO members).

It would also be useful to consider as part of the preparatory work for PACER, some cooperation on revenue diversification and collection. Soni et al. (2007) conclude that administrative reform is a higher priority than any decision on how to replace revenue shortfalls. With administrative reform and the greater fiscal efficiency that can be expected to flow from it, PICs should not have any significant problems identifying revenue flows that would replace duties on ANZ (and other PIC) merchandise imports.

The IIT report on PICTA (IIT, 2007) recommended consideration of a 'Tariff revenue offset fund' for smaller island nations. Although this option is feasible in the case of the smaller Pacific Islands and the lesser impacts that PICTA is likely to have on PIC revenues, it would be more difficult across the board in the case of PACER Plus. A fund that proposed a long-term offset for more than 10% of current revenues would be a significant extension of budget support to the PICs and could have adverse implications for both economic management and governance. However there could be some consideration of 'adjustment funds' or well-managed trust funds to assist those PICs that are particularly hard hit by loss of tariff revenue in the short to medium term.

6.1.3 Further Quantitative Analysis

A quantitative analysis of the welfare impacts of an FTA is usually based on a forecasting model such as a computable general equilibrium (CGE) model. In the final analysis, economic 'welfare' can be thought of as, 'consumer buying power'.

Such a model of an economy (or two or more regional economies) is based on a representation of how the prices of tradables and non-tradeable change in response to a change in border taxes or other trade impediments and what impact this price 'shock' has on the volume and distribution of output (or, equivalently, consumption) at 'equilibrium' between regional supply and demand. 'Equilibrium' in this case means the point that the modellers choose as the 'closure' point of the model: the mathematical point on which the expressions embodying the model of the economy converge.

As long as the economies in a trade model are not exact replicas of one another, prices of factors and goods will not be identical across countries before trade is opened up. The prices of certain goods will be lower in one economy and higher in another. This creates the basis for mutually beneficial exchange. Gains from trade come from allowing factors of production within a country to be allocated to sectors that are more productive.

What parameters are relevant for a CGE model of the PACER welfare impacts? A useful representation can be found in the Social Accounting Matrix (SAM) that illustrates a 'circular' flow of resources between the different sectors of an economy.(See Appendix J) Each column representing the expenditure (sum of inputs) of a sector is matched by a receipt row (demand for outputs).

Several basic sources of economic information contribute to the SAM: the economy's input-output table, the national accounts, government (budgetary) accounts, balance of payments and trade statistics. A CGE model of trade collects the SAMS of several countries in a standardized format and combines them using a base year and a single currency. When data are missing or are inconsistent the modeller must 'adjust' them in a manner that is, if possible, transparent to the operation of the model.

This data collection and standardization task is so daunting for a large number of regions and sectors (often 30 – 50 sectors) that many modellers rely on specialized published databases such as the GTAP database published by Purdue University.

Unfortunately, most of this data – much of it not trade data – is unavailable for a majority of the PICs. The latest version of the GTAP database, for example, includes all of the PICs in a residual aggregate Rest of World (ROW) category due to the lack of the detailed data needed for a SAM.

We do not consider that there are any short-term solutions to this problem (see the 'Ways Forward' section below). But we also do not believe that the Australian Government or PICs should be especially concerned about it. A detailed welfare-distribution projection is not necessary to decide whether to proceed with PACER Plus or even with regional trade liberalisation. Those decisions have already been taken in the creation of PICTA and the ratification of PACER. We do not need an economic model to tell us what the scope of the RTA should be: we can say from general principles and based on the experience (and WTO obligations) of governments involved that it should be comprehensive and without a priori exceptions. We understand that it will be important to provide for progressive implementation in accordance with the particular needs and capacities of each member country. It would be helpful to have more detailed analysis of the distribution of welfare gains and losses among PICs and among sectors in each economy based on a model. But we can plan implementation and adjustment strategies that are likely to be reasonably effective using available data sets, including the ADB model of the impacts of labour movements and data on individual sectors (infrastructure, communications, transport, revenue).

6.1.4 Some ways forward

Given the lack of data available to construct a typical GTAP-like CGE model of PACER Plus, one option would be to radically simplify the model to fit the available data and to estimate parameter values where necessary. Economic models are already simplifications; otherwise they would not be models. But the functions that describe the relationships between parameters are estimated by statistically fitting them to 'real world' outcomes (in the past). An acceptable function replicates 'real world' relationships with a high degree of reliability. But a model built on guesses about the relationship of intermediate outputs to final outputs in an economy—such as we would need to use in the case of most of the PICs—is really no more use than another guess. In fact, it's worse, from a policy perspective, because models may look as if they mean something when they don't.

In terms of useful analysis for the purposes of evaluating PACER Plus and its future quantitative and welfare impacts, we would therefore suggest the following measures:

- Further update and consolidate existing available data and mirror data based on ANZ export and import data – but this is still limited. This report has begun that process by using available data sets for example from USP, ADB and other sources.
- In each PIC, invest in partnership between a local economist/statistician and a major economics firm/practitioner in Australia or New Zealand, to develop the most accurate data available for purposes of modelling the impact of PACER.
- Put in place a long-term effort to build at least basic input-output tables for all the PICs and to collect or reliably estimate the other data needed for a Social Accounting Matrix. This is a major project that could consume several dozens of person-years of work (a firm estimate of the time required is beyond the scope of this project).
- Invest in building the long-term capacity of individual PICs to more accurately record and analyse economic and trade data by the time PACER Plus comes into full effect. We are aware from PFTAC country notes that existing statistical advisors in several PICs have already started on, or established, some long-term work toward better data. It would make sense to accelerate/expand this work in order to build the database necessary for region-wide modelling of welfare impacts. This option would have the added advantage of investing-in and building the long-term capacity of individual PICs to more accurately record and analyse economic and trade data by the time PACER comes into full effect.

6.2 Trade diversion

The effect of the discriminatory tariff cut can be to make the 'invisible hand' of an efficient market point in the wrong direction.

Consumers inside an RTA may prefer the products of producer in an RTA partner country to those of a more efficient (lower-cost) producer from a country outside the RTA because, as a consequence of discriminatory tariff reductions, the products from the less-efficient producer in the RTA partner country have a *lower duty-paid price.*

Thanks to trade diversion, the preference-granting country ends up paying more for imports than it would have had it made the same tariff cuts on a non-discriminatory basis. Part of this extra cost is a simple transfer from taxpayers in the importing partner to producers in the exporting partner financed by monies that had initially accrued to the government as tariff revenue. But the diversion also wastes real, as opposed to financial, resources because the real cost of imports has risen (the partner is less efficient than non-partner producers). If trade diversion predominates across the board, an RTA can reduce the welfare of *all* partners.

Viner's concept—that the benefits of an RTA could be estimated as a balance between trade expansion and trade diversion effects—endures as the appropriate measure of the impact of particular RTAs (one of his insights is that no *a priori* conclusion can be drawn about the benefits of RTAs in general). Ultimately, however, the *Vinerian* calculus is very difficult because it depends on a comparison—between trade flows and a *counterfactual* in which no RTA is in place—that is often difficult to defend.

Recent developments in the theoretical understanding of regional trade liberalisation (Ohyama, 2004) demonstrate that trade diversion is not an intractable problem for free-trade areas. In principle, even an incomplete regional trade agreement with only partial trade coverage can be welfare enhancing for participants and for the rest of the world under two conditions. The first is that the volume of trade with extra-regional partners is not adversely affected by raising duties on their exports and the second is that there should be a mechanism for compensating terms-of-trade losses within the region ('winners' compensate 'losers').

Most *post-facto* economic evaluation of RTAs suggests that trade diversion effects have indeed been offset by accompanying reductions in barriers (unilateral and multilateral) to trading partners *outside* the RTA (Schiff and Winters, 2003). PACER is likely to be no different. The simultaneous liberalisation required over the period 2009 to 2023 from PACER, the EPA and multilateral trade liberalisation in the WTO, added to the active FTA programs of ANZ, suggests that the trade diversion impacts of PACER in the PIC-ANZ region will be small because barriers to imports from trading partners outside the region will be falling at the same time.

There may still be a danger of some trade diversion costs for the PICs because not all PICs are members of WTO and even those that *are* members will likely fall beneath the thresholds of most of the market liberalisation obligations that could be imposed upon conclusion of the Doha Round. In order to avoid trade diversion costs, those economies may have to implement some of the PACER cuts on a multilateral basis. But since they will be cutting tariffs with a trading partner (ANZ) responsible for the largest share of their imports, cutting MFN tariffs at the same time may have little or no impact on actual protection.

6.2.1 The way forward

Because it is impossible adequately (or robustly) to evaluate the trade-diversion costs of an RTA *a priori*, the most sensible course is to take steps likely to avoid the problem in the first place, as part of the construction of the RTA. The most effective measure (and the simplest to implement) is to cut duties and services barriers on an MFN basis at the same time as the RTA is implemented. This means limiting the margin of preference, but not necessarily eliminating it. *Some* reduction in external barriers will tend to have *some* impact on any trade diversion. Given their already low MFN barriers and active RTA programs, it is unlikely that ANZ will need to do much more than they are already doing to cut third-party barriers. The PICs, however, may need to consider a 'staggered' schedule of trade liberalisation in which some proportion of the preferential cuts in favour of ANZ are subsequently offered on an MFN basis, or possibly on a discriminatory basis to other important trading partners.

6.3 Rules of origin (ROO)

The purpose of ROO in a discriminatory trade agreement is to prevent 'leakage' of the benefits to non-members. But, in practice, FTA members frequently use ROO to moderate the impact of liberalisation on 'sensitive' sectors. Since there are no WTO rules on preferential ROO, the actual rules adopted differ among RTAs *and* among the parties to an RTA. Even where the overall form of ROO is the same throughout the *region*, it is not uncommon to find that each party has different specifications or additions for its own sensitive products.

The biggest challenge in the design of ROO is to keep them as simple as possible so that exporters are not *dissuaded* by the costs of ROO compliance from taking advantage of preferential access. This is especially important where - as in the case of PACER - one party to the agreement has a much smaller market than the other and the smaller party has a significant import *dependence* on the larger.

ROO can threaten a double disadvantage to a smaller party in an FTA if:

- the larger party's ROO raises the costs of export to the larger market, robbing the preference of some of its value.
- the smaller party's own ROO raises the costs of imports dissuading exporters in the larger market from seeking preferential access to the smaller market because they can continue to sell over the MFN duty into the smaller market (where the price elasticity of demand for imports is low). Since the importer pays a higher tariff, the result is both a transfer from consumers to the government of the smaller party and a reduction in the quantity of imports consumed: a two-part loss of consumer welfare.

It might be thought that a profit-maximizing exporter would always seek preferential access if it were available. But exporters have to balance the costs of compliance (perhaps including special product composition or additional value-adding processes) against the benefits. Where the export market is small the calculation is less likely to favour compliance with the ROO.

ROO have proved to be the main point of friction in the operations of SPARTECA, despite a number of concessions from ANZ. In PIC products such as tuna, horticulture and even textiles, the combination of SPARTECA ROO and low margins of preference relative to MFN rates (which are themselves low) have not allowed PIC products to make much headway in the ANZ market.

6.3.1 The way forward

ANZ and PIC governments should undertake a preliminary examination of a simple CTH ROO supplemented where necessary by product-specific provisions. Although CTH is in principle simpler than other methods of determining 'substantial transformation', it requires a minimum degree of documentation and classification of imported components. The less restrictive the CTH the more detailed this classification has to be. ANZ should be ready to work through the implications of CTH with the smaller PICs.

If ANZ agree an FTA with ASEAN and Australia also concludes FTAs with Japan and China in the next 5 years, ANZ should consider progressively *removing* preferential ROO from their own PACER Plus schedules or conferring origin on *any* level of regional value-added.

6.4 Trade facilitation

The main barriers to import and export trade in the Pacific are distance, the availability and quality of transport including local transport, the administration of border transactions and the cost and quality of communications. We note that, without exception, the PICs are sliding *down* the World Bank's 'Doing Business' rankings.

Table 12: *PIC 'Ease of Doing Business' ranking, 2007 (lower is better)*

2007 Rank	2006 Rank	Country
2	1	**New Zealand**
8	9	**Australia**
31	29	**Fiji**
41	36	**Samoa**
51	46	**Tonga**
57	53	**Papua New Guinea**
58	54	**Vanuatu**
60	58	**Kiribati**
62	57	**Palau**
69	61	**Solomon Islands**
87	86	**Marshall Islands**
106	105	**Micronesia**

Source: World Bank

Cooperation on trade facilitation, and possibly the opening of markets for commercial services, is the most appropriate way to address these problems on a region-wide basis. Accordingly, PACER Part 3 provides for a work program on trade facilitation that would be defined in the South Pacific Forum, managed by the Forum Secretariat and funded in part by ANZ. It could prove to be the most valuable part of the PACER program from the perspective of bringing about closer integration of the PICs with the regional and global economy.

The Nathan 'Baseline Report' (Nathan, 2007) claims - but does not elaborate - that the focus of the WTO (Doha Round) debates on trade facilitation and the World Bank's *Doing Business* reports are not very relevant to PICs needs. We agree that the diversity, isolation and small size of many of the PICs strongly suggests that a tailor-made trade facilitation program for each PIC will be needed within some region-wide cooperative framework. Also, some factors related to the Melanesian/Polynesian culture, such as communal land ownership, although inconsistent with the standard capitalist business model, cannot be 'facilitated' away. Nevertheless, we see no reason why the standard metrics of facilitation - especially regulatory and administrative burdens and costs due to inadequate or poorly managed infrastructure - should not be employed in the design of the PACER Plus trade facilitation program.

PACER itself does not give any guidance on the content of a trade facilitation program. It is not difficult, however, to identify the main areas of need which we believe should come under prime consideration:

- Administration of borders and ports, including documentation;
- Fiscal administration;
- Public service efficiency;
- Land transport and ports infrastructure and management;
- Communications infrastructure and management.

6.5 SPS and TBT standards

The dual challenge in the implementation of a PACER Plus chapter on standards in trade is to provide both for appropriate liberalisation of ANZ and PIC barriers where possible and to ensure that the PICs acquire the technical capacity to improve their own SPS/TBT administration. The two are linked, especially in the case of SPS where the liberalisation of import barriers in ANZ will depend to some extent on more secure SPS administration in the PICs (especially where food or agricultural items enter ANZ under relaxed ROO).

The purpose of the SPS and TBT frameworks is to permit (exceptionally) the use of trade barriers to maintain the integrity of reasonable standards in the domestic market. But they do not require that states develop their *own* standards. In the case of SPS standards, for example, each WTO member should determine for itself its ‘appropriate level of protection’ (ALOP) that sets the degree of import risk that it will accept. But the standards that are developed to give effect to that ALOP - if different from the international standard - need not be developed nationally. They may be ‘imported’ from scientific work done elsewhere and given effect by appropriate measures including import restrictions.

6.5.1 SPS standards

SPS standards are likely to be more significant for the expansion of regional trade because the PICs have comparative advantage in the production of some agricultural exports including tropical fibre and forestry products, horticulture, fish and fish products, and livestock products.

One desirable consequence of the PACER Plus regional agreement might be the adoption, as far as possible, of a region-wide set of standards (especially for SPS) that could be adapted, as necessary, to fit within the ALOP of each PACER member. A precedent exists for such a regional standards body in FSANZ: Food Standards Australia-New Zealand, the Trans-Tasman food standards authority. FSANZ is an independent statutory agency established, in Australia, by the Food Standards Australia New Zealand Act 1991. It develops food standards, and joint codes of practice with industry, covering the content and labelling of food sold in Australia and New Zealand. Consideration could be given to extending the membership of FSANZ to the PICs.

Unfortunately, the FSANZ standards do not cover some of the most troubling aspects of standards administration including ANZ quarantine. The two governments have not adopted the same set of FSANZ standards covering food safety (Chapter 3 of the Food Safety Code). This is chiefly because this chapter covers standards for primary production and minimum residue levels of compounds in food products where each side insists that its own production conditions demand different standards. Inevitably this leads to conflicts that seem avoidable (such as the dispute over imports of NZ Apples into Australia).

Existing ANZ FTA agreements contain provisions on quarantine (e.g. Chapter 6 of TAFTA) that may not be directly applicable to the future PACER. They are predicated on a significant existing SPS administrative capacity in each of the partners, providing the foundations for a ‘joint Council’ on quarantine that in turn acts as the conduit for cooperation on matters such as mutual recognition and ‘regionalization’. In the case of the smaller PICs (especially) an arrangement will be needed that will assist with:

- The creation of PIC capacity for the development of SPS policy and administration of quarantine, and;
- Arrangement by the PACER partners to delegate standards development to some region-wide cooperative body (such as an extended FSANZ).

PNG and Fiji, however, already have an SPS policy and quarantine administration capacity and may be in a position to advance to early membership in a regional standards-settting body.

6.6 Overall impact on poverty reduction

As Prasad (2008) notes, the deficiencies in trade data for the PICs at the 6-digit level of the HS make it impossible to estimate distribution of the economic impacts of the proposed PACER Plus among Members. This, in turn, defeats any detailed estimate of poverty reduction due to trade liberalisation under PACER Plus – this requires further study - but it is possible to examine which aspects of PACER Plus might be able to assist PIC governments in achieving poverty reduction objectives.

PICs are not usually considered to have problems with *extreme* poverty. A 2004 survey of Millennium Development Goals by the South Pacific Commission for the ADB (ADB 2005) concluded, however, that hardship is widespread, with at least 20% of households studied in 12 of 13 PICs studied suffering from basic needs poverty (defined as the inability to meet the cost of food and other basic needs and essential services from current cash income). The regional average was 28.5% of households surveyed. AusAID's Pacific Economic Survey (AusAID, 2008) includes recent figures and suggests that many PICs are off-track in meeting the MDGs with some of the poorest countries – PNG and the Solomon Islands – having the 'highest mountains to climb'.

International trade, when coupled with domestic reform and sound macroeconomic policies, can be a powerful engine in promoting sustained economic growth, employment opportunities and poverty reduction (Dollar and Kray, 2001). Surveys and some actual performance have demonstrated the complexity but *reproducibility* of the link, with the agriculture sector playing a key role in a number of developing countries that have achieved impressive economic growth rates and substantial reductions in poverty. (Winters, 2000; Winters and Hertel, 2005).[30]

6.6.1 Agriculture and poverty reduction

Chand (2006), among others (CIE, ADB), points out that the challenges faced by the PICs in the management of their economies do not stem primarily from their size or isolation (although both factors are important in some of the PICs). Rather, the problems are connected with a failure of governance that has allowed substantial fisheries, manpower and land resources in a number (not all) of the PICs to remain idle; short of investment, short of training, short of economic incentives in a market kept small by policy instability, poor contract enforcement and, in several cases, deteriorating law and order.

Agricultural production, especially, holds the key in many economies to the transmission of the benefits of trade-led growth to the poorer households. Although agriculture now contributes less than 30% of GDP in all of the PICs save Solomon Islands and PNG - and is below 20% of output in the majority of PICs[31] - it is still likely to account for half, or more of all household incomes.[32]

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[30] Vietnam is a regional example of a country that has combined the three elements of border barrier liberalisation, sound macro policies and domestic policy reforms that give appropriate priority to poverty development. The results measured by the fall in poverty levels have been outstanding: poverty levels of $1 income per day (PPP) have been cut from 50% to below 10% of the population in little over a decade. See the Joint Donor Report entitled "Aiming High" (December, 2006) available from the Vietnam Development Information Center (www.vdic.org.vn), to which AUSAID subscribed.

[31] ADB Key Indicators 2007 (www.adb.org/statistics)

[32] Estimates of the proportion of the population employed in agriculture vary. Duncan and Reddy (2006) say that it ranges from 26% in Micronesia to 74% in PNG but do not cite their source for this estimate.

Table 13: *Share of Agriculture in GDP*

	1990	2000	2006
Cook Is.	**21.2**	**13.4**	**12.8**
Fiji	22.2	17.0	14.3
Kiribati	15.6	6.1	6.0
Marshall Is.	45.5	…	…
Micronesia	…	…	…
Nauru	15.6	6.0	7.0
Palau	8.1	3.9	3.1
PNG	29.0	31.7	34.6
Samoa	23.0	16.8	11.4
Solomon Is.	49.6	44.2	…
Tonga	29.8	25.8	32.2
Tuvalu	34.7	29.7	25.9
Vanuatu	25.6	18.0	16.6
Cook Is.	20.7	15.6	13.8

Source: ADB

Real agricultural production overall, and crop production especially, has not increased since the 1980s in the majority of the PICs. The livestock sector has seen some growth in many of the PICs but the trend has been very modest, apart from Kiribati and PNG (Reddy and Duncan, 2006). This disappointing result means that the real value of *per capita* agricultural production has *fallen* in all of the PICs for which data is available since the 1960s, even in Samoa and Tonga where population growth has been held low by emigration.

There is evidence from Fiji, PNG and Samoa (Nathan, 2007) that communal landowners can unblock some of the non-market impediments to more efficient agricultural production. Capital and training for an expansion of agricultural production depends, however, on profitable outlets. A survey by Reddy and Duncan (2006) analysis shows that in most of the PICs, although production in the crop and livestock sector has increased, production *per capita* has fallen. Estimates of the total factor productivity in agriculture reveal little gain over the past four decades. In fact, economic efficiency has declined in all countries considered in the study.

Accounting for the inefficiency of the PICs agriculture sectors, Reddy and Duncan point to:

- Misallocation of resources due to input and output subsidies and fixed exchange rates;
- Uncertainty about prices or agricultural policies including land-tenure policies;
- Remittances from workers abroad, that raise household incomes (consumption) without adding to the stock of agricultural capital and that raise the opportunity cost of agricultural labour (by creating more valuable labour opportunities).

The PACER Plus agreement can help to address some of these factors; especially by reducing price distortions due to the high level of protection for some agricultural products produced in many of the PICs (see above). But import protection - and the impact of rents from preferential trade access to the EC market for sugar - are only one part of the complex of factors affecting productivity in PIC agriculture.

The potentially adverse impacts of remittances on the supply-side of agricultural production in the PICs needs further research. However it must be taken into account when considering the overall impact of the PACER Plus agreement on the future structure and growth of the PICs' agricultural sectors and economies.

What this means for poverty cannot be easily determined (the data for a CGE model may not be available). Although remittances increase the price of agricultural labour and may flow to consumption rather than into farm investment they nevertheless add to household income and so cut poverty rates. The question is whether this boost to incomes is achieved by more efficient use of resources through trade in labour services or represents only a short term increase in incomes that will be eroded by the exchange impact of the remittances (that will reduce their value in local currencies) and by inflation. It depends on many of the issues raised earlier in the section on employment and labour mobility and the ancillary measures that might accompany trade in labour services.

From a technical point of view, agricultural production could be sustained with lower labour inputs if prices warranted it. But achieving economic efficiency - that is, productivity improvements due to cuts in the labour inputs - depends crucially on avoiding distortions of both input and output prices (low effective rates of protection). Here, PACER Plus could help to ensure that prices reflect import-parity.

We should also reiterate the success stories of agricultural production in various PICs. As mentioned earlier in this report, there are exemplary success stories in the Pacific such as with Fiji Water or Mahen Export. These firms to date, have managed to overcome either transport or quarantine barriers, to prove the point that with appropriate technical assistance for example to meet Australian SPS requirements and through private-public sector cooperation and capacity building, both of which PACER Plus can facilitate, then a more productive export oriented agricultural sector is possible.

6.6.2 Services and poverty reduction

Other recent studies highlight the increasing significant role that services liberalisation can play in poverty reduction if underpinned by appropriate regulative measures. [33]

There is significant potential for Pacific Island economies to gain from services trade and investment liberalisation, and in the process for low income households to gain as well. There are particular benefits from the introduction of foreign investment in these services into these economies, including for poor households. It adds to capacity, lowers domestic prices and creates new services. Poor households gain as consumers of these services, and some research suggests the income effects for those households are more significant than for the average (for example, access to Information and Communication Technologies)[34]. Poor households also gain indirectly as services reform adds to the productivity in other sectors, reducing the costs of intermediate inputs which raise their income. The impact of reform on the transport and logistics sectors is one example of these sorts of effects. Poor households may also gain through the labour market effects of reform, which lead to higher output and additional demand for labour.

These effects refer to the impact of reform in the home country, however reform in export markets also matters, particularly for people movement. The potential for gains from these forms of services transactions can be large for the labour exporting countries.

Transactions in other modes offer access to new lower cost services to households as consumers, or provide complementary inputs adding to productivity in various service sectors which poor households consume directly or indirectly. The growth of outsourcing is one

[33] Recent studies include the Pacific Forum Island study on 'Impact of PICTA for Smaller Forum Island Countries' and the soon to be published IIT book on 'Trade and Poverty Reduction in the Asia Pacific region' which includes specific sections on implications for PICs

[34] See Abrenica, Findlay and Lim, 'Trade in Services and Poverty Reduction' also in the soon to be published IIT book on "Trade and Poverty Reduction in the Asia Pacific region"

example of this mode of doing business, which can add further to the demand for labour in PICs. The skill orientation of that labour demand and the implications for poor households is a topic for further research.

Poor households can gain therefore from services trade and investment liberalisation which occurs both in their home countries, in the region as well as in the rest of the world. However, there are significant challenges in the implementation of reform. PACER Plus can play its 'stepping stone' role by both encouraging and supporting PICs to progressively embrace services and investment liberalisation which can assist in poverty reduction outcomes.

6.6.3 The way forward

By ambitiously locking in the necessary economic and trade reform , the building blocks can be established for future investment in agricultural productivity and diversification, fishers and fisheries, in niche manufacturing and in a range of services exports including tourism, ICT industries, education and health services, and off-shore financial services.

However Australian and New Zealand need to recognise the challenges facing PICs and work together through PACER Plus to try and ensure that sufficient market access for example for unskilled labour, as well as adequate time and capacity-building support is given to SVEs for them to adjust and consolidate domestic reforms that can lead to economic growth and poverty reduction outcomes.

Our key recommendation at this early stage however, is that further research on the most effective ways in which PACER Plus as a trade agreement can best contribute to long-term poverty reduction of PICs with particular attention to the interaction between services liberalisation, the role of remittances and agricultural productivity.

This report has not been able to consider the implications of protecting traditional knowledge, cultural expressions and folklore nor for that matter the potential use of geographical indicators in the Pacific all of which might possibly assist in poverty reduction - but these issues were raised by more than a few of those consulted in the region. We would therefore also suggest the further work be considered in this area perhaps as part of a broader report on the implications of PACER Plus for poverty reduction as suggested above.

6.7 Building community support

Based on the short but quite intensive phase of consultations undertaken, we identified strong negative reactions to the outcomes of the EPA negotiations and therefore the need for quite specific action to encourage more open and accurate debate about the benefits and costs of a free trade agreement and closer economic integration with Australia and New Zealand. Appendices D, E and F document the concerns and suggestions for a much stronger public and private sector campaign to promote more active and accurate debate and have led us to put forward the following suggestions for ways forward.

6.7.1 Ways Forward

Because of the negative public perception associated with the EPA negotiations, it is recommended that Australia invest in private and public consultation, education and media outreach, building on the work and feedback that has come out of these initial consultations. This consultative strategy could be divided into three specific but complementary areas:

- as previously mentioned in the section of this report on engaging the private sector, Australia could assist in the development of consultations and workshops organised jointly with the Pacific Island Private Sector Organisation (PIPSO) throughout the

Pacific on PACER Plus which has both an educative component and an investigatory component with respect to their capacity and current barriers to trade that they face.

- Funding for each PIC for a media outreach and public consultation process with respect to the benefits and challenges of PACER Plus.
- A collaborative and regionally organised 'series of sensitising events' which extol the benefits but deal with the challenges of PACER Plus; to include trade fairs and joint media events, and promote meetings with private sector delegations and the show-casing of specific success stories.

Australia might also encourage or assist in the formation of a 'Private Sector-Government Ad Hoc Working Committee' to work together on PACER Plus preparations and negotiations.

Finally, Australia could work to increase the awareness of PACER Plus and the benefits of trade reform across government departments with in-country workshops as well as training exercises in ANZ so as to build the negotiating capacity and skill development of current and future trade negotiators.

7. Conclusion

A PACER Plus agreement with the scope discussed in this report would more deeply integrate the economies of ANZ and the PICs while transforming aspects of the economies of each member country; more deeply in the case of the smaller PICs economies than in ANZ, but all of the economies of the region to some extent. Two factors, especially, will make this agreement the most challenging regional trade agreement Australia has undertaken to date.

First, the prospect of such a profound change for the PICs prompts hopes, fears and some suspicions about motives and the distribution of economic gains. Meeting expectations and helping the PICs through capacity building support to engage in the negotiations and implement the agreement as full partners will be challenging and will take time, as our recommendations on the schedule for the negotiations imply.

The second factor that brings a unique degree of difficulty to this project is the proposed inclusion, of a provision on the movement of (possibly) large numbers of unskilled or partly-skilled labour. This provision alone will change the economic landscape throughout the region. In our view, a GATS-compliant regional trade agreement framework is needed in order to secure a legally-sustainable arrangement that will be limited to the PICS-ANZ region. But a trade agreement is not a sufficient framework for managing this change (immigration, labour-market cooperation, social security cooperation aspects must be addressed) and in some respects introduces additional difficulties (trade-classification questions, trade-reciprocity considerations). It is important that the labour-mobility chapter of PACER Plus be carefully planned and that ANZ and PICS expectations be clearly delineated in order to avoid later complications. It is also important that the labour mobility chapter in the agreement be complemented with provisions on related domestic policies (immigration, social security, workforce integration and re-integration).

We can say that the net boost to the growth and efficiency of PIC economies (on top of PICTA and the EPA) is likely to be substantial but, because we lack the data for a full economic evaluation, we cannot accurately estimate how the gains will be distributed nor where the major economic losses will occur. We should, however, anticipate terms-of-trade losses and significant adjustment pressures as the PICs implement the agreements. ANZ must be ready to share the gains that they will make for example from the temporary movement of PICs labour, not as 'compensation' but in the form of aid-for-trade adjustment assistance.

The depth of integration of the sixteen economies will be moderated by the small size and isolation of the PIC economies. Integration under PACER Plus will, however, be helped by the concurrent implementation of the PICTA and EPA agreements that it complements and extends rather than 'overrides'. But the PACER Plus framework, as we have described it, has the breadth and ambition to anchor the economic platform of regional growth and economic development in the Pacific – if it is pursued as a joint enterprise among the PICs and ANZ and especially if it includes labour market access for unskilled labour. Our strongest single recommendation would be that ANZ take the time to prepare both themselves and the PICs to meet the challenge of constructing this new framework of regional integration.

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9. Appendix A: List of those Consulted

1. Pacific General and Fiji

Pacific Island Forum Secretariat - Peter Forau

Fiji – Australia Business Council – Caz Tebbutt

Fiji Private Sector/ Pacific Island Private Sector Organisation (PIPSO) **-** Desmond White and Francis Hong-Tiy

Academics/Key Figures– ex-Minister Kaliopate Tavola , Wadan Narsey, Mahendra Reddy and Ron Duncan

Reserve Bank of Fiji - Jitendara Singh, Senior Economist and team

Pacific Financial and Technical Assistance Commission (PFTAC) - Carson McNeil, Tax Policy Adviser and Susan Adams

UNESCAP - David Smith, Regional Economic Adviser and Siliga Kofe

UNPD - Mr. David Abbott – Project Mgr (MDG & Poverty Alleviation) & Mr. Jeff Liew – Sustainable Livelihood Specialist

FIRCA – Fiji Revenue and Customs Authority - Mr. Jitoko Tikolevu-CEO, Mr Jalal Ud Dean, Mr. Rishi Deo, Mr Jagat Narayan and Mr Fazrul Rahman

2. Melanesian and Micronesian Group

MSG – **Melanesian Spearhead Group**, Chairperson and Deputy Chair (Names from Nik)

PNG – PNG Manufacturers - Wayne Golding and Arun Shah, Chairman

Solomon Islands – Ministry of Foreign Affairs, Sam Hetherington, Trade Policy Analyst and the Director of the **S.I. Business Council**, Peter Tam

Marshall Islands - Minister for Resources and Development, Fred Muller and **Trade and Investment Services Division,** Iva Reimers-Roberto

Kiribati - Minister for Trade, Hon M Tofinga

Nauru – Nauru Small Business Association - Lockley Denuga

3. Polynesian consultations

Tonga - Minister of Labour, Commerce & Industry, Hon.Lisiate 'Akolo, recently appointed as the Pacific's Alternate Lead Spokesperson for the PACER Plus negotiations and CEO of the Department and chief trade negotiator, Mr Paulo Kautoke

Samoa - Pacific Trade Consult - Margaret Malua

PIPSO - Henry Sando and Grant Percival

<u>4. Australia</u>

DFAT – David Ritchie, Deputy Secretary, John Quinn and Claus Dimberger

AusAID – Chakriya Bowman, Trade Policy Advisor

International Finance Corporation, Pacific Enterprise Development Facility, Robert Sims

PIPSO – Frank Muller, General Manager, New Pacific Co Ltd

Coconut International Pty Ltd - Karen Straatmans (not yet)

Virgin Blue International Airlines - Karam Chand

<u>5. New Zealand</u>

MFAT – Belinda Brown and Joanna Kempkers

NZ Pacific Business Council – Gilbert Ullrich

Pacific Trade Consult – Heather Baijent

April 2008

10. Appendix B: PACER Plus List of Potential Benefits And Issues

RESEARCH STUDY ON PACER PLUS

List of Potential Benefits and Issues

The following lists have been developed by the research team at the Institute for International Trade in Adelaide, in liaison with the University of the South Pacific and the Trade Policy Institute in Vanuatu. It is intended purely as an initial attempt to outline what are expected to be some of the key benefits and challenges for the future negotiation and development of a PACER Plus agreement. These lists are to form the basis of preliminary consultations with a small, select group of public and private sector leaders and officials from Forum Island Countries as well as from Australia and New Zealand. On the basis of these consultations and further research the Institute for International Trade will complete a report to the Australian Government by the end of May 2008 with recommendations on how best to move forward on PACER Plus. The report will also identify those areas requiring further consultation and more detailed research over the next two years.

A. Potential Benefits of PACER Plus for the Pacific

Goods

1. Cheaper imports from Australia and New Zealand (ANZ) for Forum Island Countries (PICs);
2. Aggregate demand and consumer welfare benefits of cheaper imports, particularly for food items and essential goods;
3. More flexible rules of origin for Pacific exports to ANZ;
4. Reduced trade diversion costs of the EPA with the EC;
5. Some special and differential treatment/flexibility in the phasing in and timing of tariff reduction schedules;
6. Increased collaboration and assistance in trade facilitation and customs reform. The existing PACER agreement provides for trade facilitation measures (A$2.5 million over five years for Regional Trade Facilitation Program) including the streamlining of customs procedures, quarantine regulations and standards and conformance - to make trading with Forum Island Countries easier and to assist in economic development. PACER Plus will see a separate comprehensive package of assistance negotiated for trade facilitation and structural adjustment costs;
7. Greater harmonisation of SPS and TBT standards, and capacity building (in-country quarantine assistance), and customs procedures (in particular implementation of the 2007 Harmonized System) with attendant capacity building;
8. Pooling of resources to deal with intellectual property issues (such as counterfeiting in PNG);
9. Increased transparency and efficiencies in customs and business transactions;
10. PACER ensures that individual PICs maintain their existing level of market access in Australia and New Zealand, even if other PICs negotiate new arrangements with Australia and New Zealand.

Investment and Services

1. Increased ANZ investment, job creation, improving skills of the workforce for PICs;
2. Increased competition as a result of services liberalisation with potentially increased efficiencies and lower cost services in key economic infrastructure industries;
3. Potentially more efficient financial institutions and financial markets;
4. Improved and expanded temporary labour market opportunities leading to higher levels of employment and remittances (two way labour market liberalisation);
5. Increase in education and training opportunities through capacity building, greater access to education markets of ANZ, increase in joint-facilities and greater competition in the provision of educational services;

6. As above, but in health;
7. Increased tourism to the Pacific as a result of fewer barriers and investment in tourist facilities;
8. Increased opportunities for the Pacific to provide off-shore services for ANZ citizens (eg health services);
9. Potential benefits to the aviation and shipping sectors.

General

1. Agreement provides non-WTO PICs with same treatment as WTO members;
2. Agreement recognises the particular circumstances of individual island states and the need for an interim adjustment period as appropriate;
3. Aid and trade: Increased trade and economic capacity building programs: for trade related infrastructure, industry reform and strengthening, domestic reforms that reduce business costs for those trading in the region, and trade promotion;
4. Support for improved trade related governance, for trade negotiation services and PIC negotiation costs;
5. Increase in capacity building funds for trade related poverty reduction programs although this may be funded more through country specific Pacific Parnership agreements;
6. Support and closer collaboration on trade related environmental issues and climate change issues;
7. Technology transfer from the public and private sectors of ANZ;
8. Increased opportunity for new market innovations/entrepreneurs;
9. Improvements in policy transparency in trade and related domains, reducing the influence of sector-based groups while improving policy predictability and stability;
10. Stronger and more effective independent regulatory regimes and institutions;
11. Contributes to the establishment of the long term goal of a 'single regional market' among Forum members;
12. Heighten growth through closer economic, trade and development integration of FIC economies with Australia and New Zealand due to specialisation on a region-wide basis;
13. Greater ANZ-Pacific cooperation in other regional and multilateral fora (ASEAN, WTO);
14. Valuable stepping stone to adjust to the inevitable impact of global economic integration;
15. Inbuilt annual review mechanisms in place to regularly monitor the implementation and operation of the agreement;

B. Potential Challenges of PACER Plus for the Pacific

General

1. Loss of import tariff revenue – some PICs may lose more than 10% of total government revenue as a result of the elimination of duties on imports from ANZ;
2. Developing sustainable taxation base and other alternative revenue raising mechanisms;
3. PICs should expect ANZ to maintain stringent quarantine regimes under PACER which is one of the most significant barriers for FIC food exports to ANZ. Therefore considerable investment and resources required to improve and harmonise customs and quarantine procedures and to increase the ability in PICs to meet ANZ requirements (eg ANZ export promotion/SPS-quarantine officers in individual PICs);
4. High adjustment costs for import-competing industries;
5. Political consequences of significant restructuring of production or disappearance of industries/employment in import-competing sectors;
6. Difficulty of identifying future economic opportunities for resources formerly specialized in protected production (e.g. land) and developing dynamic comparative advantage;
7. Redirection of private investment from tradables to the non-tradables sector;
8. Opposition among private sector groups that formerly profited from trade rents to market liberalisation that threatens these rents;
9. Use of trade remedies/safe-guards by ANZ;
10. Harmonising dispute resolution mechanisms and resourcing PICs (human and financial capacities) to deal with Dispute Settlement issues;

11. In the absence of effective regulation the potential for private sector monopolies to replace local public sector monopolies (Community/Business fears of being swamped by ANZ goods and investment and SMEs unable to compete);
12. Agreeing on an approach leading to comprehensive services liberalisation eg (negative vs. positive approach in services schedules) Under ANZCERTA, Australia retains six items on its negative list, air services, broadcasting and television, third-party insurance, postal services and coastal shipping. New Zealand retains air services and coastal shipping on its negative list;
13. Community/Business fears of loss of ‘sovereignty’ and ‘policy space’ to regulate and safe-guard key domestic interests;
14. How to best engage and increase participation and support of the private business sector, for example PACER Plus is seen by some as an attempt by Australia and New Zealand to avoid the EU obtaining trade advantages, especially in regard to services and investor protection, suspicion of ANZ motives (“just in for their own interests”);
15. Architecture of the PACER Plus agreement – exceptions/sensitive areas/sequencing and timing issues (eg could a services/investment agreement be constructed as an initial first step towards the development of PACER Plus?, However there will be maximum flexibility, eg a head agreement containing provisions common to, and for immediate advantage to, all PICs (eg rules of origin, IP, general provisions, dispute settlement etc, and possibly trade remedies) and individual annexes tailor-made for each FIC – on tariff phase-out periods, services/investment liberalisation, mode 4/labour mobility, trade facilitation and other assistance needs etc);
16. Effective resourcing and technical support to PICs for the actual trade negotiation process for PACER Plus may be an issue (possibly a trade advisory office, direct resourcing of national ministries, role of the Forum Secretariat?).

Jim Redden
Institute for International Trade

May 2008

11. Appendix C: PACER Plus Questionnaire

RESEARCH STUDY ON PACER PLUS

The Institute for International Trade has been contracted by the Australian Government to undertake an overview report on PACER Plus based on desk research and an initial round of key consultations. The report will summarise the potential benefits and challenges of PACER Plus with recommendations for further research and consultations necessary to identify the most beneficial ways for PACER to successfully move forward for all parties concerned.

A draft list of potential benefits and challenges has been sent to you. The Institute would now appreciate your participation in our initial round of consultations and is particularly interested to hear your views and reactions to the list provided and your views in general on PACER Plus.

1. What do you consider to be the most important negotiating points for a Pacific Agreement on Closer Economic Relations between Pacific Island Countries, Australia and New Zealand?

2. What are the most likely potential benefits of a PACER Plus agreement for the Pacific region (and/or for your industry/sector/country)?

3. What do you see as the major challenges associated with negotiating PACER Plus?

4. What processes do you think need to be put in place to enable PACER Plus to successfully move forward? (This could include timing issues, capacity building issues, support for domestic reform considerations, how best to conduct the negotiations etc)

5. Where do you think further research or consultation is most needed to assist in successfully moving PACER Plus forward?

6. How might PACER Plus assist with or encourage domestic reform and good governance?

7. Any other comments?

Thank you again for your assistance.

May 2008

12. Appendix D: Report on Consultations in Tonga

The Hon Lisiate ‘Akolo, the Tongan Minister for Labour, Commerce and Industries, has been appointed the **Pacific Alternate Spokesperson for PACER Plus negotiations**. Consultations were held with Minister ‘Akolo, his CEO, Paulo Kautoke and other Tongan officials and community representatives on 9 and 10 May 2008. The following is a summary of the discussion on how best to effectively move forward on PACER Plus negotiations.

Framework/Timeframe issues

Receptive to the idea of a PACER Plus ‘umbrella agreement’ with PICs as a region followed by specific annexes for each individual FIC, especially if this included more tailored capacity building commitments for each country. For example, there may be in principle agreements on regional integration, tariff reduction targets, rules of origin and services liberalisation objectives followed by specific agreements with each FIC, for example on phasing out of tariffs (Samoa has very low tariffs already and may require much less time than other PICs), quotas for temporary labour movement etc. Lisiate would prefer more lead-way for pre-negotiation preparation and capacity building in each FIC with a small regional coordinating office in Vanuatu.

Labour mobility

Labour mobility was seen as the number one issue for PACER Plus to deal with. Access to the Australia market was seen as very important due to:

- strength of the Australian dollar;
- more diverse opportunities;
- warmer climate compared to NZ.

Pacific leaders keen to offer labour supply beyond fruit picking and agriculture into other areas such as support for manufacturing and services, particularly aged care, transport and hospitality services.

They would like to see much more emphasis on skills training for low income workers, before, during and after temporary work schemes – skills that could be harnessed at home for local development purposes.

Educational Services

There was a strong emphasis throughout consultations given to the importance of PACER Plus covering education services in relation to three areas:

- increased investment from ANZ education service providers in the Pacific including in secondary schooling, technical and vocational and in university education and training, particularly through joint-ventures and/or private-public partnerships;
- mutual recognition and where possible harmonisation of standards and qualifications;
- capacity building support from ANZ in skills development and training, particularly in areas of technical training to broaden job opportunities for younger people at home and abroad.

Building Jobs: Agriculture, Fishing and Manufacturing

Those consulted want a focus on:

- capacity building to deal with Australian quarantine requirements – SPS issues;
- support to focus on supply side constraints – much interest in how to develop and market root crop exports of cassava, taro, corn or maize into ANZ markets and how to value add using such products;
- recommendation for further research on the future operational and investment intentions of Australian and NZ companies either already operating in the Pacific or who may consider it as a result of FTA negotiations;
- qualified support for the idea of an investment liberalisation arrangement – want case-studies on success stories such as Fiji Water;
- Pacific keen to know if Australia might consider any investment or export concessional measures – pointed to SPARTECA with TCF and duty drawback arrangements;
- Want fisheries and value adding to feature in PACER but had no specific recommendation other than capacity building again.

Pacific Noodle Bowl

Recommendation for further work to be undertaken on the overlapping impact of SPARTECA, MSG, PICTA, EPA and potential PACER Plus with recommendations on how to rationalise, harmonise and move forward. eg Pacific keen that regulative requirements/international standards are not a completely different set with ANZ from those that have just been negotiated with the EU

Intellectual Property

See PACER as potentially assisting PICs to protect traditional knowledge and build capacity.

Promoting the agreement

- Pacific want funding for media and consultation processes with their constituencies especially the private sectors but also with media and NGOs – and would like to see such funding up front;
- Recommended a PIPSO-Government Ad Hoc working committee on PACER;
- To assist this committee in its formation and work IIT should recommend key consultations continue which enable us to listen to and educate the private sector;
- A ‘series of sensitising events’ was put forward to build support – including visits to Pacific countries by potential ANZ investors, vice-versa, trade promotion events, opinion pieces in major dailies, labour scheme promotional events and training for Pacific officials in both ANZ and the Pacific.

May 2008

13. Appendix E: Consultations with Melanesian and Micronesian Representatives

RMI

Reluctant to make specific comments prior to the Auckland meeting, they said they wanted to comment after. However, conversations with the Minister suggest that they do want to be actively involved as they see this as a means to move away slightly from heavy reliance on the US.

MSG Secretariat

This will depend a little on the outcome of the MSG meeting the week after next – however in general there was concern about the revenue implications and also the bad experience with the EPA. The Chairman of the MSG wanted to comment only after the MSG meeting. However, the Vanuatu support team seemed more positive about PACER in terms of the approach but did not want to repeat the EPA experience – the main concern again being revenue loss.

PNG – manufacturer council

Intend to provide written comment. But said that very worried about revenue implication without agreements on supporting projects – particularly in the area of infrastructure. These never eventuated from the original PACER apparently and resulted merely in ANZ having access to PNG and not the other way round.

The core concern was that reducing tariffs would ironically reduce competition by wiping out local firms and creating external monopolies – this was based on experience. They would prefer to build local competition first by looking at supporting factors first (regulations, infrastructure etc) in order to help companies prepare before entering into PACER.

Other comments

MFN status under EPA could effectively kill PACER for some countries as the revenue loss would be too large.

Since EPA did not include services, and post August PICTA is then the PICTA that will be the template for future EPA talks on this and also de-facto for PACER – is this true?

Lot of skepticism about ROO as it is not working as well as expected under MSG, it never worked at all under SPARTECA (so they say) and so there is doubt about how it will benefit some countries given their lack of institutional capacity.

Solomon Islands

Meetings were held with the Director of the Small Medium Enterprises Council (SMEC), Mr. Leliana Firisua, who participated in some of the EPA negotiations on behalf of SI business. I also met with the Chairman of the Solomon Islands Chamber of Commerce and Industry (SICCI), Mr Michael Hemmer. The Solomon Islands Business Council (SIBC) was shortly to have an AGM to re-elect new leadership positions and the old leadership was not willing to meet with me in their official capacity. The Chief Executive Officer of the SICCI, Mr Daniel Tuhanuku, was away at the time of my visit to Honiara but when he returns to Solomon Islands in two weeks, will be available for a teleconference.

The SICCI is the eminent body representing business in the Solomon Islands. It has around 60 members and has close relations with the Government of SI. SIBC is open to manufacturers (also called the SI Manufacturers Association) with around 30 members. SMEC has around 90 members, all small and medium enterprises which mostly cater to domestic markets. SMEC does not have a lot of influence on government decision making although has been sponsored to attend the EPA negotiations on behalf of SI businesses, by the EU.

1. **What do you consider to be the most important negotiating points for a Pacific Agreement on Closer Economic Relations between Pacific Island Countries, Australia and New Zealand?**

Both representatives expressed a lack of understanding as to the negotiations or the potential benefits for SI. They agreed with the listing attached to the Research Study questionnaire, although did not understand some of the more technical points (eg 'reduced trade diversion costs of the EPA with the EC'). Also they were not aware of the current status of market access to Australia/NZ or the tariff rates that currently apply to SI export goods or ANZ imports. They also did not know the quantity of SI exports or specifics on potential impacts. Generally speaking, although the SI has recently been through an extensive set of negotiations with respect to the EPA, private sector organisations were ill-informed on these issues.
The SMEC considered that whereas imports from ANZ may well be cheaper for wholesalers, that it could not be guaranteed that these cheaper prices would be passed on to consumers, as a result of very limited competition and the dominance of a few wholesale/importers operating in SI. This would therefore negate the benefits of any trade agreement.
Funding for capacity building of Trade Department, business representative bodies, and for individual businesses was also cited as an important feature of any PACER Plus agreement. Individual businesses, especially small and medium enterprises which are largely in the informal sector, have traditionally been left out of government assistance packages. SMEs account for 1400 jobs and SI$18 million assets and need training, assistance, mentoring and access to finance. SMEC argues that promoting SMEs will have the greatest impact on communities and expansion of the formal cash economy in SI.

2. What are the most likely potential benefits of a PACER Plus agreement for the Pacific region (and/or for your industry/sector/country)?

The PACER Plus agreement is seen to be inevitable but there was little analysis as to the benefits of the agreement itself. The SMEC considered the key benefits in the potential to get capacity building assistance for small businesses to increase trade with Australia and New Zealand. There was however little understanding of potential challenges to trade including ROO, quality of goods or quarantine issues.

The SICCI considered that enhanced labour mobility through mode 4 would be significant benefit for SI and the region more broadly (not necessarily for its members). They cited the importance of remittances and stimulating employment, especially for youth. However the SMEC argued that this would limit the ongoing development of labour resources and the maturation of the local economy. SMEC considered that instead SI should be focussing on training its locals in manufacturing, services that would generate employment, cash and trade potential for the SI economy. Nonetheless if the regional labour scheme is to go ahead, substantial funding should be allocated to ensure the workers get adequate work and cultural training.

3. What do you see as the major challenges associated with negotiating PACER Plus?

Pacific issues: The EU was considered to have 'bullied' the Pacific with their strong negotiating teams. They had more people, more expertise, and a greater strategy of what they wanted. While the EU did provide funding to the Forum Secretariat for capacity building to assist the Pacific in its negotiations, this was spent on expensive consultancies and reports which didn't go anywhere. As a result, capacity within the Forum was not supported, and neither was capacity within individual country Trade departments.

It was the view of Mr Firisua that the Trade Departments need significant assistance in determining the SI strategy on trade policy, and that any global assistance package provided by trade partners (EU, Australia or New Zealand) should be provided directly to individual countries for domestic dispersal.

It was also Mr Firisua's view that Australia and New Zealand would (and probably should) liaise with MSG directly instead of through the Forum. He considered that the Forum had demonstrated its inability to properly negotiate on behalf of the region. These broader structural issues within the Pacific will be a crucial challenge in negotiating PACER Plus. At present the Forum Sec does not have the legitimacy to do so, although there is no other Pacific-wide body able to take its place.

SI issues: The three business representative organisations communicate regularly but there is no established consultative mechanism and the SMEC argued that the Chamber often puts out its own papers without considering the views of the other two organisations; there is little coordination on these policy papers. The Chamber's Chairman agreed that it is reactive to policy issues and is demand driven in accordance with the views of its individual members.

As such the lack of coordination and consultation between the representative bodies may constitute a challenge in engaging the private sector in upcoming trade negotiations. It would be worth sponsoring a forum where an independent person or institution could facilitate a discussion between the three agencies in agreeing a position and 'way forward' on this issue.

Getting these messages heard is a further concern. The Department of Trade is understaffed, with one ODI fellow largely managing all strategy, coordination, meeting negotiation etc, with support from 1-2 other officers. The previous ODI fellow, Julie Tijaja, was very thorough in consulting with business but since she has left there has been little consultation. SICCI manages its own consultation agenda with a range of government departments. This agenda is demand-driven in accordance with individual members' issues, and at this stage has not covered trade matters to a great extent. Broad whole-of-government consultation with the private sector is essential.

4. What processes do you think need to be put in place to enable PACER Plus to successfully move forward? (This could include timing issues, capacity building issues, support for domestic reform considerations, how best to conduct the negotiations etc)

There was fairly limited consultation between government and business sector on the EPA negotiations. Mr Firisua, attended some EPA meetings held by the Forum in the latter part of 2007, although he considered that Trade was not prepared on the SI position in the negotiations. He also considered that the Forum Secretariat was not helpful, and that many detailed research reports were prepared that were either overly technical, missed the point, or were ignored. He said that information should be conveyed to people using easy, understandable language. Also Mr Firisua wondered why he had been invited to the negotiations at the 11th hour when the agreement framework and strategy was already nailed down, and when there was limited scope for change and input.

These lessons learned should be heeded in the PACER Plus negotiations – capacity building is essential, sequencing of SI strategy (first consultation, then information gathering, consultation again, strategy development, then discussions at a regional level), and consultation with the private sector at all steps of the way. Regional discussions should be informed by relevant information for countries. The head negotiator should be strong and authoritative.

5. Where do you think further research or consultation is most needed to assist in successfully moving PACER Plus forward?

First and foremost direct assistance to individual Trade Departments. Consultation with private sector at all stages is also crucial. The Integrated Framework initiative has the potential to help on this matter, and it should be supported at all levels. More studies to provide a clear picture of the possible gains/losses and opportunities for reform and growth, and assistance (again likely to be provided through the IF) to develop an agreed SI strategy document.

14. Appendix F: Consultations with the Pacific Island Forum Secretariat, Multilateral Organisations in The Pacific and Fijian Private and Public Sector Representatives

CONSULTATIONS WITH THE PACIFIC ISLAND FORUM SECRETARIAT, MULTILATERAL ORGANISATIONS IN THE PACIFIC AND FIJIAN PRIVATE AND PUBLIC SECTOR REPRESENTATIVES

UNESCAP

- There is a perception that Australia produces basically similar goods to the Pacific Island Countries (PICs), therefore, they are not very concerned about trading with the PICs.
- Australia is very protective particularly of its Agricultural sector.
- The PACER-Plus agreement should be negotiated in such a way that it generates increased benefits to all the relevant parties.
- There should be a trade adjustment fund provided by Australia and New Zealand to the PICs to help them absorb the costs of trade liberalisation.
- More trade by the PICs will generate more economic growth in these countries, which will then help to generate good governance.
- Agricultural production in the PICs can be sustainable if it is for export purposes.
- One of the potential benefits of the PACER-Plus agreement is that it can lead to infrastructure development in the PICs, which would increase the productivity of their Agricultural Sector.
- Trade liberalisation can also assist PICs to initiate the economic reforms that are long overdue.

UNDP

- One of the perceived potential costs of the PACER-Plus agreement is the revenue loss which would be encountered by the PICs.
- However, the PICs can get around this problem by imposing some form of consumption tax, such as, VAT or GST. There is a lesser chance of tax evasion when it comes to consumption tax.
- Another cost of this agreement is the cost of complying with Australia and New Zealand's quarantine regulations. The PICs would need technical assistance to address this cost.
- One of the potential benefits of this agreement will be that it will force the PICs Governments to have a hard look at their tax and tariff policies.
- Another benefit of this agreement would be that it can promote temporary labour mobility of Pacific Islanders. However, this can lead to able-bodied people from the Pacific moving off-shore, thus creating labour shortages in the Pacific.
- The private sector also needs to be engaged during the negotiations of this agreement.
- The PACER agreement could be used as a means of utilising the vacant land in the PICs.
- There should be a sensitisation of events by the leaders in the PICs.
- The PACER agreement should be considerate of the development needs of the PICs.

IMF/PFTAC

- Opening up trade forces a lot of dialogue across a broad range of services including intellectual exchanges.
- Trade liberalisation picks up the professionalism of the Customs Departments of the countries concerned.
- Fiji has a huge potential to export tourism and education services. Fiji could offer qualifications that are accredited by other established institutions around the world.
- There needs to be some liberalisation in investment to get some competition in the domestic economies of the PICs.

Wadan Narsey (USP)

- The PACER-Plus agreement could kill off about three quarters of all the domestic manufacturers in the PICs. Hence, there are significant costs as far as trade liberalisation is concerned.
- The PICs need considerable upfront help from Australia and New Zealand before the PACER-Plus agreement comes into force.
- Throughout the Pacific, we have a lag in technical capacity on all sorts of fronts. We need help from Australia and New Zealand to overcome these lags.

FIRCA - Fiji Islands Revenue and Customs Authority

- An in-house study on EPA showed that the loss of revenue to the Fiji government would be around \$19million. This figure was low because of the negative list decided on by Fiji and the European Union. Amongst other things, this negative list included motor vehicles and tobacco.
- At the moment, there is an in-house committee analysing the potential costs and benefits of a PACER-Plus agreement.
- The PACER-Plus agreement could be used to develop their marine resources.
- The PICs could promote investment liberalisation using this PACER-Plus agreement.
- The PACER-Plus agreement could also be used to develop the PICs trade in services which does not rely on natural resources.

RBF – Reserve Bank of Fiji

- The preferences that will be given to the PICs under this agreement will also have to be given to the Asian countries under the MFN principle of WTO. This has the possibility of eroding the preferences that the PICs will receive from Australia and New Zealand.
- Maybe the starting point should be a Customs Union, which would lead to the harmonization of tariffs and quotas between the PICs and Australia and New Zealand.
- Dispute settlement should also be part of this PACER-Plus agreement.
- We should also include the MFN clause within the PACER-Plus agreement.
- The rules of origin and the derogation of the rules of origin could be offered a bit favourably to the PICs.
- It would be a real challenge for the PICs to sustain the competitive edge in the Australian economy.
- Trade liberalisation will force manufacturers within the PICs to be more efficient in order to survive in their individual industries.

Peter Forau (Pacific Islands Forum Secretariat)

- There are a lot of differing views as to what a PACER-Plus agreement would entail.
- Forum Island Countries (PICs) should have built a solid trading relationship with Australia and New Zealand before trying to build relationships with other trading blocs (such as the European Union).
- Maybe negotiations can still happen between PICs and Australia and New Zealand for a PACER-Plus agreement but at the same time we can have parallel negotiations on other fronts like labour mobility and defence co-operation.

- It would be good to carry out an analysis on the cost structure/competitiveness of individual industries in the PICs to see which industries (if any) are likely to benefit and which industries are like to lose from the possible trade liberalisation that PACER-Plus would entail.
- Maybe Australia and New Zealand should first get the PICs onto a good growth path before trade liberalisation takes place so that these counties will be in a better position to absorb the costs of trade liberalisation.
- The PICs have to decide whether they will be rushed into negotiations for a PACER-Plus agreement come 2011 or they will use time space from now until 20011 to negotiate an agreement that is mutually advantageous.
- PICs have a good opportunity at the moment to exploit the benevolent political environment in Australia.
- Technically, PACER-Plus has already been triggered but the PICs do not have the technical capacity to negotiate for this agreement.
- A trade negotiations office is likely to be built in Vanuatu to administer the negotiations for PACER-Plus. Maybe Australia could fund the operations of this office to show that it's really committed towards negotiating a PACER-Plus agreement with the PICs.
- What Australia and New Zealand can also do is to start giving some benefits upfront to diffuse the fears that it will offer an unfair package to the PICs under the PACER-Plus agreement.
- Maybe Australia and New Zealand should provide budgetary support (in terms of funding Governments capital expenditure projects) to the Governments of the PICs in the transitory period.
- Australia and New Zealand have to invest in or push for this agreement as they will be the "net winners" from this agreement.

Mr Kaliopate Tavola (former Fijian Minister of the Foreign Affairs and External Trade)

- The PICs look a bit confused on how they will legally define the upcoming PACER-Plus agreement.
- The exercises that are undertaken by Australia and New Zealand at the moment are aimed at legally defining PACER-Plus.
- It is important that all the relevant parties are clear on the priority areas that can be exhausted in order to reap mutual benefits from this agreement.
- The MSG countries have shown interest in teaming up as a sub-regional group in order to negotiate an FTA with Australia and New Zealand.
- The PIFS is likely to take the "back seat" as far as the negotiations are concerned, as the MSG countries have shown a keen interest in taking a lead role.
- However, if PIFS takes the back seat now, it could spell disaster come 2011 when it doesn't have anything clear and constructive to take to the negotiating table.

15. Appendix G: Membership of Regional Agreements

	Pacific Regional Trade Agreements							*Country Classification*		
Country	**SPARTECA**	**PACER**	**PICTA**	**EPA**	**Compact of Free Association**	**MSG Agree-ment**	**WTO**	**Develop-ing Countries**	**Least Develop-ed Countries**	**Small Island States**
					FORUM ISLAND COUNTRIES					
Cook Islands	□	□	□							□
Fiji	□	□	□	□		□	□	□		
Kiribati	□	□	□						□	□
Marshall Islands	□	□			□					□
Micronesia	□		□		□			□		
Nauru	□	□	□							□
Niue	□	□	□							□
Palau	□	□			□					□
PNG	□	□	□	□		□	□	□		
Samoa	□	□	□						□	
Solomon Islands	□	□	□			□	□		□	
Tonga	□	□	□				□	□		
Tuvalu	□	□	□						□	□
Vanuatu	□	□	□			□			□	
					OECD					
Australia	□	□					□			
New Zealand	□	□					□			
EC				□			□			
USA					□		□			

16. Appendix H: Australia's GATS Schedule

Extract, Australia's GATS Schedule (Horizontal commitments on mode 4)

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
	mode 4) Unbound except for measures concerning the entry and temporary stay of natural persons in the following categories: a)Executives and senior managers, as intracorporate transferees, for periods of initial stay up to four years. Executives and senior managers being natural persons who are employees of a company operating in Australia, and who will be responsible for the entire or a substantial part of that company's operations in Australia, receiving general supervision or direction principally from higher level executives, the board of directors or stockholders of the business, including directing the company or a department or sub-division of it; supervising and controlling the work of other supervisory, professional or managerial employees; and having the authority to establish goals and policies of the department or sub-division of the company. b) Independent executives, without requiring compliance with labour market tests, for periods of initial stay up to a maximum of two years. Independent executives being natural persons who meet the criteria of executives and senior managers who intend, or are responsible for the establishment in Australia, of a new business of a service supplier with its head of operations in the territory of another Member and which has no other representative, branch or subsidiary in Australia. c) Service sellers, as business visitors, without requiring compliance with labour market tests, for periods of initial stay of 6 months and up to a maximum of 12 months. Service sellers being natural persons not based in Australia who are (sales) representatives of a service supplier and are seeking temporary entry for the purpose of negotiating for the sale of services or entering into agreements to sell services for that service supplier, where those representatives will not be	4)Unbound except for measures concerning the categories of natural persons referred to in the market access column	

engaged in making direct sales to the general public or in supplying services themselves.

Applicants for business visitor visas are natural persons seeking to travel to Australia for business purposes and not intending to engage in work that might otherwise be carried out by an Australian citizen or Australian permanent resident. This requirement will be satisfied where the service seller's remuneration and financial support for the duration of the visit are derived entirely from sources outside Australia.

d) Specialists, subject to individual compliance with labour market testing, for periods of initial stay up to a maximum of two years with provision of extension provided the total stay does not exceed four years.

Specialists being natural persons with trade, technical or professional skills who are responsible for or employed in a particular aspect of a company's operations in Australia. Skills are assessed in terms of the applicant's employment experience, qualifications and suitability for the position.

Labour market testing is not required for (i) natural persons who have specialised knowledge at an advanced level of a proprietary nature of the company's operations and have been employed by the company for a period of not less than two years and (ii) if the position in question is within a labour agreement in force at the time of application. A labour agreement is an agreement between the Australian Government, employers or industry organisations and unions for the entry of specialists from overseas.

The above commitments do not apply in cases of labour/management dispute.

17. Appendix I: A Quantitative Analysis of the Potential Benefit and Cost of a PACER-Plus Agreement

A Quantitative Analysis of the Potential Benefit and Cost of a PACER-Plus Agreement

Prof Biman Prasad

Abstract

1.0 This study attempts to quantify a major potential benefit and cost of the proposed PACER-Plus agreement. With regards to the benefit, this study has shown, using the Gravity model approach, that if one of the countries in a given country pair is part of this agreement, it will generate an additional bi-lateral trade flows of 13 percent than would be the case otherwise. On the other hand, if both countries in a given country pair are part of this agreement, then bi-lateral trade will increase by an additional 30 percent than would be the case otherwise. As far as a major potential cost of this agreement is concerned, this study has shown that the loss in tariff revenue would be substantial for the 3 countries whose data have been analysed. As far as Fiji is concerned, the loss in tariff revenue would be around F$74 million at each stage if the average tariff rate of 7% is lowered at a fixed rate of 3.5 percentage points (a hypothetical reduction). With regards to PNG, the decline in tariff revenue would be about 128 million Kinas if the average tariff rate is reduced from 6 to 3 % (a hypothetical decline) and a further 128 million Kinas if the average tariff rate is lowered from 3 to 0%. As far as the Solomon Islands are concerned, if the average tariff rate of 22% is lowered at a constant rate of 5 percentage points, the loss in tariff revenue at each stage would be around SI$44 million.

2.0 Introduction

In the last 10 years or so, the Pacific Island Countries[35] (PICs) have been vigorously negotiating Free Trade Agreements (FTA) in pursuit for greater economic integration in order to trounce the many economic and social difficulties they confront. From the economic point of view, PICs see the proliferation of regional and international agreements as a mechanism to ensure easier market access, social and cultural integration, and increase of competitiveness as a precondition for better quality, greater interest for foreign investments, as well as security and political support among parties to the agreement.

From political point of view, easier implementation of political and economic reforms is achieved by the agreements, as well as greater harmonization among countries in the international community, increased security among members, ensuring of political support. Such an initiative are shown in the negotiations of the overarching trade and economic framework agreement by Pacific Island Countries through the Pacific Island Countries Trade Agreement

[35] These PICs make up the Pacific Forum. The Forum comprises of Australia, Cook Islands, Federated States of Micronesia (FSM), Fiji, Kiribati, Marshall Islands, Nauru, New Zealand (NZ), Papua New Guinea (PNG), Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. French Polynesia and New Caledonia are associate members. Wallis and Futuna and Timor Leste have observer status.

(PICTA), negotiations with the European Union on the Economic Partnerships Agreement (EPA) and negotiations with Australia and New Zealand through the Pacific Agreement on Closer Economic Relations (PACER).

The Economic Partnership Agreement with EU expected to come into effect after 2007 is negotiated under the context of the Cotonou Agreement which is the successor to the Lome Agreement looking at the preferential trade arrangements. PACER is the 'umbrella' agreement on which the PICTA sits and entered into force in 2002 after the required number of ratifications. PACER is a framework agreement that sets an outline for the future development of trade and economic relations across the forum region and for free trade to be established gradually among forum members on a stepping stone approach but these negotiations are not scheduled until 2011.PICTA is the first agreement to be established under PACER, which came into force in 2003 but only became operational from 2007 is an accord to lower tariff and non-tariff barriers among the pacific island states. Under the provision of the PACER agreement (Article 6, paragraph 3) negotiations of Forum-wide Free Trade Arrangement (FTA) between the PICs and Australia and New Zealand should start no later than 8 years after the PICTA enters into force and negotiations could be brought forward under the Most-Favoured Nation (MFN) obligation if they are triggered by the PICs commencing negotiations over preferential trade agreements with other prospective partner or developed non-Forum countries.

Australia and New Zealand are now insisting that PACER's trigger has been pulled by the EPA negotiations with the EU in the context of the Cotonou Agreement and therefore requiring PICs to undertake consultations as soon as practicable to commence what is called the PACER Plus trade negotiations for the free trade arrangements. Forum Island governments resent the aggressive way that Australia and NZ forced PACER on them therefore justify the legitimate call to convene a study to investigate the potential impacts and the analysis of PICs needs of such a move towards a comprehensive framework because PICs imports are dominated by Australia and New Zealand and a fiscal adjustment of a tariff reduction or elimination to implement trade liberalisation and economic integration under such agreement will result in massive loss of tariff revenue which will devastate the Pacific Islands economies and the lives of their people.

This paper attempts to quantify the potential costs and benefits on the Forum Island Countries as a result of the triggering of the PACER Plus trade negotiations between the PICs and Australia and New Zealand in a move towards free trade. Although PACER commits Australia and New Zealand to provide financial and technical assistance for the development of pacific island economies in key areas such as trade facilitation, capacity building and structural reforms on the other hand it envisage to significantly affect the governments fiscal prospects and other key areas of the economy. For the purpose of this study we employ the gravity model approach to quantify the potential benefits of undertaking the PACER Plus negotiations and use a crude measure though consistent to quantify the potential costs where we look at one aspect that is loss of tariff revenue from gradual removal of import duties in the future. The other potential costs are just discussed practically because of the non availability country specific data which makes up the limitations of our study.

The balance of this paper is organized as follows: Section 2 gives an overview of the PACER agreement and its scope. Section 3 briefly surveys the existing literature on the potential costs and benefits of PACER coming into effect. Section 4 discusses a major (increase in bi-lateral trade flows) quantitative benefit of the proposed PACER-Plus agreement, while section five looks at a major (the decline in tariff revenue) quantitative loss of this agreement. The penultimate section of the paper presents some concluding remarks, while the last section gives some policy recommendations.

3.0 Overview of the PACER agreement

The proposal for having in place regional trade agreements that promote freer trade and economic integration amongst island countries goes back to as early as 1971 when South Pacific Bureau of Economic Cooperation first came into inception and thereafter progressed into the Forum Agreement when the Forum Secretariat was first established in 1991. More recently, the concept was reintroduced at the Forum Economic Ministers Meeting (FEMM) in Cairns in Australia 1997 when the proposal for a Pacific Regional Trade Agreement was tabled[36]. From there on, the concept gained momentum and was deliberated on at the 1999 Forum Trade Minister's meeting (FTMM) which recommended to the Forum that Leaders endorsed in principle a free trade area among all Forum members.

[36] The Secretariat was given the mandate to convene a study and develop a framework to be tenable in the FEMM in 1998 on the benefits from preferential and non-preferential approaches. Scollay (1998) and Stoeckel (1998) commissioned this study looking at the potential economic benefits and cost of a free trade agreement in goods and services amongst the PICs and the second study looking at the benefit and cost of including Australia and New Zealand in the same agreement.

On the 18th of August 2001, at the 32nd Pacific Islands Forum in Nauru, Forum Leaders endorsed and signed the Pacific Agreement on Closer Economic Relations (PACER) (amongst all 14 PICs and including Australia and New Zealand) and the Pacific Island Countries Trade Agreement (PICTA)[37] (a Free Trade Agreement amongst the 14 PICs). At the Nauru Forum Leaders meeting, the three Compact countries as well as PNG and the Solomon Islands did not sign the two agreements. This means that only 11 Forum countries signed PACER and 9 PICs signed the PICTA agreement. PACER will enter into force after 7 countries have ratified the agreement while PICTA on the other hand will come into force after the ratification by 6 PICs.

Pacific Closer Economic Relations (PACER) is an 'umbrella' agreement to promote reciprocal free trade in the region and came into effect on the 3rd of October, 2002 after being ratified by seven pacific island forum members. PACER provides a framework for future establishing and strengthening of trade and economic cooperation among all Forum members (including Australia and New Zealand) at an appropriate 'pace', eight years after the Pacific Island Countries Trade Agreement (PICTA) comes into effect. It does not contain substantive trade liberalisation provisions but rather provides a step-by-step process starting with a subsidiary free trade in goods among Pacific Island Countries (PICTA), than to future negotiations of Forum- wide reciprocal free trade arrangements, including Australia and New Zealand in 2011.

As of July 2004, PACER applied to 11 forum members (Vanuatu and Tuvalu have yet to ratify the agreement) while compact states (Federated Sates of Micronesia, Marshall Islands and Palau) are given three years to become members. PACER members include Australia, Cook Islands, Fiji Islands, Kiribati, Nauru, New Zealand, Niue, Papua New Guinea, Samoa, Solomon Islands and Tonga. Under the PACER agreement all members are to begin negotiations on free trade by 2011 at the latest while still holding on to the luxury of current trade arrangements such as SPARTECA until substantial improved trade arrangements providing equal or better access to their markets have been found.

[37] PICTA aims to establish a free trade area in goods (and, in future, services) among the Forum Island Countries (PICs) and to strengthen, expand and diversify trade between the partners. Promote and facilitate this expansion and diversification through the elimination of tariff and non-tariff barriers to trade between the parties in gradual and progressive manner.

The key feature of PACER is that it lays the groundwork for future trade and economic cooperation among all members and establishes the long term goal of ‘single region market’ among PICs. Australia and New Zealand are committed under PACER to provide for programmes of assistance to the island country members with trade facilitation (summarized in the ‘Regional Trade Facilitation Programme), capacity building and structural adjustment including fiscal reform measures to assist the PICs with implementation of PICTA and to be able to take advantage of market access opportunities in export markets. On one side PACER is seen as a mechanism for welfare enhancing but on the other side it envisages to hit hard PICs attempts to generate revenue due to elimination of tariff barriers in the future to accord the free trade arrangements.

PACER is seen as an attempt by Australia and New Zealand to maintain their political and economic interests in the pacific where the provisions assure Australian and New Zealanders that their goods will not be hit by competition from cheaper imports from other parts of the world if the islands do deals with trade blocs like European Union. The key implications for PICs is once PICs negotiation for an EU- Pacific trade agreement over preferential trade arrangements begin this is set to trigger a requirement for consultations with Australia and New Zealand to negotiate free trade deal and the PACER Plus negotiations will to be brought forward from 2011.

3.0 Literature Review

The Forum Island Countries (PICs) have been witnessing the emergence and proliferation of Free Trade Agreements (FTAs) in recent years but quantification of the economic impacts of these trade agreements amongst PICs represents a major analytical challenge due to the complexity of the underlying issues, a limited number of studies generally based on either computable general-equilibrium’[38] simulation studies or on econometric analyses using the ‘gravity model’[39] have tried to assess the implications of such an initiative undertaken by PICs to liberalize trade among the member countries in order to move towards free trade. The first of the study of this nature was undertaken by Scollay (1998) and Stoeckel (1998) on the implementation of PICTA/PACER (a free trade arrangement among

[38] Computable General Equilibrium Model attempt to estimate the impact of regional trade agreements at both the aggregate and sectoral levels

[39] Gravity models try to assess the actual impact of policy changes on trade flows between countries.

PICs) being under the mandate of Forum Secretariat on the request of the Forum Economic Ministers Meeting (1997).

Scollay and (1998) commissioned a study looking at the potential economic benefits and costs of the free trade agreement in goods and services amongst the PICs[40] by applying a computable general equilibrium model (CGE). He projected very minimal economic gains of around A$5 million in aggregate but having more non-economic benefit except for Cook Islands, Samoa, Kiribati and Palau which could face negative impacts. According to the report if these countries incorporate a 25% cut in tariffs on imports from the rest of the world would be able to converts a net economic loss into a net economic benefit. The report also pointed out that significant losses of tariff revenue are inevitable and an alternative source of government revenue will therefore have to be developed (such as VAT). Furthermore the study also concluded that the resulting gains from free trade agreement for PICs could be improved further provide the trade facilitation initiatives helped harmonize and improve the quality of customs, sanitary and phytosanitary (SPS) and standard regimes.

On the same note Stoeckel (1998) also commissioned a study under the same mandate to examine the benefits and costs to PICs of including Australia and New Zealand[41] where using the same data and methodology as of Scollay, the computable general equilibrium model provided some attracting results whereby welfare gains of around A$200 million in aggregate and a resulting moderate benefits to Australia and New Zealand. The report further revealed that out of the 14 PICs, Fiji, PNG and Cook Islands would be the significant gainers because they have high tariff and once tariffs were removed it will results in greatest efficiencies. Furthermore the report goes to say that the resulting loss of revenue by such a move does not pose a threat to these countries because they have in place VAT which could be raised to makeup for any loss of revenue. Stoeckel further predicts that the proposed free trade agreement will have minimal impact on Nauru, Palau and Federated States of Micronesia (FSM) because of their low levels of trade and tariffs. Marshall Island, Kiribati, Niue, Samoa, Solomon Islands, Tuvalu, Tonga and Vanuatu are indirectly alleged to reconsider their stance of joining the free trade agreement basically due to the prediction to suffer huge revenue losses when tariffs are removed since these countries do not VAT in place to fall back.

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[40] known as the Pacific Island Countries Trade Agreement (PICTA)
[41] known as the Pacific Agreement on Closer Economic Relations (PACER)

Scollay and Gilbert (1998) using the framework of computable general equilibrium model envisage free trade agreements with reduced tariffs can result in increased employment and significant welfare gains for the island states. Similarly Stoeckel and Davis (1998) see significant net benefits to the former if Australia and New Zealand are included in the free trade agreements. On the other hand Narsey (2004) predicts new trade arrangements in the region will result in job losses and a significant impacts on the customs duties collected by those PICs that impose tariffs.

In formulating a background paper, ADB (2007) points out that trade agreement amongst small developing states (such as PICTA or the MSG) are unlikely to results in welfare-enhancing mainly because it in fact it can be seen as a setback for the promotion of free trade within the PICs. Furthermore there is tendency for trade diversion and tariff and investment diversion to the more advanced states, resulting in income divergence and increased opposition against free trade. On the other hand a trade agreement between the small Pacific states and a large developed country (such as EPA and PACER) would be much more likely to be welfare-enhancing because the risks of trade diversion outweighing trade creation effects are much less likely because in these agreements are embedded with development assistance in various forms, including trade facilitation. PACER is likely to generate greater benefits for the Pacific states if effective trade facilitation, particularly to overcome quarantine barriers is realized.

The Centre for International Economics (1998) modelled the tax revenue impact of a free trade area between the PICs and Australia and New Zealand under PACER. The projected losses in government revenue are much larger in the case of PACER than for PICTA. For the least developed countries the estimated losses in total revenue are as follows: Kiribati (13 per cent), Samoa (11.8 per cent), Solomon Islands (7.2 per cent), Tonga (14.2 per cent) and Vanuatu (19.9 per cent).

4.0 Benefits of PACER

4.1 The Gravity Model

One of the major benefits of the proposed PACER-Plus agreement is the increase in bi-lateral trade flows between countries which will ratify this agreement. An attempt is made to quantify the increase in bi-lateral trade flows using the gravity model. The gravity equation is a simple empirical model used for analysing bi-lateral trade flows between geographical entities. The gravity model for trade is equivalent to the Newtonian physics function that describes the force of gravity. The model explains the flow of trade between a pair of countries as being proportional to their economic "mass" (national income) and inversely proportional to the distance between them. The model has a lineage that goes back to Tinbergen (1962) and Poyhonen (1963), who specified the gravity model equation as follows:

$$Trade_{ij} = \alpha \cdot \frac{\left(GNP_i \times GNP_j\right)^{\beta_1}}{\left(Dist._{ij}\right)^{\beta_2}} \qquad (1)$$

Where Tradeij is the value of the bi-lateral trade between country i and j, GNPi and GNPj are country i and j's respective national incomes. Dist.ij is a measure of the bi-lateral distance between the two countries. α and βs are parameters and apriori β1 is positive and β2 is negative.

Taking the logarithms of the gravity model equation as in (1), we obtain the linear form of the model and the corresponding estimable equation as follows:

$$log(Trade_{ij}) = \alpha + \beta_1 log(GNP_i \times GNP_j) - \beta_2 log(Dist._{ij}) + u_{ij} \qquad (2)$$

where α, β1, and β2 are the coefficients to be estimated. The error term (uij) captures any other random events that may affect bi-lateral trade between the two countries and has a mean zero and constant variance. Equation (2) is the core gravity model equation where bi-lateral trade is predicted to be a positive function of income and a negative function of distance.

4.2 Our Approach

In addition to the basic gravity model equation, we estimate an augmented gravity model equation to first analyse international trade flows and then assesses the potential increase in trade flows which can be experienced once PACER-Plus comes into effect. The model is "augmented" in the sense that several conditioning variables that account for other factors that may affect bi-lateral trade have been included over and above the (natural logarithms of) income and distance. The models, basic and augmented, as formulated for estimation are as follows:

4.2.1 Basic Gravity Model

As stated above, the gravity model in its most basic form explains bi-lateral trade (Tij) as being proportional to the product of GNPi (Yi) and GNPj (Yj) and inversely related to the distance (Dij) between them.

$$log(T_{ij}) = \alpha + \beta_1 log(Y_i \times Y_j) + \beta_2 log(\frac{Y_i}{pop_i} \times \frac{Y_j}{pop_j}) - \beta_3 log(D_{ij}) + u_{ij} \tag{3}$$

To account for other factors that may influence trade levels, dummy variables have been added to the basic model. The augmented gravity equation is thus expressed as follows:

4.2.2 Augmented Gravity Model

$$Log(T_{ij}) = \alpha + \beta_1 log(Y_i \times Y_j) + \beta_2 Log(\frac{Y_i}{pop_i} \times \frac{Y_j}{pop_j}) - \beta_3 log(D_{ij}) + \beta_4 (Border_{ij}) + \beta_5 (Lang._{ij}) + \gamma_1 (RTA)$$
$$+\gamma_2 (Comcol) + \gamma_3 (Col) + \gamma_4 (Lndlkd) + \gamma_5 (Isld) + u_{ij}$$

(4)

where i and j denotes countries and Tij denotes the value of bi-lateral trade (merchandise exports and imports) between i and j. The explanatory variables in the gravity model are defined as follows:

(Y) - GNP and (Pop) - Population: There are two standard ways of measuring the size of the countries in the gravity model: GNP (Output) or population. With regards to GNP, the model will be estimated using nominal GNP in US dollars and also GNP in terms of purchasing power parity (PPP). The main assumption here is that trade usually happens at international prices, and so GNP at PPP has no bearing on trade levels. At the same time, given the strong undervaluation of certain countries GNP, it is worthwhile to estimate the model with GNP at PPP and observe if the corresponding coefficients change in any significant fashion.

(Y/Pop) - Per Capita Income: While mathematically, it is precisely equivalent, whether we use the explanatory variables as GNP and per capita GNP, or as GNP and population, we choose the former. In particular, the specification with GNP per capita allows us to explore the link between a country's trade and its stage of development. Several explanations have been provided in the literature for the inclusion of GNP per capita as an independent variable in addition to GNP. One possible explanation is that exotic foreign varieties of goods are superior in consumption. Other possibilities arise out of the literature on endogenous growth. For instance, the process of development may be led by the innovation or invention of new products, which are then demanded as exports by other countries.

It is also instructive to focus explicitly on GNP per capita as a determinant of trade. The standard gravity model predicts that countries with similar levels of output per capita will trade more than countries with dissimilar levels. This is true of the Helpman- Krugman type of theory, as it predicts that the volume of trade should increase with increasingly equal distribution of national income. This, however, contradicts the traditional Hecksher-Ohlin theories of trade that predict that countries with dissimilar levels of output will trade more than countries with similar levels. In addition, the Linder hypothesis says that countries with similar levels of per capita income will have similar preferences and similar but differentiated products, and thus will trade more with each other. This hypothesis is often viewed as similar to the Krugman-Helpman theory in its predictions. While the Krugman – Helpman hypothesis predicts that the sum of the logs of (GNP/popi) and (GNP/popj) will have a positive effect on the log of trade, the Linder hypothesis is associated with the prediction that the absolute value of the difference of the two variables will have a negative effect on trade. A positive value of this falls in the category of Hecksher – Ohlin theories.

To distinguish among these influences - Hecksher-Ohlin style factor endowments differences, Linder –style taste differences, and the effect of development on trade and in an attempt to capture the distinctive features of each, we add a term for the difference in per capita GNP in the standard formulation of the gravity model. A negative sign on this term would support the Linder hypothesis, while a positive sign would support the Hecksher-Ohlin hypothesis. We test for both the hypotheses.

(D) - Distance: is the distance between country i and country j measured "as the crow flies" – technically called the great circle distance between the two latitude-longtitude combinations. Currently, a major proportion of trade goes by air (and not by sea or land) and, therefore, the air routes provide the most convenient justification for using the straight-line or great-circle measure of distance. The ultimate justification is, of course, given by the fact that this measure seems to be a reasonable measure of averaging across different modes of transportation and works well in practice.

To capture the impact of geographical factors and historical ties between countries on bi-lateral trade, we include dummy variables. These are explained as follows:

(Borderij) - Border/ Adjacency: A dummy variable to identify a pair of countries that are adjacent or contiguous or share a border. This dummy is in addition to the inclusion of the distance variable to account for the possibility of centre-to-centre distance overstating the effective distance between neighbouring countries that may engage in large volumes of border trade. The dummy variable is one if countries i and j share a common border and zero when they do not.

(Langij) - Common Language: is equal to one when the two countries share a common language (official or commercial) and zero if otherwise. Common language is expected to reduce transaction costs, as speaking the same language helps facilitate trade negotiations.

Colonial Links: Shared history is expected to reduce transaction costs caused by cultural differences. With regards to colonial links, the dummy variables that we intend to include in this study are:

- (Comcol) - Common Coloniser: is equal to one if country i and j were colonies after 1945 with the same coloniser and zero if otherwise; and
- (Col) - Colony: is equal to one if country i colonized j or vice versa and zero if otherwise.

(Lndlkd) - Landlocked: Takes a value of one if the countries in the pair are landlocked and zero if otherwise

(Isld) - Island: Assumes the value of one if the countries in the pair are islands and zero if otherwise

(RTA) - Regional Trade Agreements: Countries often enter into regional trade agreements with the intention of facilitating bi-lateral trade. This dummy variable is equal to one when both countries in a given pair belong to the same regional trade agreement and zero if otherwise. The estimated coefficient will then tell us how much of the trade can be attributed to a special regional effect. On average, it has been found that free trade agreements impact positively on trade with a study by Frankel and Rose (2002) indicating a tripling of trade between partners on account of membership of RTAs.

Uij is a log-normally distributed error term and represents the myriad other influences on bi-lateral trade. E (lnUij) = 0).

4.3 Methodology

The estimation method used in this study is in two stages. In the first stage, we estimate equations (3) and (4) for world trade flows. These equations will be estimated using the OLS technique using cross-section data for the year 2006. The dependent variable will be merchandise trade (exports plus imports in US dollars), in log form, between pairs of countries. All estimates will be checked for heteroskedasticity, as this is a very common problem in cross-sectional data.

While panel data has advantages in terms of being able to capture the relevant relationships overtime and panels monitor unobservable trading-partner-pairs' individual effects, classical gravity models have used cross-section data to estimate trade effects and trade relationships for a particular time period, which is invariably one year. Furthermore, in all the gravity models that have been estimated so far, it has been observed that aggregation overtime does not really add any value to the estimations overtime. We have, therefore, followed the classical tradition of estimation with cross-section data.

4.3.1 Econometric Issues

4.3.1.1 Multicollinearity

Klein's thumb rule, as well as, simple correlations has been used to test for multicollinearity42 in our specification. Simple correlations are small (refer to Appendix- Table 2) and the auxiliary regressions for Klein's rule do not indicate multicollinearity. Multicollinearity is thus not a problem in our specification of the gravity model.

4.3.1.2 Endogeneity

Both economic size and income per capita are treated as exogenous variables in the gravity equation. There is, however, empirical and theoretical support for the impact that trade can have on income. The possibility of endogeneity of these variables, therefore, cannot be denied and the apparently significant effect of income on trade may be spurious. To resolve this problem, we have attempted alternative instrumental variables (IV) estimations using instruments like population and land area for size[43]. The use of the instrumental variable technique does not alter the coefficients on any of the variables to any significant extent, implying thereby that the endogeneity of income does not lead to any significant distortion of the initially postulated relationship in the gravity model.

4.3.1.3 Country Pairs with Zero data

For some country pairs the data entry is zero, normally due to levels of trade that are too small to be recorded. These are generally countries that, by virtue of their small size and remoteness, would be expected to have little trade with each other. It is not always possible, though, to ascertain whether their trade is actually zero or is very small and has in the process of being rounded off appeared as a zero value. In any case, these pairs with zero trade values present a problem for estimation of the gravity model in the log linear form. We have tried to resolve this problem by estimating the model using three different techniques:

- Omission of the zero pairs from the data set.

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[42]According to Klein's rule of thumb, multicollinearity is a problem if max $Rj^2 > R^2$ where Rj^2 is the statistic from the OLS estimation of the auxiliary regression of the j_{th} regressor on the other regressors and the intercept term. Several auxiliary regressions were estimated and this condition did not hold true for any of the regressors, as all Rj^2 were less than 0.2.

[43]Correlation between population and GNP and land area and GNP is greater than 0.5, thereby indicating the strength of these variables as instruments or proxies for GNP/size.

- Estimation of a restricted model, that is, estimate the gravity model for all countries that have income above US$3 million[44].
- A semi-log formulation of the gravity model. The reformulated gravity equation is then estimated using the Tobit technique[45].

No significant changes in coefficient values are however found.

4.4 Data Sample

The dependent variable in our analysis is the natural log of total bilateral trade (exports plus imports) measured in current international prices (US dollar value). Our analysis is based on the maximum possible geographical coverage of world trade flows. Our data sources are the UN COMTRADE and the Bank of Papua New Guinea direction of trade figures for 2006. UN COMTRADE is derived from the trade database of the United Nation's Statistics Division, and covers over 90 per cent of world trade. Over 140 countries[46] report their exports and imports with trading partners drawn from a set of over 245 countries. There are 20,531 observations in the sample. Observations for all variables are for the year 2006.

GNP is measured in current international prices (US dollars), as well as, in PPP terms. Population of all countries is measured in millions. The data source for population and GNP is the World Bank published World Development Indicators online database.

Bilateral distance is measured, in kilometres, as the great circle distance between two capital cities of the trading partners[47]. Bilateral distance is taken from the data set developed by Haveman[48] and the CEPII[49]. For language, contiguity, colonial background and other such information, we have used the Central Intelligence Agency (CIA) World Factbook.

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[44] Model IX – Results presented in Appendix – Table 3A.
[45] Model XI and XII – Results presented in Appendix – Table 3B.

[46] A list of the sample countries is given in the Annex-Table 2.

[47] Great circle distance is measured between any two latitude-longitude combinations-i.e. "as the crow flies" between two cities. Where distance between capital cities is not available, distance between major cities of the trading partners has been used.
[48] www.macalester.edu/research/economics/PAGE/HAVEMAN/Trade.Resources/Data/Gravity/dist.txt
[49] www.cepii.fr.

As there are missing observations for some of the regressors, the usable sample may be much smaller for most estimations.

4.5 Estimation Results

Table 3 presents the OLS estimates of the basic and augmented gravity models[50.] We analyse the results of the augmented model for both GNP at current international US $(Model VII) and in terms of PPP (Model IV).

4.5.1 Gravity model estimation results using GNP valued at Current US$

The models for both the basic and augmented version fits the data well and explain 67 and 72 per cent of the variation in bilateral trade across our sample of countries, respectively. The standard features of the gravity model work well. Distance and income provide most of the explanatory power in all the regressions. The baseline variables (both GNP and distance) are very highly significant, have the expected signs and are of reasonable magnitude.

The coefficient on the GNP variable in our specification is positive, statistically significant and economically reasonable indicating that, holding everything else constant, the higher the GNP product (of a given country pairing) the higher is the bi-lateral trade between them and vice versa. Specifically, an income elasticity of 0.91 implies that, ceteris paribus, a 1 percent increase in the size of a given country pair would increase bi-lateral trade between them by roughly 0.91 percent (a less than proportionate increase) and vice versa. A Wald test was carried at this stage to see if the income elasticity estimates from the various models are significantly different from unity. This test concluded that the estimates were not significantly different from unity.

The estimated coefficient on log distance has the anticipated negative sign, is statistically significant and is slightly over 1, indicating that, ceteris paribus, trade between a pair of countries falls by a little over 1 percent for every 1 percent increase in the distance between them[51] and vice versa. A Wald test was also carried out here to see if the distance elasticity estimates from the various models are significantly different from unity. The results again showed that the estimates were not significantly different from unity.

[50]Some other variations of the gravity model that have been estimated are also reported with model descriptions in Table 3 of the Appendix.

[51] When the adjacency variable is not included in the gravity equation, the estimated coefficient on the log distance is a little more than, when it is included. When we hold constant for common borders, the estimated coefficient on the distance variable is diminished by a very small magnitude. The adjacency variable is to be included however, as it has its own relevance, beyond distance, for bilateral trade.

On controlling for adjacency; that is, inclusion of the variable for common border, the magnitude of the coefficient on distance is reduced slightly. The coefficient on the dummy variable for a common border itself is estimated to be 0.62. As trade is specified in logarithmic form, we interpret the coefficient on the dummy by taking the anti-log (to base e) of the estimated dummy coefficient, subtract 1 from it and multiply the difference by 100[52.] Hence, a coefficient of 0.62 implies that, holding everything else constant, two countries that share a common border are estimated to engage in about 86 percent more trade than two countries who do not share a common border.

We have also included an effect for landlockedness, which may add to transportation costs. The coefficient on the dummy for this effect is estimated at -0.32. This implies that, holding constant for other factors, the lack of ocean ports reduces bi-lateral trade by about 27 percent.

Sharing a common language increases trade by economically and statistically significant amounts. The estimated coefficient of the common language dummy is 0.58. The implication is that, ceteris paribus, two countries sharing linguistic links tend to trade roughly 79 percent more than they would otherwise. The effect of sharing a common language, though positive and significant, is not as much as the effect of sharing a common border.

Ex-colonies and their colonizers and countries with the same colonizer all have disproportionately intense trade, consistent with intuition and received wisdom. Coefficients on the dummy variables representing these effects are positive and significant.

We have also included an island dummy variable to capture the effect of an "island status" on bi-lateral trade. The coefficient on this dummy variable is 0.10. This implies that, holding everything else constant, two countries, which are islands by nature, are likely to engage in about 11 percent more trade than two countries which are not islands by nature.

4.5.2 Effects of RTAs

We find that the dummy variable for intra-regional trade is highly significant statistically. The common membership of a RTA explains some amount of bilateral trade over and above that explained by the five basic variables - size, per capita income, bilateral distance, common borders, and common languages. The coefficient on the dummy variable for regional trading arrangements is 0.98, implying that the preferential trading arrangements can lead to over twice

[52] This technique was suggested by Halvorsen and Palmquist in their article titled "The interpretation of dummy variables in semi-logarithmic equations", American Economic Review, vol 70, no. 3, pp. 474-475.

as much trade as is otherwise possible for a country pair[53]. Moreover, the regional dummy, when dis-aggregated into individual RTA dummies, seem to have the same impact. Specifically, when we consider PICTA, MSG, SPARTECA-TCF, EPA and the upcoming PACER-Plus in our specification, the trade creation effects of all these agreements stand out for being highly significant.

4.5.3 PACER-Plus

Looking at the proposed PACER-Plus agreement specifically, it can be seen that, if 1 of the two countries in the pair is under this agreement, trade flows between the pair will increase by an additional 13 percent than would be the case otherwise. On the other hand, if both countries in the pair are under this agreement, then bi-lateral trade will increase by an additional 30 percent than would be the case otherwise. (Refer Appendix-Table 3B).

4.5.4 Gravity Model estimation results using GNP at PPP

The results reported above are for GNP and per capita GNP at current exchange rates. Alternatively, these variables are measured at purchasing power parity rates (PPP). In theory, the PPP rates are preferable as large temporary swings in the nominal exchange rate can distort the comparison of incomes across countries. The usual disadvantage cited against measurement of PPP values is that they may be subject to large measurement errors. Considering, however, that some developing and least developed countries incomes are reasonably overstated in current US dollar terms, we estimate the gravity model using the PPP measure also. Most of the coefficients are left largely unaffected in terms of sign and significance. The coefficient for GNP per capita was statistically significant and positive. This was in contrast with the model with income measured at the current exchange rate. In that case, per capita income was insignificant and was later dropped on account of high multi-collinearity. (Refer to Appendix - Table 2)

4.5.5 Linder vs. Hecksher-Ohlin hypothesis

To test for the strength of the Linder hypothesis as against the H-O hypothesis, we have included the log of the absolute difference in GNP per capita for a country pair. As stated earlier, this allows us to address the question: whether trade flows are large among similar countries or dissimilar countries. Our estimation results support the Linder hypothesis; that is, similar countries trade more than dissimilar ones. The log difference of per capita incomes appears as negative and significant for the model with these variables expressed in current US dollars. In case of the PPP model, the negative sign is retained even though the variable does not remain significant. The coefficient on the product of per capita incomes remains positive however, and is highly significant. This suggests that the trade and development relationship is the most powerful of all the three channels through which per capita income can impact upon trade.

5.0 Cost of PACER

This section attempts to quantify the potential cost of PACER plus agreement coming into effect once the trigger is pulled as a consequence of the Pacific Island Countries negotiation for a free trade agreement outside the forum such as an Economic Partnership Agreement (EPA) with the European Union. It is difficult to quantify the potential cost of PACER due to the non-availability of quality data to work with. Despite of all this shortcomings we make an attempt to quantify potential loss of tariff revenue by the PICs. Other potential costs are just discussed practically.

- **Tariff revenue losses currently collected on imports due to trade liberalisation eliminating tariff barriers.**

In order to quantify the resulting revenue losses we make use of a crude measure though consistent by taking sample of three countries Fiji, PNG and Solomon islands to make up the forum island countries. In Table 1, we take the average of imports for these countries from the periods 2000-2006 and the average of tariff rates to calculate tariff revenue for each of these countries. Thereafter we try to gradually eliminate the tariff rate in different bands for each of these countries and observe the tariff revenue.

Table 1: IMPORTS AND TARIFF REVENUE FOR PICs FOR THE PERIODS 2000-2005			
Year	**Fiji ($M)**	**PNG (KM)**	**Solomon Islands ($M)**
2000	1647.7	2778.9	468.2
2001	1769.1	3160.0	475.0
2002	1749.4	4196.8	452.2
2003	2017.5	4231.0	622.9
2004	2228.6	4703.0	636.2
2005	2471.8	4665.1	1393.0
2006	2839.4	6064.3	1597.9
Average Imports	2105.4	4257.0	806.5
Average Tariff Rate (%)	7	6	22
Tariff Revenue	147.4	255.4	177.4

Source: IMF International Financial Statistics.

On average for the periods 2000-2006 Fijis import were $2105.4 million with the average tariff rate of 7%, Fijis tariff revenue was FJ$147.4 million. Similarly PNGs average imports were Kina 4257 million and with the average tariff rate of 6%, the resulting tariff revenue was Kina 255.4 million. Solomon Islands imports on average was SBD$806.5 million. With the average tariff rate of 22% its tariff revenue accounted for SBD$177.4 million. Solomon Islands on average charges a tariff rate of 22% on imports which indicate that it is very protective of its industries at home.

In Table 2 we account for the gradual reduction of the tariff bands to show the potential impact on tariff revenue when PACER Plus agreement is operational. Based on the estimates from table 2 Fiji is expected to loose on average around $73.7 million in tariff revenue from elimination of tariff on imports at each tariff band whereas PNG is expected to loose around Kina 127.7 million in tariff revenue from the removal of tariff at each tariff band. On the same note Solomon Islands is expected to loose on average around SBD$44.3 million in tariff revenue from the removal of tariff at each tariff band. The results show that there is a substantial loss in tariff revenue from imports for these three countries which forms an integral part of the government revenue.

TABLE 2: TARIFF REVENUE AT DIFFERENT BANDS	
TARIFF REVENUE FOR FIJI	
Average Tariff Rate (%)	**Tariff Revenue ($M)**
7	147.4
3.5	73.7
0	0

TARIFF REVENUE FOR PNG	
Average Tariff Rate (%)	**Tariff Revenue (KM)**
6	255.4
3	127.7
0	0

TARIFF REVENUE FOR SOLOMON ISLANDS	
Average Tariff Rate (%)	**Tariff Revenue ($M)**
22	177.4
16.5	133.1
11	88.7
5.5	44.4
0	0

Source: IMF International Financial Statistics.

Even though this study has shown that there would be a significant loss in tariff revenue, this does not in any way imply that there would be a drastic fall in total Government revenue for these three countries. This is due to the fact that the loss in tariff revenue would be partly offset by the increase in import VAT/GST revenue and a possible increase in income tax revenue. At this stage, it is also important to mention that there are a few countries in the Pacific that do not have a consumption tax like VAT or GST. Therefore, if these countries are seriously considering being part of this proposed agreement, they will have to introduce a consumption tax such as VAT or GST to mitigate the potential loss in tariff revenue as a result of their participation in this agreement.

6.0 Concluding Remarks

This study attempts to quantify a major potential benefit and cost of the proposed PACER-Plus agreement. With regards to the benefit, this study has shown, using the Gravity model approach that if one of the countries in a given country pair is part of this agreement, it will generate an additional bi-lateral trade flows of 13 percent than would be the case otherwise. On the other hand, if both countries in a given country pair are part of this agreement, then bi-lateral trade will increase by an additional 30 percent than would be the case otherwise. . However, from the model we cannot specifically say out of the total increase in the volume of trade, what percentage would in favour of the Pacific Island countries but it would make some sense to say that increase in trade flows is likely to be mutually beneficial.

As far as a major potential cost of this agreement is concerned, this study has shown that the loss in tariff revenue would be substantial for the 3 countries whose data have been analysed. As far as Fiji is concerned, the loss in tariff revenue would be around F$74 million if the average tariff rate is lowered from 7% to 3.5% (a hypothetical reduction). Furthermore, Fiji would incur a tariff revenue loss of F$74 million if the average tariff rate is further lowered from 3.5% to 0 %. With regards to PNG, the decline in tariff revenue would be about 128 million Kinas if the average tariff rate is reduced from 6 to 3 % (a hypothetical decline) and a further 128 million Kinas if the average tariff rate is lowered from 3 to 0%. As far as the Solomon Islands are concerned, if the average tariff rate of 22% is lowered at a constant rate of 5 percentage points, the loss in tariff revenue at each stage would be around SI$44 million.

Whilst this study attempts to contribute to the existing literature on the potential benefits and costs a free trade agreement, it does suffer from a number of limitations. Firstly, even though we had 6 digits tariff data using the HS classification; we were not able to get imports data which were consistent with the 6-digits HS classification. This prevented our ability to do a more rigorous analysis whereby we could have lowered the tariff rates on various prohibitive and protective products and seen the resulting loss in tariff revenue.

Secondly, even though we know what would be the potential benefits and costs of this agreement in theory, it is hard to quantify these benefits and costs at this early stage due to the unavailability of relevant data. It would require further research and analysis of data available at the country level.

7.0 Policy recommendations

The potential costs and benefits will remain a matter for concern for both parties in the negotiations on PACER Plus. It would involve quantifying these at various stages but the full impact and analysis could only be done once the agreement is in effect. Nevertheless, two things come out clearly from our quantitative analysis. First, the trade volume is likely to increase with the agreement and any increase in the volume of trade through free trade between parties does bring in mutual benefits. The extent of the distribution of the gains is not known. However, trade theory tells us that freer trade does present opportunities for welfare gain. In addition to actual trade gains there are other potential benefits. In terms of costs, loss of tariff revenue is probably the biggest concern. The analysis based on tariff rate reduction shows significant revenue loss. However, alternative taxes such as the VAT can compensate significantly for the loss of tariff revenue. As a policy option, PICs will have to seriously consider this as an option. Some like Samoa and Fiji already have VAT.

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Sub-Appendix to Appendix I

Table 1: Descriptive Statistics

	Obs	Mean	Std. Dev	Min.	Max.
Trade	7249	863750.3	7695192	1	4.12e+06
Trmfg	5611	84321.6	6651419 4	4	3.12e+05
gdp1	20803	2.12e+13	9.06e+11	6.23e+04	10.18e+10
gdpc1	20972	3.12e+18	8.18e+11	5.7e+08	11.13e+11
pc1	20803	9600.20	9349.66	543	52341
cpc1	20972	7101.32	9528.98	98.75	5431.32
Dist	20291	8232.54	4622.63	5.03	132156.33
area1	21294	876543.98	2152450	465	3.69e+04
pop1 (mn)	22231	5.04e+04	1.49e+08	45000	1.43e+05
dl	22603	.09	.27	0	1
dcomcol	22603	.05	.18	0	1
dlandlock	22603	.44	.55	0	2
dborder	22603	.03	.10	0	1
disland	22603	.64	.61	0	2
Dcomctry	22603	.00	.04	0	1
Dcolonial	22603	.00	.06	0	1
dregnl	22603	.03	.10	0	1

Table 2: Simple Correlations

	trade	area1	Pop1	gdp1	pc1	dist	Dl	dcomcol	Dlandlock	dborder	disland	dcomctry	dcolonial	dregnl	cpc1	trmfg
trade	1															
area1	0.05	1														
Pop1	0.06	0.50	1													
gdp1	0.07	0.54	0.69	1												
pc1	0.08	0.014	-0.31	0.25	1											
dist	-0.04	0.25	0.12	0.18	0.07	1										
dl	0.05	0.06	-0.05	0.09	-0.14	-0.15	1									
dcomcol	-0.03	-0.10	0.07	-0.09	-0.20	-0.12	0.31	1								
dlandlock	-0.04	-0.12	-0.09	-0.13	-0.09	-0.22	-0.19	-0.08	1							
dborder	0.20	0.07	0.09	0.00	-0.15	-0.25	0.19	0.11	0.07	1						
disland	0.03	0.00	-0.13	0.08	0.32	0.23	0.23	0.17	-0.28	-0.16	1					
dcomctry	0.03	0.00	0.05	0.13	0.09	0.00	0.17	-0.08	-0.14	-0.07	0.20	1				
dcolonial	0.00	-0.07	-0.07	0.00	0.08	-0.05	0.25	-0.09	-0.09	-0.05	0.19	0.19	1			
dregnl	0.17	-0.08	-0.08	-0.07	0.08	-0.23	0.22	0.18	-0.08	0.18	0.18	0.07	0.08	1		
cpc1	0.10	0.00	-0.25	0.38	0.99	0.12	-0.14	-0.15	-0.09	-0.17	0.28	0.08	0.05	0.08	1	
trmfg	0.93	0.05	0.08	0.12	0.16	-0.13	0.05	-0.06	-0.08	0.26	0.07	0.13	0.03	0.21	0.18	1

Table 3: Gravity Model Estimates

Dependent Variable: log (trade between country pairs)

A.	**GNP - PPP**					**GNP - Current US$**					
Var/model	**I**	**II**	**III(L/ H-O)**	**IV**		**V**	**VI**	**VII**	**VIII**	**IX:<3**	**X(Li/ HO)**
PGNP	0.89 (59.65) ***	0.90 (60.27) ***	0.87 (56.36) ***	0.91 (57.78) ***		0.89 (60.04) ***	0.88 (58.38) ***	0.91 (56.82) ***	0.95 (54.45) ***	0.90 (56.78) ***	0.90 (55.55) ***
Dist.	-1.12 (50.23) ***	-1.15 (51.12) ***	-1.06 (50.02) ***	-1.10 (501.12) ***		-1.15 (50.23) ***	-1.14 (49.78) ***	-1.05 (49.83) ***	-1.08 (46.65) ***	-1.10 (47.89) ***	-1.11 (46.67) ***
PGNPPC		0.45 (2.37) **	0.42 (2.01) **	0.44 (2.22) **			0.005 (1.08)				
Border			0.70 (2.58) ***	0.78 (2.84) ***				0.62 (2.50) **	0.47 (2.55) **	0.59 (2.89) ***	0.50 (2.57) **
Language			0.77 (2.89) ***	0.80 (3.05) ***				0.58 (2.68) ***	0.75 (2.60) ***	0.54 (2.72) ***	0.52 (2.59) ***
Comcol			0.58 (2.21) **	0.60 (2.35) **				0.58 (2.55) **	0.38 (2.45) **	0.57 (2.55) **	0.50 (2.49) **
Col			1.22 (1.99) **	1.26 (2.43) **				1.15 (2.46) **	0.94 (2.22) **	1.08 (2.52) **	1.10 (2.47) **
Comctry			1.40 (1.88) *	1.44 (1.95) *				1.45 (1.96) **	-	1.52 (2.12) **	1.56 (2.02) **
Landlocked			-0.51 (2.23) **	-0.48 (2.46) **				-0.32 (2.42) **	0.01 (1.05)	-0.22 (1.78) *	-0.21 (1.49)
Island			0.06 (2.38) **	0.06 (2.49) **				0.10 (2.62) **	0.09 (2.57) **	0.10 (2.94) ***	0.18 (2.56) **
Regl.			1.15 (2.50) **	1.17 (2.55) **				0.99 (2.62) **	0.60 (2.51) **	0.65 (2.73) ***	0.89 (2.49) **
crude 1			-	-					-0.05 (2.10) **		
crude 2			-	-					-0.05 (2.45) **		
LPC			-0.05 (1.38)								-0.08 (1.89) *
Int.	-23.23 (3.56) ***	-30.25 (4.96) ***	-30.24 (3.58) ***	-31.12 (3.68) ***		-23.45 (5.09) ***	-24.54 (4.90) ***	-24.05 (4.67) ***	-26.68 (4.68) ***	-24.67 (4.04) ***	-24.07 (4.14) ***
Adjusted R^2	0.67	0.70	0.74	0.73		0.67	0.68	0.72	0.75	0.74	0.72
No. of Obs.	5801	5801	5798	5801		5986	5986	5986	2422	5986	5986

B. Tobit Models RTA Effects

Var/model	XI(PPP)	XII (Current)		PICTA	MSG	SPARTECA-TCF	EPA	PACER-PLUS
PGNP	0.86 (59.07) ***	0.88 (58.06) ***		0.90 (57.05) ***	0.89 (60.03) ***	0.87 (57.03) ***	0.88 (56.05) ***	0.91 (58.01) ***
Dist.	-1.08 (51.12) ***	-1.10 (52.20) ***		-1.09 (50.12) ***	-1.08 (51.35) ***	-1.05 (52.23) ***	-1.06 (53.21) ***	-1.12 (54.21) ***
PGNPPC	0.44 (7.44) ***	-						
Border	0.70 (2.69) ***	0.53 (2.79) ***		0.32 (2.81) ***	0.36 (2.72) ***	0.41 (2.80) ***	0.43 (2.77) ***	0.45 (2.86) ***
Language	0.78 (2.89) ***	0.60 (3.05) ***		0.58 (2.98) ***	0.54 (2.87) ***	0.50 (2.89) ***	0.54 (2.96) ***	0.51 (3.01) ***
Comcol	0.59 (2.21) **	0.49 (2.32) **		0.30 (2.20) **	0.41 (2.15) **	0.43 (2.18) **	0.42 (2.02) **	0.44 (2.05) **
Col	1.30 (2.49) **	1.10 (2.55) **		1.05 (2.46) **	1.01 (2.49) **	1.02 (2.47) **	0.99 (2.42) **	0.98 (2.39) **
Comctry	1.31 (1.78) *	1.52 (2.02) **		1.64 (1.65) *	1.83 (1.69) *	1.86 (1.77) *	1.86 (1.88) *	1.87 (1.85) *
Landlocked	-0.42 (2.12) **	-0.22 (2.34) **		-0.03 (2.23) **	-0.04 (2.29) **	-0.05 (2.22) **	-0.06 (2.30) **	-0.07 (2.32) **
Island	0.12 (2.50) **	0.11 (2.87) ***		0.18 (2.53) **	0.20 (2.52) **	0.23 (2.87) ***	0.16 (2.82) ***	0.17 (2.89) ***
Regl.	1.12 (2.37) **	0.87 (2.58) ***		0.85 (2.32) **	0.82 (2.45) **	0.87 (2.50) **	0.81 (2.68) ***	0.84 2.70 ***
PICTA$_i$				0.06 (3.68) ***				
PICTA$_{ij}$				0.15 (3.88) ***				
MSG$_i$					0.05 (4.35) ***			
MSG$_{ij}$					0.12 (4.85) ***			
SPARTECA-TCF$_i$						0.11 (4.10) ***		
SPARTECA-TCF$_{ij}$						0.19 (5.02) ***		
EPA$_i$							0.02 (5.68) ***	
EPAij							0.09 (6.12) ***	
PACER-PLUS$_i$								0.12 (6.01) ***
PACER-PLUS$_{ij}$								0.26 7.25) ***
Int.	-32.32 (4.12) ***	-24.12 (3.89) ***		-22.32 (3.97) ***	-25.23 (4.02) ***	-23.32 (4.14) ***	-26.12 (4.20) ***	-27.54 (5.25) ***
No. of Obs.	5801	5988		4796	4796	4796	4796	4796

All variables except dummies are in logs.
All results are checked for heteroscedasticity.
Figures in brackets are t-ratios.

***, ** and * indicate significance at the 1, 5 and 10 percent levels, respectively.
LPC = log of the absolute difference in per capita incomes of country 1 and 2 in the bilateral pair.

$$PGNP = Log(Y_1 \times Y_2)$$

$$PGNPPC = Log(\frac{Y_1}{pop_1} \times \frac{Y_2}{pop_2})$$

Model Description

I. $log(Trade_{ij}) = \alpha + \beta_1 log(GNP_i \times GNP_j) + \beta_2 log(dist._{ij}) + u_{ij}$

[54]II. $Log(Trade_{ij}) = \alpha + \beta_1 Log(GNP_i \times GNP_j) + \beta_2 Log(Dist._{ij}) + Log(Pc_i \times Pc_j)^1 + u_{ij}$

III. IV with PC entered as absolute value of the difference of log per capita incomes

IV. II + All dummies

Models I to IV are estimated using GNP in terms of PPP.

V. I with GNP in current US$

VI. II with GNP in current US$

VII. VI + All Dummies[55]

VIII. VII+ Crude Oil Reserves[56]

IX. VIII for all reporter countries with GNP > US$3 million

X. VII with PC income variable entered to test for Linder/H-O hypothesis

XI. Semi-log (Tobit) estimation of VII

XII. Semi-log (Tobit) estimation of IV

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[54]Alternative model: II':

$$Log(Trade_{ij} = \alpha + \beta_1 Log(GNP_i \times GNP_j) + \beta_2 Log(Dist._{ij}) + \beta_3 Log(Pop_i \times Pop_j) + u_{ij}$$

[55] The variable for per capita income is dropped in this and all the subsequent models using current GNP figures.

[56] To account for natural resources of individual countries.

18. Appendix J: Social Accounting Matrix (SAM)

Receipts	Expenditures								
	Activities	Commodities	Factors	Enterprises	Households	Government	Capital Account	Rest of World	TOTAL
Activities		*Gross output*							*Total sales*
Commodities	*Intermediate goods demand*				*Household consumption*	*Government consumption*	*Investment*	*Exports*	*Aggregate demand*
Factors	*Vale added*							*Factor service exports*	*Factor income*
Enterprises			*Gross profits*			*Transfers*			*Enterprise income*
Households			*Wages*	*Distributed profits*		*Transfers*		*Foreign remittances*	*Household income*
Government	*Indirect taxes*	*tariffs*	*Factor taxes*	*Enterprise taxes*	*Direct taxes*				*Government revenues*
Capital Account				*Retained earnings*	*Household savings*	*Government savings*		*Capital transfers from abroad*	*Savings*
Rest of World		*imports*	*Factor service imports*		*Transfers abroad*	*Transfers abroad*	*Capital transfers abroad*		*Foreign exchange payments*
TOTAL	*Total costs*	*Aggregate supply*	*Factor expenditure*	*Enterprise expenditure*	*Household expenditure*	*Government expenditure*	*Investment*	*Foreign exchange receipts*	

Source: Reinert, K. A. and Roland-Host, D. W. (1997).

19. Appendix K: PFTAC Country Strategy Notes

PFTAC COUNTRY STRATEGY NOTES

Updates
April 2008

Prepared by PFTAC Advisors:

Suhas Joshi
Carson McNeill
John Vaught
Zia Abbasi

For updates/revisions by PFTAC Member Countries and Donors

PFTAC STRATEGY NOTES BY COUNTRIES

PUBLIC FINANCE ADVISOR

<table>
<tr><th></th><th>CURRENT SITUATION</th><th>RECENT RESULTS AND OUTCOMES</th><th>ADVISOR VISITS – 2007/2008</th><th>STRATEGY/ FUTURE VISITS</th><th>OTHER DONOR ACTIVITY</th></tr>
<tr>
<td>COOK ISLANDS</td>
<td> Reform. Ambitious Economic Restructuring Program commenced in ’96-97, based on the NZ model, designed to bring the overall budget outcome under control after a period of unsustainable deficits and excessive borrowing. Legislative and policy framework came into effect in the late ‘90s. Implementation of the reforms has laid the foundation for sound PFM.
Economic/Fiscal Issues: Gov’t finances appear to be in a good position with an operating surplus over the past 5 years. Data from ‘06/07 Budget :
<table>
<tr><th></th><th>‘05 % GDP</th><th>Est ‘06 %GDP</th><th>Proj ‘07 % GDP</th></tr>
<tr><td>Growth</td><td>2.2</td><td>1.8</td><td>3.5</td></tr>
<tr><td>Deficit</td><td>0.7</td><td>3.3</td><td>0.0</td></tr>
<tr><td>Ext Debt</td><td>26.9</td><td>11.0</td><td>10.3</td></tr>
</table>
Capacity: Have a number of very competent local managers. AusAID’s 2 yr funding of the Principle Economic Adviser ended in Dec ‘06. Strengthening Outer Island financial capacity has recently been undertaken in 3 islands and is to be undertaken in others.
PFTAC PFM missions. Earlier assessment was that no follow-up TA was necessary due to the strong NZ and AusAID TA presence. During March ’07 mission, new requests now made by authorities.
IMF Article IV. Not an IMF member. </td>
<td> CIs has successfully implemented a sound financial management framework and generally good practice. There has been a long period of sustained economic growth, with an average growth rate of 6.7% between 1999 and 2004, driven primarily by the private sector and tourism in particular but stagnated at 0.1% in 05 due to several cyclones. Planning, output budgeting, accounting policies and funds management have been refined over this period with significant multilateral and bilateral TA.
Major reduction in Crown Debt in 2005/06, down from 73% GDP to 28%, arising from the successful settlement of the long outstanding failed Hotel Project. Major policy announcements in the 2006/07 Budget, include: removal of import levies, estimated to cost $6.3m and expected to be offset by higher projected growth in other sources of revenue; and a cost of living adjustment, estimated to be around 10-12%. In addition, from March 2006, superannuation coverage is being progressively expanded to the private sector and authorities are considering an increase in the minimum wage. </td>
<td> PIFMA: 3 participants attended the March ’06 conference in Suva and seven in March 2007 in Rarotonga.
April ‘06 : Mission undertaken at request of Minister to develop ToR for Training of Outer Island Finance Officers (OIFO).
March 07: During the introductory mission of PFTAC Advisor, in conjunction with the PIFMA meeting, two requests, one for training in debt management and another for assistance in medium term budgeting, were received. </td>
<td> PIFMA: Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009.
Attachments: One official on attachment to PFTAC for 2 weeks in February, 2008.
Further TA: provide assistance in medium term budgeting (MTB) and debt management (expected to start in June) </td>
<td> NZAID/AusAID: Co-funded project facility managed by NZAID ’04-’06, focused on outer islands development, education, human resource development and good governance.
ADB is providing assistance primarily through support for specific sectoral programs, including for reform of SOEs and strengthening economic development and planning capacity and governance and has expressed an interest in working with PFTAC in the MTB area. A Pacific Island Economic Report (PIER) for Cook Islands has recently been concluded. </td>
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PFTAC STRATEGY NOTES BY COUNTRIES

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
Cook Islands	No T/A advice has been sought nor given since the 2002 mission.	**PITAA Conference August 2006.** Informal discussion with Cook Islands Commissioner during PITAA, August 2006 indicated difficulties with RMS and case selection together with the capacity of the server PFTAC has since discussed this issue with *Datatorue,* developer of RMS. Dialogue is now taking place. Court action is being taken against high profile business persons for fraud. Of note is the decision to abolish most import levies effective 1 July 2006. The total value of the removed levies is estimated at approximately $NZ4.5 m per annum.	**Nil**	No major activity planned	Assistance from New Zealand Government, mainly through the providing of skilled staff from New Zealand. As at September 2006 three staff are employed ex IRDNZ

PFTAC STRATEGY NOTES BY COUNTRIES

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
Cook Islands	CI removed from NCCT "black list" February 2005. The Financial Supervisory Commission (FSC) is tasked with the regulation and supervision of all licensed financial institutions in the Cook Islands. Licensed financial institutions include banks (both domestic and international), trustee companies, and insurance companies. The FSC has conducted a number of on-site inspections focusing on credit risk management and AML/CFT compliance in both the banking and trust company sectors. The Financial Intelligence Unit (FIU) has a mandate under the legislation to conduct compliance audits on financial institutions, analyze suspicious transactions reports and currency reports.	PFTAC has liaised with the FSC to identify areas where further work is needed – supervision of the insurance and trust and company service provider sectors. (IMF MFD has previously provided peripatetic bank supervision TA). IMF peripatetic advisor visited FSC in February 2008 to review draft insurance legislation, prepare licensing guidelines for different insurance types, prepare reporting forms for gathering financial and statistical information and to train FSC staff on insurance supervision. A follow-up visit is scheduled for August 2008 once revised legislation is in place. New insurance legislation covering domestic and offshore sectors is expected to be introduced in 2008.	PFTAC advisor visited CI for one week in August 2005. Focus of the mission was to: Train newly appointed bank supervisory staff; Review, comment, and make recommendations on existing trust company legislation; and Conduct general training on bank supervision issues and provide guidance in the area of analysis and report writing. PFTAC advisor visited CI in Jan/Feb 2006 to lead an on-site examination of a licensed financial institution. PFTAC advisor arranged for an attachment of two BPNG staff to the FSC in March 2007 to assist in an on-site examination of a domestic bank. PFTAC advisor visited in May 2007 to assist with an on-site examination of a domestic bank and to train FSC staff.	Future TA visits will be needed to strengthen capacity once revised insurance legislation is in place. PFTAC has recommended that consideration be given to establishing a supervisory regime for pension funds. TA to improve legislation in the area of trust and company service providers is required and the Commissioner FSC will be looking for assistance.	**AMLAT & PALP** have been mentoring the FIU and assisting with an investigation. PALP is to provide assistance to review AML/CFT and related legislation. **NZAID** provided assistance under the Public Sector Technical Assistance Fund to assist with drafting new insurance legislation. **Forum Secretariat** recommended that it and PFTAC identify gaps in CI's supervisory framework and explore ways to address these gaps. To date, the Forum has not progressed the issue.

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR/EXPERT VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
COOK ISLANDS	A relatively complete statistical system for a Pacific Island country. Annual data for GDP, GFS and BOP, quarterly CPI and banking data. Reasonable source data for GDP, although compilation methods need to be improved and expanded to other NA aggregates. There is scope to improve range and data quality for all statistics sectors. An experienced Government Statistician and a relatively stable and experienced team. Use the NZ dollar, no central bank. Signed up to GDDS and metadata has been drafted – but not yet finalized. Not an IMF member.	A monetary statistics short-term expert mission was arranged during 2007, to assist in the implementation of *MFSM 2000* standards, including standard report formats for the Depository Corporations Survey (DCS). Two expert missions undertaken in 2003 to assist with transition to *BPM5* standards One staff attended regional BOP course in April 2005. Recently completed processing of 2006 Population Census data. Rebase of the Consumer Price Index (CPI), using 2004 Household Income and Expenditure Survey (HIES) expenditure data, with technical assistance (TA) from Statistics NZ.	Advisor: GFS mission in October 2007 to commence implementation of *GFSM 2001* standards. Experts - MFS review mission undertaken in September 2007 to assess ways to improve monetary statistics. Follow-up GFS mission in April 2008 to continue implementation of *GFSM 2001* standards. And to produce revised statistics.	Advisor: NA statistics mission to assess and recommend improvements to sources and methods tentatively planned for early 2009. Finalize GDDS metadata. Experts: Prices statistics mission to rebase CPI and introduce import price indexes planned for early 2009. Future GFS and MFS missions subject to needs assessment.	SPC were assisting with improvements to GDP, but ceased in 2004. SPC assisted with 2004 HIES. Statistics NZ assisted rebase of CPI, and will be assisting on strategic planning and forward work program development. UNDP provided funding assistance to finalize 2006 Population Census analysis and reporting work.

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
FEDERATED STATES OF MICRONESIA	Federation system makes fiscal management difficult. Last Article IV Review in 2006; 24 month cycle.	PIFMA: One person each attended the workshop in Dec. 2006 and meeting in March 2007.	The advisor has not visited FSM since May 2006. However another mission is planned for later in 2008, possibly with ADB.	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. **Attachments:** One official on attachment to PFTAC for 2 weeks in May 2007	

PFTAC STRATEGY NOTES BY COUNTRIES

TAX & ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
FEDERATED STATES OF MICONRESIA	National and State legislatures yet to fully commit to revenue reforms. Need to resolve constitutional issue relating to taxing rights AusAID long-term TA to implement tax/customs reforms utilizing PFTAC detailed implementation plan.	Government preparing to implement tax reform.	**May 2007:** T.A. on Revenue estimates **May 2007:** T.A. to assist Authority to market the tax reform program to a newly elected national legislature and State legislature. **June2007**:T.A-.Detailed Implementation plan prepared.	PFTAC to provide high-level overview and continue with selective assistance	AusAID – refer to Current Situation.

PFTAC STRATEGY NOTES BY COUNTRIES

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
FEDERATED STATES OF MICRONESIA	The Banking and Insurance Board (BIB) is responsible for the supervision and regulation of licensed banks and insurance companies (captives). The Board is also responsible for consumer protection legislation. The Federal Deposit Insurance Corporation (FDIC) provides deposit insurance coverage of licensed banks. Reporting of suspicious transactions to the FIU is mandatory for financial institutions and cash dealers. No guidelines have been issued by the BC The FSM BIB and its Banking Commissioner have received extensive technical assistance and training from PFTAC/IMF-MFD over the past 5 years.	In response to the increased supervisory responsibilities, the BIB has hired additional staff. The PFTAC advisor has been providing assistance to the Commissioner in relation captive insurance regulation. Effort by the Commissioner to have credit union subject to oversight by the BIB have been rejected by Congress (and Yap), as these are not seen as “deposit” taking institutions. A credit union in Yap had deposits with a failed Palauan bank.	The advisor has not visited FSM reflecting the level of peripatetic TA provided by IMF MCM. An IMF MCM peripatetic advisor on banking supervision concluded a two-week visit with BIB in March 2008 providing assistance in conducting on-site examinations of branch operations of banks and off-site monitoring techniques of banks. An further visit by the peripatetic banking supervision advisor is planned for June 2008. Additionally, a peripatetic advisor on insurance supervision is planned for June 2008.	PFTAC advisor has scheduled a visit with the authorities in mid-April 2008 to provide assistance and training in credit risk assessment, off-site monitoring and insurance regulation. Authorities will require ongoing assistance and training in the supervision and regulation of captive insurers. Additionally, authorities have recently requested assistance in reviewing a branch application by Bank of Guam in light of the lack of reciprocity by BOG’s home country/jurisdiction.	**AMLAT** may assist FSM to strengthen AML/CFT capacity in law enforcement sector and update AML/CFT legislation.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR/EXPERT VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
FEDERATED STATES OF MICRONESIA (FSM)	A review of statistical operations of the Department of Statistics within the Department of Economic Affairs was completed in 2001 and then updated in 2003, as part of an Institutional Strengthening Project (ISP funded by ADB) (refer "The Challenge of Statistical Capacity Building in the Pacific", IMF/PFTAC Nov 2002). Included plan for development. Macroeconomic data have been produced by external advisors, with little ongoing capacity building. Local staff have difficulty obtaining monetary statistics for publication and use in other macroeconomic statistics. FSM has PC Trade, used for customs processing and statistics. Has had significant TA in Customs work. Fishing is a major policy issue. FSM has no central bank and uses the US dollar. Not yet participating in GDDS. As with RMI and Palau, required to prepare annual Compact Report for US Government to monitor effectiveness of US aid.	A resident advisor was in FSM for nearly three years until mid-2005 (Aus AID/ADB funded as part of Institutional Strengthening Program). He developed and compiled GDP (income and production measures) and GFS, following the three year development plan prepared in 2003 by PFTAC. Largely based on administrative data, social security records, and public enterprise accounts data. One economics-trained counterpart in place to continue this work, but largely diverted to other tasks – she attended regional BOP course in April 2005. The previous resident advisor returned on a six week mission to update estimates for the February 2006 Compact Report (funded by FSM). Advisor trained local staff in national accounts, theory and practice as used for FSM compilation in November 2005 and October 2006. Developed a plan for the staff to attempt to update the statistics on their own, ready for peer review by PFTAC Advisor in May 2007. However, the same consultant was engaged again. Staff have not had the opportunity to apply the skills acquired through training. Brief visit by the Advisor to meet new Government Statistician and review needs in June 2006.	Advisor: • No missions in 2007/2008. • Last mission was in October 2006 – two week national accounts course presented. Contracted the (former) long term consultant who provided very hands on and practical training in the systems and methods used. Developed an agreed plan for the local staff to learn by doing, attempting to update the estimates, but this plan was subsequently not implemented. Included visits to states to explain the National Accounts to state governors and others.	FSM has requested assistance to build capacity over two years in BOP, NA, GFS and CPI, but has yet to recruit additional staff (other than in the CPI area). PFTAC Advisor will continue to encourage participation in GDDS, but severely constrained by capacity for macroeconomic statistics – encourage government to increase economic statistics staff numbers to at least three, one each for GDP, BOP and GFS. NA statistics mission tentatively planned by Advisor for August 2008 (back-to-back with RMI mission).	US Office of Insular Affairs: mainly on social statistics – largely ceased now. US Bureau of Census: assisted with processing of 2005 HIES. ADB: Institutional Strengthening Project until December 2004. PFTAC peripatetic advisor on customs processes. Assistance from SPC for CPI rebasing. Aus AID funded, with ABS, on project management training.

PFTAC STRATEGY NOTES BY COUNTRIES

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
FIJI	**Reform:** Slowed momentum since Dec. 2006 coup. Earlier, MoF driving FMR based around: implementation of the FMA '04; a new FMIS; devolution of financial management responsibilities to CEOs; intro performance-based budgeting and longer term phasing in of accrual accounting. **Economic/fiscal issues:** Especially vulnerable economic outlook post coup arising from donor reaction and even earlier, related to sugar and garment sectors; expansionary fiscal policy and increasing domestic debt; limited capacity for redirection of resources to priority areas; lack of budget discipline and poor expenditure control & cash management - increasing use of Treasury Bills. **Capacity:** PFM capacity thinly spread. Persistent vacancies in Budget. Silo operations and lack of action on compliance breaches. New FMIS should assist with expenditure control. **PFTAC PFM missions:** 7 since 2000. ROSC finalized March '04. Action Plan for strengthening PFM April '04. **IMF Art IV**: Last Article IV December 2007; staff visit May 2008.	**Public Accounts Committee** re-established end of 2004 and working its way through long outstanding accounts. Recent Gov commitment to putting in place mechanisms for following up on AG's report but stalled after the coup.. **May '05 WB/AusAID mission** assessed developments in the PSR program. Proposed a series of joint PERs to clarify the links between policy and expenditure **Dec '06 Public sector salaries and wage settlement.** Provided a 16% increase across-the-board (partly backdated) for the period '03-'07. However, post-coup a salary cut has been imposed in the new budget. The Dec. 2006 coup has made significant changes in the structure of the government and pace of fiscal reform.	**May-June '05:** development of a Good Practice Financial Management Guide to assist CEOs, Accounting Heads and line managers understand their responsibilities under the FMA and key elements of good practice PFM. **Aug-Sept '05 2006 Budget**: Assist with updating the medium term economic and revenue forecasts; and development/presentation of fiscal aggregates within a MTFF. **PIFMA Conference** in Suva, end of Feb '06: 3 participants attended. 2 participants in Nov. 06 workshop and one in PIFMA meeting in March 07 and March 2008, each. **12 wk peripatetic adviser Portfolio Performance Statements (PPS) FY2007**. Consultant completed his assignment in November 2006 but further work required. No formal request received from the new government.	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. **PPS:** After a peripatetic advisor in December 2007 to rejuvenate the system the PFTAC PFM Advisor is now working to finales the Performance Budgeting system in Fiji. **Strengthening Treasury management:** authorities requested PFTAC to provide follow-up TA to April '04 mission. However no formal follow up request after the coup although indications of request likely shortly. **Economic Reform Program (EPR) TA.** Joint AusAID, ADB and PFTAC mission to develop policy matrix, linked to ADB program loan, was under discussion, till the coup **Debt Management:** Assistance in debt management given in August 2007. **Attachments:** One officer from RMI and Tonga each, attached to MoF, Fiji in last quarter of 2006.	**AusAID:** Country Program estimate '05-06 $24m. TA focus on governance, improving human/financial resource management, and delivery of improved services in rural/urban areas. TA to the MoH for FMIS implementation. Since mid-2005, funded short term TAs to MoF in Accounting Policy, Performance Budgeting. **ADB** annual TA program of around $1.5m. TA support for FMR in '04 drafting FMR policy, FMA and Regs, FMIS tender. Early '05 S/T TA Public Sector Banking and Cash Management. **Recent ADB Reports: -** PIER update for Fiji report, June '05; - Fiji Macroeconomic Assessment, April 2006; - ERP Concept Paper June '06 and follow up meetings.

TAX ADMINISTRATION & POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
FIJI	In 2006 the Minister of Finance instructed FIRCA to undertake a review of its governance and administrative operation.	IMF/PFTAC March 2008 mission recommended : (a) improve strategic, business and reform plans; (b) develop TA requirement	**March/April 2008**: a joint IMF/PFTAC mission reviewed and made recommendations relating to the autonomy of FIRCA as a revenue authority and Domestic tax reform	T.A needed to implement the recommendations of the IMF PFTAC mission IMF/PFTAC policy mission planned [2008/09] to complement the earlier Revenue Administration mission July 2008; IMF Legal mission to finalise modernized RAA	None known

PFTAC STRATEGY NOTES BY COUNTRIES

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
FIJI	The Reserve Bank of Fiji (RBF) has supervisory responsibilities for banks (4 foreign banks and 2 local banks) and three credit institutions (all local). In 1999 the RBF replaced the Insurance Commission to perform the functions under the Insurance Act 1998. There are currently 7 general insurers and 2 life insurance companies. In August 2003, the RBF's supervisory net was further expanded to include the National Provident Fund (NPF). The FIU is currently "housed" in the RBF. In early 2006, the RBF restructured its supervision department.	The RBF is expanding its on-site inspection program for banks to include operational risk management. The RBF is enhancing its supervision of insurers. The RBF is developing policy guidelines for the pension fund sector. Other policy related work includes consideration of issues related to: The supervision of financial conglomerates; The implementation of Basel 2; Liquidity requirements for banks; and Payments System and Real Time Gross Settlements. RBF/Fiji has benefited from a considerable amount of TA from IMF MCM and LEG: 7 insurance TA missions over the past three years. New advisor commenced insurance TA in Sept. Mar 2005, MCM mission to develop pension fund supervision framework. New peripatetic advisor commences in Nov 2005.	Limited involvement from PFTAC as RBF prefers to use APRA or to access other overseas training. APRA has provided attachments (in all areas) to RBF supervisory staff. PFTAC provides funding assistance. In 2007 the Advisor assisted the RBF undertake on-site AML/CFT inspections.	PFTAC advisor will respond to requests from RBF and will also keep a watching brief on developments in the supervision of the pension fund, given RBF's reluctance to supervise the entity. PFTAC advisor to ensure that RBF supervisory staff have the necessary skills and training to undertake AML/CFT inspections of supervised financial institutions. In 2008, MCM is to provide assistance to the RBF in respect of the supervision of the national provident fund.	**APRA** is likely to be approach APRA for additional secondments during 2008. **AUSTRA** (with the assistance of AusAID funding) is developing a database and reporting system (including CTR reports) for the FIU. *(This project is on hold following the 2006 coup).* **AMLAT** based a police investigator in Fiji. Coordinator still to come to Fiji. **PALP** coordinator based in Fiji to complement AMLAT. PALP and AMLAT working with authorities in respect of Border Cash Reporting and developing a risk-based approach to AML/CFT.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR/EXPERT VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
FIJI	Fiji has a relatively good range of statistical outputs, with the Bureau of Statistics (FIBOS) producing: annual real GDP (*SNA 1993* basis) annual and quarterly BOP (*BPM5* basis), and has trial IIP migration and tourism data quarterly industrial production index, CPI and a building materials price index, building work-put-in-place. FIBOS had significant staff turnover but recruited successfully in 2007. Few experienced staff at high level in economic statistics. Severe constraints on telephone, fax, email and internet access below senior manager level hinders operations. Fiji participates in the regional ICP/PPP project, acting as the link between the Pacific and Asia. The Reserve Bank or Fiji (RBF) compiles timely monetary statistics (Depository Corporations Survey). Ministry of Finance compiles GFS tables with the budget which are published in the IMF GFS Yearbook. GDDS metadata are published.	Conducted an HIES (2003) which is being used to rebase CPI and NA (still being finalized); and 2002 business censuses to rebase real GDP to 2002 and to compile nominal GDP. Advisor reviewed the NA system and forecasting in 2005. A project to develop a tourism satellite account recently completed by FIBOS and Ministry of Tourism (1995 TSA published in December 2006). The 2002 TSA will be based on an input-output table being compiled by FIBOS. Advisor has peer-reviewed 2002 GDP(P) estimates and TSA analysis. Work has commenced on redeveloping annual expenditure measures of GDP, for reconciliation with production measure and for improving macroeconomic forecasting. GFS mission in August 2005. In 2005 budget the MOF included a GFS presentation of the budget for the first time. GFS being released in the IMF GFS Yearbook. A new FMIS is being implemented across central government. BOP/IIP mission in September 2006 – recommended changes have largely been implemented by FIBOS. Transition to *BPM5* is nearing completion. Assistance provided by PFTAC Advisor in April 2008 and expert in September 2006. Staff attended regional BOP course in April 2005. Attachment with Statistics NZ in 2005 (also Vanuatu). Attachment with Statistics NZ on price indexes – March 2006. BOP staff attended IMF BPM6 course in Singapore, March 2008. MFS workshop conducted in December 2005 - held in Fiji to promote MFSM 2000 standards (involved Samoa, Fiji and Solomon Islands).	Advisor: Ad hoc advice and peer review of business census data, GDP, HIES analysis, and BOP. February 2008 - Review of sources and methods used to produce GDP(P). March 2008 - Development of a draft TA action plan to support BOP, NA, and Prices statistics and related source data development work by FIBOS. April 2008 – Review of sources and methods used to produce BOP statistics. Experts: MFS mission in January 2008 – recommended changes being implemented by RBF. Import price index (IPI) development mission in February 2008 – FIBOS has commenced the import prices survey. Other: • March 2008 – BOP statistician attended an IMF regional course on *BPM6* standards in Singapore. • April 2008 - GDDS country coordinator attended an IMF GDDS workshop in Bangkok.	Advisor: Technical advice on statistics prerequisites, as well as BOP, NA, and Prices concepts, sources and methods. Assist with GDP rebase and GDP(E) development. Peer review of admin and surveys data, CPI rebase, BOP, IIP, GDP, and IPI. Follow up on progress on recommendations of GFS and MFS expert missions. Experts: GFS follow-up mission will be required once new FMIS implemented. IPI follow-up mission tentatively planned for July/August 2008. Other: IMF Regional Statistics Course on Financial Soundness Indicators to be conducted in September 2008 (co-hosted by Reserve Bank of Fiji, and funded by ADB) Country GDDS coordinator to update GDDS metadata.	ESCAP mission - capital formation, mid-2005. Statistics NZ – input-output table and TSA (capacity building and compilation assistance) –2005-2006. Provide considerable assistance via attachments. ICP project brings some assistance on prices and will bring some assistance in 2008 on expenditure on GDP. ADB funding for IMF Regional Statistics Course on Financial Soundness Indicators. ESCAP/SPC – assistance with micro-data management as part of the Accelerated Data Project.

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
KIRIBATI	**Reform:** National Development Strategy (NDS) '04-07 priorities includes economic growth, public sector performance and sustainable use of financial reserves. Donor concern over: a lack of demonstrated gov support for competitive private sector development; a poorly performing public service; and heavily subsidized/inefficient SOEs. **Economic/fiscal issues:** weak economic growth projections; volatility of fiscal revenues; and expansionary fiscal policy. Request made to donors in July 06 for support totaling USD 30 m. as budgetary support but withdrawn after joint ADB/PFTAC mission. **Capacity:** Improved the financial and economic management a priority. A medium term budget mechanism would help fiscal management in view of the wide fluctuations in revenue. **PFTAC missions:** 2 missions April '00 & Feb '02 focused on FTQ. A joint PFTAC/ADB mission in August 2006 was followed by a joint donor mission with AUSAID, NZAID, PFTAC and ADB in December 2006. Identified several areas where donor TA could be useful. **IMF Article IV:** 24 mth cycle. Article IV January 2007; Staff Visit February 2008.	Fiscal policy in highly expansionary and a steep drawdown from the Revenue Equalization Reserve Fund (RERF) to meet deficit. Government filled the gap by borrowing from ANZ Bank of Kiribati There is a need to reduce the wage bill, better target copra and seaweed subsidies, and limit development spending to available donor grants. Authorities recently committed to a joint country strategy with Aust/NZ with the intention to expend this to include other development partners (including Taiwan, WB and UN) and integrate in budget framework. At the Mch '06 PFTAC Tripartite meeting, the Minister requested PFTAC to be involved in this, particularly in relation to developing a MTFF. Following this PFTAC participated in two joint donor missions.	Aug. 06- **Joint ADB/PFTAC introductory mission August '06**. PFTAC advisor participated in ADB mission in July '06. TA needs identified and donor coordination underway to determine the next steps forward. **December 2006**-:A joint donor mission with AUSAID, NZAID, PFTAC and ADB led to requests to PFTAC to assist in multi year budgeting and cash management and commitment control. **PIFMA Conference** in Suva, end of Feb: No nominations received from Kiribati. Participant in workshop in Nov. 2006 and at second and third PIFMA meetings in March 2007 and 2008 respectively.	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. **Donor coordination and needs identification:** Following a joint ADB/PFTAC mission in Aug. 06 and a joint AUSAID/NZAID/ADB/PFTAC mission in Dec. 06- a basic need identification document prepared and request for assistance in multi year budgeting and cash management and commitment control now received. Work will start as soon as ADB processes the funding.	**ADB:** program for '05-06 maintains a focus on developing outer islands, promoting social development, and improving governance. Includes TA in '06 to promote private sector investment by improving the country's regulatory framework; and TA to improve corporate governance in certain public enterprises. ADB Suva office last year took over from Sydney office responsibility for ADB Kiribati programs. **AusAID:** $2.7m in '02-07 for implementation of a FMIS (recently reviewed). TA is also provided across a range of sectors. TA recruited under the *Pacific Technical Assistance Facility*. Currently several Australian volunteers, working in government and private sectors.

PFTAC STRATEGY NOTES BY COUNTRIES

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
KIRIBATI	The domestic revenue issues require to be addressed with some urgency Compliance are low and the impact of trade liberalisation is expected to reduce trade revenues by 15 percent. The timing of this impact currently being discussed.	PFTAC recommended reforms in 2003 which included: a VAT; presumptive tax; a single ad valorem tax on imports from non Pacific countries; simplifies PIT; single rate of CIT The Ministry of Finance will shortly present a case to Government on tax reform. PFTAC has advised against the option of a sales tax regime in place of a VAT	**March 2008:** IMF/PFTAC VAT policy research mission visited Kiribati.	PFTAC will encourage the government to urgently undertake much needed revenue reforms and continue to provide technical assistance in that respect	AusAID and ADB

PFTAC STRATEGY NOTES BY COUNTRIES

FINANCIAL SECTOR SUPERVISION

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
KIRIBATI				The advisor was requested to visit Kiribati in **November 2005** to meet with stakeholders prior to the enactment of legislation. (Mission did not proceed due to plane problems). It is likely that PFTAC may be asked to provide assistance to authorities to establish the supervisory authority and implement appropriate supervisory framework based on international standards. The advisor will liaise with IMF MFD as appropriate. Advisor will be inquiring with authorities regarding status of FIA adoption.	**AMLAT** is providing assistance to establish the FIU. **Forum Secretariat** recommended that it and PFTAC identify gaps in Kiribati's supervisory framework and explore ways to address these gaps. To date, the Forum has not progressed the issue

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
KIRIBATI	Overall review in 2002 (refer "The Challenge of Statistical Capacity Building in the Pacific", IMF/PFTAC Nov 2002). GDDS metadata is published, but due for updating. Most source data are not timely and have limited coverage. Public enterprises account for around 90% of economic activity. Remittances are significant. Reasonable trade data. GDP growth rates are volatile. Very limited capacity in economic statistics and needs to be improved in the medium-term. No MFS at this stage. Considerable scope to improve BOP, GFS, MFS, NA and prices statistics source data and statistics techniques, as well as updating time series. In 2006 repatriation of significant numbers of Kiribati workers from Nauru.	Production of BOP statistics has been moved from the Statistics Office to the Ministry of Finance. It had been intended in 2007 to move the BOP statistics production back to the Statistics Office but the designated officer began full time study at USP on official statistics course, so this will not happen for some time, unless additional staff with economics background are recruited. Two staff attended the regional BOP statistics course in April 2005. The Advisor visited Kiribati in April 2004, as part of UN MDG workshop, and again in August 2006 to assess statistics needs.	Advisor: • Ad hoc technical advice provided, on request. Experts: • None. Other: • April 2008 - GDDS country coordinator attended an IMF GDDS workshop in Bangkok.	Advisor: • Train a Kiribati statistics officer attending the official statistics course at USP. Plan to train in practical NA and BOP to learn how to compile them and to actually update them, even while at USP. Intend to include reviews of methodology while training. • Tentative BOP statistics development and NA statistics review mission planned for October 2008, in order to improve production of BOP and GDP estimates. Experts: • Possible GFS, MFS and prices statistics missions, subject to request from the authorities.	2005 Population Census conducted with donor financing and TA support.

PFTAC STRATEGY NOTES BY COUNTRIES

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
NAURU	**Reform:** A reformist administration elected in Oct '04 has a strong public mandate to implement economic reforms. Next elections due in Nov. 2007 **Economic/fiscal issues:** economic indicators, such as GDP and inflation not available. Ssignificant development challenges, including a shrinking resource base and unsustainable government expenditure. . **IMF Article IV:** Not an IMF member.	In March '04 Aust signed the third MOU for management of the offshore processing centre for asylum seekers and Nauru's long-term development ($29m '03-05). Key features of the MOU includes deploying an in-line finance team of Treasury and Finance officials to help carry out the economic reform agenda. This includes budgeting and revenue generation. PFM Advisor visited in June 2007, and again in December 2007, to install a cash planning system , provide training and to introduce a basic commitment control system.	**PIFMA Conference '06**: 2 participants attended. 2 participants attended both the workshop at Nadi in Nov. 2006 and PIFMA meeting in Rarotonga in March 2007..	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. **Attachment**: one official attached to PFTAC advisor for 3 weeks in March-April 2007 .	**AusAID:** Provides several in-line officers including the Secretary (Finance), Economic Advisor and the Budget Advisor. Other consultants also work in debt management, SOS, planning and related areas. For first time training now being imparted for local counterparts in SOE area. **ADB:** In 1999 ADB provided a US$5m loan and a $600,000 TA grant for a Fiscal and Financial Reform Program to introduce extensive fiscal reforms, an asset management framework for phosphate and financial investments, and carry out reforms in the public and financial sectors. The TA grant focused on strengthen capacity in financial and economic management. *Current status of ADB programs unknown*.

PFTAC STRATEGY NOTES BY COUNTRIES

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
NAURU	Political instability [stalemate over elections & appointments] is currently delaying engagement from PFTAC		nil	PFTAC sensitization has resulted in recognition on need for reform. Continue to engage at a high level [quality-control mode]	AusAID and ADB involved in economic reform.

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
NAURU	**There is no formal banking system with Nauru largely being a cash-based economy.** **Nauru removed from NCCT 'black list' in September 2005.** In June 2003, Nauru announced that it would revoke all its international (offshore) banking licenses. Further in December 2003, Nauru gave a commitment to the OECD to abandon its tax haven and banking secrecy regime. Nauru believes that the actions it had taken would get them off the FATF blacklist, without the need to set up any regulatory body, either to carry out financial supervision or implement AML measures. Nauru removed from 'black list' and placed on probation.	In July 2006 an advisor visited Nauru in response to a request from authorities for TA to conduct a diagnostic review of the current financial sector legislative and regulatory regime including (but not limited to) AML/CFT and make recommendations on an overall needs assessment for effective administration. Authorities hope to establish a supervisory/regulatory framework which will attract a foreign bank to establish operations in Nauru. Authorities have drafted a new banking act that will provide a sound basis for a supervisory framework. PFTAC/MCM/LEG provided comments on the draft to Nauru in March 2007.	No visits are planned by the PFTAC advisor although authorities have been advised that assistance, if needed, can be provide on the implementation of the new banking legislation once implemented.	PFTAC advisor will assist in the development of an appropriate supervisory and regulatory framework. This may include identifying an appropriate financial sector supervisor and developing a TOR. PFTAC advisor recommended that Nauru develop new banking and insurance legislation and liquidate the Bank of Nauru. In addition to banking supervision, assistance will be needed to develop a framework for the supervision of insurers.	Given the nature of the request from authorities it is likely that some aspects of the TA will, in addition to IMF/PFTAC TA, be undertaken by **AMLAT, PALP** and **the Forum Secretariat.** **AMLAT** has assisted the authorities in drafting AML/CFT legislation and establishing a FIU. **Forum Secretariat** recommended that it and PFTAC identify gaps in RMI's supervisory framework and explore ways to address these gaps. To date, the Forum has not progressed the issue.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
NAURU	Small NSO, with three staff compiling basic statistics on CPI, population and some trade data. Severe difficulties with source data – final actual government expenditure data produced for 2004/05 first for many years, no accounts for public enterprises for at least 5 years and no administrative records available (government computer bureau defunct for several years). Small private sector dominated by Chinese traders and restaurants with poor record keeping. Staff of the Statistics Bureau have continued to work despite being paid only irregularly until recently and now at less than one third of expected pay (government cash flow problems). At present no capacity in economic statistics. No Central Bank. Australian dollars are used as the main currency.	In 2004 the SPC statistician compiled an estimate of GDP. The Advisor conducted a review of SPC statistician's GDP estimates in July 2005 (requested by ADB). The estimates were not accepted by Nauru Government (considered too high). National development strategy was presented at donors' roundtable in November 2005, attended by the PFTAC Advisor. Statistics Bureau conducted the 2006 HIES for poverty measurement purposes and to rebase the CPI (with assistance from SPC). The Advisor participated with ADB consultants in an economic assessment mission in August 2006. The Chief Statistician will be on a six-month training course with UN SIAP in 2008.	Advisor: • Ad hoc technical advice, on request. Experts: • None.	Advisor: • Provide ongoing technical advice as the Statistics Bureau re-establishes its functions, particularly if it is able to establish an economic statistics programme. • Tentative BOP and NA statistics review mission planned for November 2008.	Forum Secretariat have assisted to establish an aid management office to coordinate aid across government departments. 2007 Demographic and Health Survey conducted with ADB funding and SPC TA. AUS Aid have staff in line positions in Min of Finance to aid budget processes. Also in police, health and education. Asylum seekers' processing centre has been a significant source of income. ADB funded, with ABS/SPC, on project management training. Taiwan recently provided funding to assist repatriation of workers from Tuvalu and Kiribati, including payment of salaries due.

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
NIUE	**Reform:** Niue was devastated by cyclone Heta in Jan '04. Estimated $NZ40m damage. The current priority of the Gov, with significant donor support, is implementation of the Cyclone Heta Recovery Plan and secondly to continue with implementation of the economic initiatives under the Niue Integrated Strategic Plan. **Economic/Fiscal issues:** Ttourism, fisheries and horticulture provide the most significant prospects for economic development. A program and sequencing of projects is being prepared in consultation with donors. Current GDP figures unavailable. **PFTAC missions:** No PFM mission given level of support from NZ and Australia. **IMF Article IV:** Not a member country.	A Trust Fund is being established through consultations between Niue, Aust and NZ to provide a revenue stream to the Gov to fund recurrent budgetary costs. In 2004 Aust contributed AUS$4m, NZ$5m and the Gov $50,000 towards the establishment of the Trust Fund. In the '04/05 Budget the Gov announced a initiative for a 'Whole of Government Review', focused on the management of gov expenditures and deficits, including appropriate government structures, as well as revenue and capital investment requirements needed to develop the economy. The review was recently undertaken with NZAID TA which assessed immediate fiscal problems and longer-term issues such as the appropriate size, structure, and configuration of government institutions. A Joint Working Group has been set up with officials from both Governments to oversee and monitor the implementation of the reform. Preliminary consultations with departments underway	**PIFMA Conference '06**: 2 participants attended. Nov '06, participant attended MTBF workshop; but no participant for Mch '07 Conference. Participant in March 2008 PIFMA.	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. At the last PFTAC TRC meeting in Mch '06, the authorities identified that PFTAC TA would be beneficial in economic and fiscal forecasting capacity development. Also mentioned 2-3 week attachments of MoF officials in the Cook Islands and/or Samoa but no formal request received. **Introductory mission proposed for 2nd quarter 2008** for new PFM Adviser to discuss these issues further.	**AusAID:** approx $1m bilateral aid annually to support efforts to promote economic development and growth, and increase in self-reliance. Includes 2yr TA placements such as an Accountant in Treasury. **NZAID:** approx NZ$8m bilateral annually $10m over 5yrs to strengthen links between NZ and Niue gov departments.

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
NIUE	In 2008 Niue will embark on a revenue reform programme with strong support given from the NZ Government in the form of technical advice and in line advisors – to build capacity and help implement the reform programme.		**July 2007:** Revenue Administration and reform mission to assist NZ advisors and provide an independent viewpoint for the Ministry of Finance on policy and administrative considerations	Continue to engage at a high level [quality-control mode]	NZAID is directly involved in providing advice to the Government

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
NIUE	The Niue Bank Act 1994 provides for the creation of the central bank. However it has not yet been established and the Monetary Board, which is also established under the Niue Bank Act, is the board of directors of the Niue Bank. The Monetary Board is "responsible" for the supervision of banks and other financial institutions. There is one bank in Niue and no insurance companies. Money remitters are not subject to any control. The FIU is responsible for the implementation of the provisions of the FTRA which include customer identification, record keeping and suspicious transaction reporting.	In August 2004, the Government of Niue announced its decision to close its international companies register. Legislation supporting this decision is still to be presented to Parliament. In **December 2004**, the APG conducted an assessment of Niue's AML/CFT regime and identified a number of gaps. In **April 2005**, IMF LEG and PFTAC visited Niue to provide TA to strengthen both the FIU and supervisory framework. During the mission, officers were assigned responsibility for the FIU and bank supervision. New legislation has been drafted covering AML/CFT with assistance from NZ.	No missions have been conducted since 2005.	At this stage no visits planned although advisor is prepared to provide assistance as needed. (There is only one bank in Niue and it is a branch of a supervised bank).	**AMLAT** advisor has been working with Niue's FIU. **Forum Secretariat** recommended that it and PFTAC identify gaps in Niue's supervisory framework and explore ways to address these gaps. To date, the Forum has not progressed the issue.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
NIUE	GDP estimated by PFTAC funded expert in 2004 – latest for 2003, current prices by industry. Produce quarterly CPI and trade statistics. Conducted HIES in 2002. Major cyclone in January 2004 caused considerable damage. No central bank. New Zealand dollars are used as the main currency.	Mission by PFTAC funded expert in July 2004 to compile NA estimates for 1999 to 2003. Government statistician attended regional BOP course in April 2005. Recent request for assistance on GFS – may try to integrate this request with expert missions arranged by PFTAC budget advisor.	Advisor: None. Experts: None.	Niue official statistics are fully supported by Statistics NZ and PFTAC statistics technical assistance is not needed.	Statistics NZ has developed a long term plan for technical assistance, following an assessment mission in November 2005.

PFTAC STRATEGY NOTES BY COUNTRIES

PUBLIC FINANCE ADVISOR

<table>
<tr><th></th><th>CURRENT SITUATION</th><th>RECENT RESULTS AND OUTCOMES</th><th>ADVISOR VISITS – 2007/2008</th><th>STRATEGY/ FUTURE VISITS</th><th>OTHER DONOR ACTIVITY</th></tr>
<tr>
<td>PALAU</td>
<td>Reform: PSR outlined in the authorities Management Action Plan. Reformist President was re-elected in Nov 2004. Continued difficulties with Congress declined or reversed budget consolidation measures over the last 4 years.

Economic/fiscal issues: Growth in FY2004 appears to have picked up and is expected to continue at the same rate. This is driven by a surge in tourist arrivals and ongoing foreign funded public projects. Fiscal performance has also significantly improved from the deficit low in FY02 of 29% GDP. Longer term prospects depend crucially on the possible extension of the US Compact past 2009. IMF ’05 data:

<table>
<tr><th></th><th>‘04
% GDP</th><th>Prov‘05
% GDP</th><th>Est ‘06
% GDP</th></tr>
<tr><td>Growth</td><td>4.9</td><td>5.5</td><td>5.7</td></tr>
<tr><td>Deficit</td><td>-6.9</td><td>-3.9</td><td>-0.4</td></tr>
<tr><td>Ext Debt</td><td>14.0</td><td>13.2</td><td>11.3</td></tr>
</table>

Capacity: Palau is the better economic and fiscally performing country out of the 3 Northern PICs. Local capacity is also higher.
PFTAC missions: June ’06 mission first one in over 6 yrs due to the absence of any TA requests and large US TA. PFM Advisor visited in January 2007 and again in March 2008.
IMF Article IV: 24mth cycle, with the most recent in March 2008.</td>
<td>Government agencies’ moved to the new capital building in Oct-Dec ’06. This is anticipated to facilitate expansion of housing and businesses out of crowded Koror</td>
<td>PIFMA Conference Mch ’06: 1 attendee. Workshop in Nov. 06 and in second PIFMA in March 07- one attendee each.

June ’06 mission. At request of Minister, developed ToRs for (i) TA development of a Finance and Accounting Policy and Procedures (FI) Manual; and (ii) TA on development of a fiscal forecasting model and associated training.

Jan 07 mission: Installed two peripatetic consultants to (i) developing FIs and (ii) fiscal forecasting models. Work has since been completed.
March 2008: Discussion underway to identify preparedness for a MT Budget system.</td>
<td>PIFMA: Hosted the Third PIFMA meeting in March 2008. Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009.

Arrange/oversight FAPP and Fiscal Forecasting TAs: Oversight being provided. FIs developed and training provided. Fiscal forecasting model submitted to government.
Discussion underway with ADB and Government to identify system preparedness for a MT Budget system.</td>
<td>USA: Largest donor under the Compact and Federal grants.

ADB: in the process of developing a TA program.

AusAID: aid to Palau targets education and training. Further support for community organisations and the work of government agencies is provided through the Small Grants Scheme.</td>
</tr>
</table>

PFTAC STRATEGY NOTES BY COUNTRIES

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
PALAU	A fiscal shortfall delayed the passing of the 2008 budget. A large number of short term revenue raising measures were considered of which two were adopted. The solution to the current difficulties and a long term solution is to arrest the current levels of non compliance and reform the revenue base.	Minister of Finance is considering recommendations of the November 2007 mission	**June 2006 Mission** a) Provide technical assistance in revising the rules and regulations of the Tax Office; b) Modernize the tax assessment and collection process and system; c) Identify and facilitate new legislative amendment and enactment arising from planned changes to the taxation structure. **November 2007 mission** In respect of short term revenue shortfalls, arising from the 2008 budget, advice was given on improving the effectiveness of the tax administration in tackling the high levels of non compliance, policy advice on 19 different short term revenue raising options and longer term reform.	Encourage the Government to (a) address the short term revenue shortfalls by strengthening and improving compliance levels and (b) address the long term revenue issue by undertaking fundamental revenue reform to increase the base and remove distortionary exemptions	**ADB** have a wide ranging country strategy for Palau including improving the revenue collecting effectiveness. PFTAC is working with the ADB

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
PALAU	The Financial Institutions Commission (FIC) is responsible for supervision of banks. Authorities are looking to extend the supervisory responsibilities of the Commission to include the supervision of trust companies. The FIC has recently appointed an additional staff member, increasing the number of FIC staff to three (including the secretary). The FIU, under the Attorney General, is responsible for AML/CFT matters. There have been suggestions, driven by budget priorities, that the FIU will be combined with the FIC. It is unlikely that additional staffing resources will be made available to the FIC should this occur.	Long awaited amendments to the Financial Institutions Act (banking law) previously recommended by IMF MCM peripatetic advisor were adopted in **February 2008**. The amendments greatly enhance the authority of the FIC to initiate enforcement measures against banks to address problem and noncompliance situations, allows for the conduct of on-site safety and soundness examinations, and authorizes the FIC to issue regulations to enforce and give meaning to the FIA. Liquidation of failed Pacific Savings Bank is ongoing. While efforts are on-going to resolve PSB, three smaller banks have been identified as problems and will require action by the FIC.	Reflecting the on-going program of peripatetic visits by a IMF MCM advisor, the PFTAC advisor has not visited Palau since **April 2007**. The IMF MCM banking supervision peripatetic advisor concluded a visit to Palau in **March 2008**, following on a previous visit in **November 2007**. Activities of the peripatetic advisor involved strengthening on-site examination capacity, off-site monitoring and surveillance.	FIC has requested long-term TA from IMF MCM to develop supervisory capacity For **Fiscal Year 2009**, three two-weeks visits by the peripatetic advisor are planned. In view of the planned visits by the peripatetic advisor, no visits are planned by the PFTAC advisor but assistance will be provided as requested by the authorities.	**Forum Secretariat** recommended that it and PFTAC identify gaps in Palau's supervisory framework and explore ways to address these gaps. To date, the Forum has not progressed the issue. **PALP** legal and law enforcement mentors have assisted authorities in the areas of legal and forensic accounting relating to the collapse of PSB. PALP is also reviewing AML/CFT legislation. **FDIC** has provided assistance in relation to the receivership of PSB.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
PALAU	Statistics Law was drafted some years ago – but has yet to be passed. Signed up to GDDS but drafted metadata not finalized. Overall review in 2002 (refer "The Challenge of Statistical Capacity Building in the Pacific", IMF/PFTAC Nov 2002). As with FSM and RMI, required to prepare annual Compact Report for US Government to monitor effectiveness of aid.	A UNDP Advisor provided limited assistance in statistics from last quarter 2005 to mid-2006. Replaced by another advisor with relevant experience of similar economies in FSM and RMI, for four months in late 2006. Developed systems as a mixture of the original Palau system and those developed in FSM and RMI – potential for sub-regional support for similar systems. Provided considerable training, although contact time was limited due to other commitments of counterparts (meetings out of country, family commitments, etc). Potential for sustainability is good. A former statistician returned to the senior role in the statistics office in early 2006 bringing experience of NA statistics and useful real world financial knowledge. However, his abilities are often sought for other purposes, limiting his time on statistical work. Participant attended the PFTAC half-funded training attachment at Statistics NZ in April 2007 on data editing. PFTAC Advisor undertook missions in: December 2003 to complete GDDS metadata and advise on NA statistics; October 2005 to assist in compiling NA estimates and provide training; and in June 2006 to provide further NA statistics training.	Advisor: May07 – NA statistics training and help to finalize GDP estimates begun by UNDP consultant. Experts: None. Other: • Training attachment to SPC for CPI rebasing.	Advisor: Follow up mission on NA statistics confirmed for September 2008, including a brief review of BOP sources and methods. Experts: Possible GFS, MFS and prices statistics missions, subject to request from the authorities.	UNDP provided a long term advisor to assist development of statistics (one left mid-2006, another very effective for four months late 2006). US Office of Insular Affairs assisted on social statistics – largely ceased now. US Bureau of Census hosted a team from Palau in late 2005 to provide training to process the 2006 Population Census. Statistics NZ provided assistance in PC Trade for customs processing and statistics. Two staff shared a six month training attachment on data processing at SIAP in 2006. SPC providing assistance with HIES and possibly on CPI rebase.

PFTAC STRATEGY NOTES BY COUNTRIES

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
PAPUA NEW GUINEA	**Reform:** Gov PSR program underpinned by a multi-donor Expenditure Review and Rationalization Program (ERRP). Key elements of ERRP include restoring the integrity of budget institutions and systems and the reprioritization of expenditures. The program is subject to biannual reviews by a joint WB, AusAID, ADB PERR team. **Economic/fiscal issues:** Progressive strengthening of fiscal policy since '02 under Somare Gov. Structural reforms to boost growth and reduce external vulnerabilities seen as a priority. However, public finance is under pressure, especially in the context of the forthcoming elections. **Capacity:** Refer Aug '05 review of PEER. **PFTAC missions:** Most recent Mch '00 focused on completion of ROSC to meet the conditionality of Fund assistance/budgetary support. **IMF Article IV:** 12 mth cycle, most recent Article IV in November 2007; staff visit May 2008. Resident Representative Office closed at end-2007.	**Medium Term Development Strategy (MTDS) 2005-10**, approved in April '05. Goals to be achieved through: the PSR; redirecting expenditures to priority areas; and creating a favorable climate for private sector growth. Financing of the MTDS mapped out in the context of a MTFF. Strategy to be reviewed annually and aligned to budget. Aug '05 review of the PEER identified that whilst some progress has been made in the areas of debt management and budget transparency, greater effort required in strengthening: expenditure control (payroll); transparency & accountability; leadership management and operational capacities. **Implementation of new FMIS** (with ADB/AusAID TA) in Finance, Treasury, Planning, Health and Works during '05with the intention of using the budgeting sub-system in '06 to develop the '07 national budget. Stage 2, will implement the FMIS in remaining national departments as well as provinces and districts.	**PIFMA Conference** '06, one participant. MTBF workshop; and Mch '07 PIFMA-one participant each. PFM adviser was scheduled to participate on the Dec. 06 Article IV mission due to joint mission with AUSAID and ADB to Kiribati could not join in again in Dec. 2006 but likely to join next staff visit.	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. At the PFTAC Tripartite Committee Meeting in Mch '06, the authorities identified a number of areas for future PFM TA: - participation on the multi donor annual PEER; - strengthening legislative framework with a view to 'locking-in' the MTDS to provide a greater level of stability, regardless of changes in government; and - strengthening expenditure reprioritization and control, including at sub-national level. However, no formal request received. **Introductory mission proposed with PEFA assessment:** Possibly in May 2008.	**ADB**: Financial Management Program (FMP), US$27m loan, focused on improving financial management. Program assistance provided for public service improvement, including implementing an integrated FMIS. **AusAID**: Aust/PNG 5yr *Enhance Cooperation Package* ($800m). Includes up to 36 economic and public admin specialists working within central economic and sectoral national agencies. Also funding a *Provincial Financial Management Training Program* (PFMTP), A$30m in grants to strengthen financial management across national and sub-national government; and a *Strengthening Provincial Internal Audit* project.

PFTAC STRATEGY NOTES BY COUNTRIES

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
PAPUA NEW GUINEA	Internal Revenue Commission redeveloping IT strategy in concert with the overall O.D.	PITAA Conference 2007 took place in July 2007.	**Project -Development of IT Strategic Plan:** Five short term missions spanning July 2006 – September 2007 were completed.	A mission is planned in May 2008 to prepare a business plan for government and other potential Donor agencies to purchase Hardware and applications aligned to the ITSP. Further T.A. will be considered as requests are made	ATO appear to be the principal advisors to the IRC.

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
PAPUA NEW GUINEA	The Financial System Supervision Department (FSSD) of the Bank of Papua New Guinea (BPNG) is responsible for the supervision of deposit-taking institutions (4 banks, 8 finance companies and 10 savings & loan societies), life insurance companies and the superannuation funds. Between August 2001 and December 2003, BPNG was the recipient of extensive TA on banking supervision by two IMF peripatetic advisors. The advisors covered policies and procedures for both off-site surveillance and onsite examinations of deposit-taking institutions. BPNG is content to work on its own in the near future and would seek a review by the advisors later in 2005. Supervision of life insurance and superannuation has benefited from AusAID funded consultants. This program ends on 31 October 2005 and BPNG would like to see it extended. APRA has also assisted in training BPNG staff in the supervision of pension funds[57].	After the end of the AusAID supervision project (of four years), BPNG obtained services of a NZ consultant to continue to improve supervision of pension funds and insurers.	There have been no visits to PNG given the involvement of MCM. The advisor visited BPNG in **July 2005**. A number of TA needs were identified: Non-life insurance supervision is likely to be taken on by BPNG. Capacity building will be necessary. AML/CFT inspection training for supervisors. Life insurance and superannuation will, despite 4 years of TA, need on-going assistance with a focus on on-site inspections. Supervision of microfinance schemes.	The advisor has indicated to BPNG a willingness to provide TA in the areas of bank and pension fund supervision going into 2007 to develop capacity. Advisor can conduct training in conducting on-site AML/CFT inspections. On-going TA from PFTAC will need to be coordinated against IMF MFD's proposals, AusAID and APRA.	**AusAID** continues to provide training to supervisory staff through its existing program. **AMLAT & AUSTRAC** AMLAT and AUSTRAC may provide assistance to establish the FIU.

[57] With funding from AusAID, APRA has held four 'hands-on' training sessions in PNG during 2004/05. Invitations have been extended to other PICs to participate in the training program. It is likely that this program will continue into 2006 as AusAID has agreed to provide further funding.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
PAPUA NEW GUINEA	Overall reviews conducted in 2002 (refer “The Challenge of Statistical Capacity Building in the Pacific”, IMF/PFTAC November 2002) and 2006 (refer to Report on Multisector Statistics Mission, September 2006). Outputs of the National Statistics Office have declined over recent years, including national accounts, due mainly to staff capacity and funding constraints. The base year for the CPI is 1977 and there is an urgent need to rebase. A joint ABS-IMF mission in December 2007 met with the authorities to develop a medium-term institutional strengthening plan. TA is conditional on the authorities addressing certain prerequisites. The BPNG compiles BOP statistics quarterly, largely based on exchange transaction records. A senior BOP analyst attended the regional BOP statistics course in April 2005. BPNG also compiles monetary statistics. TA is required to improve statistics for both sectors. The Ministry of Finance compiles budget tables but coverage is poor and not in GFS format. Again, significant TA is required. Signed up to GDDS but metadata not finalized. Severe constraints on telephone, fax, email and internet access below senior manager level or transport for field work limit effectiveness of survey operations.	The Advisor undertook one week BOP statistics mission in February 2006, to review progress on BOP developments and finalize TOR for expert mission in September 2006.The BPNG has made good progress in implementing recommendations made in previous BOP expert missions, reducing the reliance on foreign exchange records. Exchange controls on current account flows were liberalized in June 2005. STA missions on monetary statistics were conducted in April 2005 and May 2006. 2004 business survey completed. The Advisor was part of an IMF multi-sector statistics team lead by senior STA staff conducted a review of the macro-economic data system in September 2006. Made many recommendations for each data set. Major work needed for GFS, NA and CPI while progress is underway on BOP and MFS developments. Major recommendations included moving responsibility for national accounts compilation from the NSO to BPNG. Follow-up visit by STA Department Head and senior ABS staff held in December 2007.	Advisor: • None. Experts: None.	Advisor: • BOP statistics mission confirmed for June 2008. • Possible NA statistics mission in 2009, subject to the authorities taking action on recommendations to move NA to BPNG. Expert: • MFS mission planned for mid-2008, to be undertaken by IMF Statistics Department (STA) staff. • NA statistics mission by STA to train BPNG staff on concepts, sources and methods, subject to the authorities addressing certain prerequisites. Other: • Subject to the authorities addressing certain prerequisites, the IMF Statistics Department will undertake targeted TA missions to improve macroeconomic statistics, in cooperation with ABS.	SPC have provided some TA in NA statistics up to 2004. ADB agreed to fund a Demographic and Health Survey in 2006. The NSO plans to follow that up with an HIES, with assistance from SPC, subject to availability of counterpart funding. ABS has offered significant TA (2-3 staff years), subject to the authorities addressing certain prerequisites.

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
REPUBLIC OF MARSHALL ISLANDS	The Banking Commission is responsible for the prudential supervision of the two commercial banks, and is also the AML/CFT supervisory authority. The Banking Commissioner is the Head of the FIU. The Banking Commission has adopted FDIC on-site examination procedures focusing on AML compliance by financial institutions and cash dealers. The on-site examination program is to be extended to other areas of banks' activities. The Commission continues to strengthen others aspects of its supervision of banks. Further amendments to legislation are planned to strengthen the Commission's supervisory powers. IMF Article IV: Last Article IV December 2007; Staff Visit March-April 2008; 24 month consultation cycle.	The current Banking Commissioner has recently resigned. In March 2004, IMF MFD peripatetic advisor spent a month with the Commission to assist with a credit onsite examination and to provide training in offsite surveillance. Reporting and offsite analysis are weak. A follow up IMF MFD mission occurred in early 2005. To the detriment of banking issues, AML/CFT issues have received considerable attention from the previous Commissioner and RMI has received assistance from the US to establish its FIU. Two consultants – one on cash management and one on macro fiscal modeling were installed and have since completed their work.	Advisor visited in **May 2006, January 2007 and January 2008.** following the introductory mission to meet the new Banking Commissioner and to assess TA needs and to review current supervisory work the two latest missions have been to install a cash management system, provide training and to develop a commitment control manual.	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. Following a recommendation from made by the IMF MFD advisor, PFTAC has arranged an attachment for the Assistant Commissioner to the Hawaiian supervisory authority. The attachment would assist in the development of the officer. To maximize training opportunity, the attachment will be timed to coincide with the Hawaiian supervisory authority's onsite examination workplan. Possible further assistance in macro fiscal modeling and commitment control in 2008. **Attachment:** One officer from Budget likely on attachment in June 2008.	**Forum Secretariat** Forum Secretariat recommended that it and PFTAC identify gaps in RMI's supervisory framework and explore ways to address these gaps. To date, the Forum has not progressed the issue.

PFTAC STRATEGY NOTES BY COUNTRIES

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
REPUBLIC OF MARSHALL ISLADNS	RMI has an urgent need to improve revenue performance. Low levels of compliance combined with a ineffectual system of a dual national and local government collection mechanism offers opportunity in the short term. Revenue reform will be needed to sustain the improvement of revenue collection in the longer term		**December 2007 Mission:** Short term: Revenue enhancing measures-_including integration of local and national government taxes Long term: engaged in initial discussions of revenue reform to address the narrow tax base and low levels of compliance	Assist in setting up administrative structures for combined tax collection administration. Encourage the strengthening of the revenue administration. Encourage revenue reform in the longer term.	None in the revenue field

PFTAC STRATEGY NOTES BY COUNTRIES

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
REPUBLIC OF MARSHALL ISLADNS	The Banking Commission is responsible for the prudential supervision of the two commercial banks, and is also the AML/CFT supervisory authority. The Banking Commissioner is the Head of the FIU. The Banking Commission has adopted FDIC on-site examination procedures focusing on AML compliance by financial institutions and cash dealers. The on-site examination program is to be extended to other areas of banks' activities. The Commission continues to strengthen others aspects of its supervision of banks. Further amendments to legislation are planned to strengthen the Commission's supervisory powers.	Advisor visited in **May 2006**. The mission was an introductory nature to meet the new Banking Commissioner, to assess TA needs and to review current supervisory work. The mission recommended that the Banking Commission expand the scope of its work to include liquidity and operational risk management. In **September 2007** the Advisor arranged for an attachment of the Deputy Commissioner with the Division of Financial Institutions, State of Hawaii to enhance the supervisory capacity of the Banking Commission.	PFTAC advisor visited in **March 2007**. The mission developed guidelines for liquidity and operational risk management, delivered training and assisted the Banking Commission undertake an on-site examination of a local bank. In **November 2007**, the advisor conducted a follow-up mission to review progress on recommendations arising from the March 2007 mission.	Following a recommendation from made by the IMF MFD advisor, PFTAC has arranged an attachment for the Assistant Commissioner to the Hawaiian supervisory authority. Advisor is planning a visit to RMI in 2008 in response to a request for assistance from the authorities in drafting amendments to legislation and the implementation of off-site monitoring and surveillance of banking institutions.	**Forum Secretariat** recommended that it and PFTAC identify gaps in RMI's supervisory framework and explore ways to address these gaps. To date, the Forum has not progressed the issue. **PALP** legal mentor has visited RMI and made a number of recommendations to strengthen AML/CFT framework. PALP is reviewing the FIU.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
REPUBLIC OF MARSHALL ISLANDS (RMI)	A limited range of statistics are produced within the Economic Policy, Planning and Statistics Office (EPPSO). Headed by a capable manager. One appointee for economic statistics, focused to date on national accounts statistics. He attended the regional BOP statistics course in April 2005. Limited capacity and resources restrict further development possibilities and participation in GDDS project. Priority areas for further strengthening include national accounts statistics, foreign trade volumes and values data, BOP statistics sources and methods, and GFS. PFTAC conducted an overall review in 2003, including developing an action plan, but there was little progress until early 2005 when an economic statistician was appointed. No central bank. US dollars are used. As with FSM and Palau, RMI authorities are required to prepare an annual Compact Report for the US Government, to monitor effectiveness of aid.	An ADB funded advisor (with previous experience of three years in FSM) developed GDP systems and estimates during missions in 2006. Counterparts have been trained to update the estimates. July 2007 update of NA was to have been done by counterpart, but he was busy conducting the DHS so the NA was updated by the ADB consultant again. NA training course for Palau, FSM and RMI participants in October 2006 in FSM – RMI was represented. The Advisor assisted the IMF Article IV mission in October 2005 in addressing data needs and discussed future TA needs with EPPSO and ADB advisor. Also discussed possibility of RMI joining GDDS.	Advisor: July 2007 – BOP statistics mission to update and improve estimates and methodology, in conjunction with the ADB team to prepare data for the US Compact Report.	Advisor: NA and BOP statistics mission tentatively planned for August 2008 (back-to-back with FSM mission) to work on BOP and NA sources and methods, as well as to assist in updating BOP and NA estimates.	ADB – An advisor for two, two month missions to help build the NA compilation system. Extended until July 2006. Again provided in July 2007 for Compact Report update. US Office of Insular Affairs mainly on social statistics. SPC assistance on 2007 Demographic and Health Survey, funded by ADB. Aus AID funded PGSP, with ABS/SPC, on project management, strategic and forward work program planning training.

PFTAC STRATEGY NOTES BY COUNTRIES

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
SAMOA	**Reform:** Strong Gov support for economic and public sector reform over the past ten years. Legislative and policy framework for PFM and PE reform enacted in mid-'03. Strategy for the Development of Samoa (SDS) 2005-2007 updated annually. **Economic/fiscal issues:** After a strong performance in 2004/5 growth has recently slowed down to 2%. However, inflation remained low at 3-4%, although in the run up to the elections in 2006 fiscal policy loosened. Short term prospects are good and real GDP growth is expected to recover to around 3% for 2006-7. Over the medium term steady real per capita growth is expected to continue at around 3% till 2010/11 and external debt is expected to decline to 30% of GDP by 2010/11. **Capacity:** MoF lacks depth of skills/experience. Budget process very centralist and weak integration with strategic plans. Poor quality and timeliness of fiscal reporting. **PFTAC PFM missions:** 6 since '00, ROSC completed in June '04. Most recent, new PFM Advisor in Dec. 2006 to install peripatetic advisor on forward estimates system. **IMF Article IV:** 24mth cycle; last Art IV mission March 2007.	**5-year Financial Management Improvement Implementation Plan** and a Integrated Management Cycle, developed with ADB TA, announced in the '05/06 Budget. The plan is focused on the phased operational zing of the strengthened budget, reporting and accountability requirements of the PFM Act. **New FMIS (GOFAR) implemented during FY06**, should significantly improve expenditure control and reporting. **Government re-elected in May '06**. New Minister for Finance appointed. **Departure of Assistant CEO,** Finance, in July '06 leaves large vacuum in staff skills/experience for a considerable time.	**Mch '05:** participation in Article IV. **PIFMA Conference**, 2 participants, Nov. workshop – 2 participants, Second PIFMA meeting in March 2007- one participant. **April '06: Peripatetic Fiscal Forecasting Adviser**, 3wks: policy analysis and advice on the fiscal impacts of various policy initiatives under consideration in the FY07 Budget; and agree with authorities follow-on TA needs	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. **Dec. 06-** Installed peripatetic Advisor to develop a Forward Estimates system over two budget cycles (17 weeks of work). Work completed in March 2008. **Further visits:** One more visit likely in April 2008 and, if needed another one later.	**ADB** Financial Management Improvement Project: July 2003 to June 2005: 16 pm of TA, 3advisers over 24 mths. Update PIER mission scheduled for July '06. **AusAID/NZAID:** Joint Aid Program Strategy '05-07. PFM related programs: (i) *Public Sector Improvement Facility,* $10m '05-09, to improve the efficiency and effectiveness of the public service to support national development priorities; (ii). *Financial Management Information System,* $1.5m;and (iii) *Pacific Technical Assistance Facility*, supporting the secondment of Aust expertise generally for 2yr capacity-building assignments.

PFTAC STRATEGY NOTES BY COUNTRIES

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
SAMOA	AusAID on behalf of the Government have reviewed the Revenue administration. The Government is currently considering the recommendations IMF Legal have recently drafted law to implement Self assessment and a presumptive tax (income tax) Government is considering measures to anticipate the impact of trade liberalisation which will soon be faced. PFTAC has provided advice and reasoning on the preferred options		**November 2006:** T.A. given to achieve higher compliance of the large taxpayer sector. **February 2007:** Mission The Government of Samoa asked that the preparation of the Asian Development Bank's (ADB's) next Country Partnership Strategy be done jointly between the ADB and World Bank. PFTAC was invited as an observer to this process. **March 2008:** Joint IMF/PFTAC VAT research mission	Work closely with the AusAID program. And will provide technical assistance in specific areas, which initially is likely to be in the large taxpayer sector	Aus Aid are working extensively in Samoa, including technical assistance to the Samoan Revenue Authorities

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
SAMOA	The Central Bank of Samoa (CBS) is responsible for the prudential supervision of all commercial banks in Samoa, major non-bank financial institutions including the Samoan National Provident Fund (SNPF), the Development Bank of Samoa (DBS) and insurance companies. The Samoa International Finance Authority (SIFA) administers the offshore legislation and supervises all registered offshore entities, encompassing trustee companies, international companies, offshore banks and offshore insurance companies. The FIU, which is headed by the Governor of the CBS, has a mandate under the legislation to conduct compliance audits on financial institutions, and analyze suspicious transactions reports.	CBS is feeling the weight of its increased supervisory burden. With the closure of Niue's IBC business, Samoa is now being targeted by the Panamanian law firm behind Niue's IBC business. The advisor visited Samoa in June 2005. A number of potential areas for TA were identified: The need for a new statistical database for supervision department. Insurance supervision – capacity building and developing guidelines. Pension fund – supervisory capacity (and the fund itself needs TA to develop investment guidelines). FIU – developing guidelines, analysis of STRs and reports, and capacity building. Trust companies – assistance developing supervisory skills. Offshore banks and insurers – need to develop supervisory capacity to ensure compliance with BCPs and IAIS CPs.	In **October 2007**, Samoa hosted the AFSPC Annual Meeting and Workshop. The Advisor also provided assistance to the CBS to address recommendations arising form a 2007 IMF assessment of supervisory framework for domestic and offshore banks.	Authorities will likely need assistance to continue to develop insurance and pension fund supervisory skills. Assistance will be required in respect of recommendations arising from the 2007 IMF assessment. Assistance will likely be provided to both the CBS and SIFA.	**AusAID/AUSTRAC** is providing the FIU with a new database to assist in the analysis of information. **World Bank** to assist SNPF develop its investment guidelines. **PALP** is to provide assistance to review aspects of Samoa's offshore legislation.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVSIOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
SAMOA	NSO is responsible for CPI, household and agriculture surveys, and is due to take on NA statistics compilation from July 2008. Minister of Finance (Economic Policy and Planning Department) has been producing NA and GFS on annual and quarterly basis. Relatively good quality. GFS on *GFSM 1986* basis. Central Bank compiles BOP and monetary statistics and a quarterly production index. Significant progress made toward *BPM5*. Senior BOP compiler attended regional BOP course in April 2005. Joined GDDS project in 2003, but metadata not yet published – the coordinator is the Government Statistician.	Statistics missions by the PFTAC Advisor include: BOP statistics in July 2004; and statistics development needs review in April 2006. A BOP statistics expert mission was undertaken in April 2006 to review data sources and methodology, recommended some changes to improve coherence. Progress is slow (due to resources) but ongoing. A monetary statistics workshop was held in Fiji in December 2005, involving Samoan participants, to assist move to international standards and use of standard report formats for IMF reporting. Participant attended the PFTAC half-funded training attachment at Statistics NZ in April 2007 on data editing. NA statistics production planned to be moved to NSO in July 2008. An Aus AID funded expert has recently reviewed the statistical system to assess what changes to structures and responsibilities, etc, are needed. Report with Government Statistician. Samoa has requested assistance to: • improve the indicator data for quarterly GDP; • reconcile the two sets of trade data compiled by NSO and CBS; and • review and improve the GFS compilation.	Advisor: GFS review mission undertaken in November 2007 – draft revised tables produced for one year and methodology established. Experts: MFS follow up mission undertaken in September 2007.	Advisor: NA statistics review mission tentatively planned for July 2008. Experts: GFS follow up mission, subject to request from the authorities. MFS statistics - progress on recommendations of September 2007 mission will be monitored and aided by STA. Import price index development project planned for June/July 2008 (JSA project, using Statistics NZ expert).	SPC have provided some TA in NA. ABS has been approached to undertake a 5 year Institutional Strengthening Program (ISP). The anticipated ISP is very detailed covering a wide range of subject matter areas. Request currently being reviewed by Aus AID and NZ Aid. Aus AID funded, with ABS, on project management training.

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
SOLOMON ISLANDS	**Reform:** The Gov has started addressing some of its reform priorities, but progress has been mixed. The wage bill needs to be contained and spending re-oriented to priority sectors. Improving tax administration and a comprehensive tax reform are priorities. **Economic/fiscal issues:** Economic recovery started in '03 has continued against a backdrop of macroeconomic stability, but structural reforms have lagged. Debt sustainability fragile. **Capacity:** Significant capacity development needs being addressed by AusAID and ADB. **PFTAC missions:** Last mission in Aug '06 to install consultants to write Financial Instructions. **IMF Article IV:** most recent in May 2007.	**Honiara Club meeting in mid-Oct '05:** Aust agreed to a two year moratorium on debt repayments. In 2007 SI will be eligible for at least 60% of debt to Aust to be forgiven as long as SI continues good budget management and follows through on the reforms. **April '06:** New PM, Minister of Finance and Permanent Secretary (PS) of Finance. The PM also announced that all PS posts will be advertised as the contracts of current holders of the positions are due to expire at the end of June '06.	**PIFMA Conference, Mch '06;** two participants. MTBF workshop and Mch '07 PIFMA-one participant each. **May '06.** Mission requested by authorities to review PFM legislative and procedural framework. Outcome was development of ToR for TA to undertake a process redesign of the key accounting operations, linked to a significant redraft of the finance and accounting manual. **August 06**. New Advisors introductory mission and installation of two peripatetic consultants to write Finance Instructions.	**PIFMA:** Participants to be invited for workshop in Nov 07 and for third PIFMA meeting in Early 2008. **Financial instructions:** Still waiting governments comments on FIs before training component can commence.	**AusAID:** significant TA under Budget Stabilization Program; ensuring basic gov functions; several advisors and in-line personnel working in the key areas of budget, audit, treasury, inland revenue, customs, payroll and debt management; and Economic Reform Unit, focused on a longer-term and targeted economic reform program **ADB:** '98 a US$25m loan to support policy and PS institutional reforms. Program for '05-06 focus on transport and private sector development. TA grants totaling up to US$3m to assist reforms including economic reform. **NZAID** focus on education, law and justice sectors as well as to support civil society and sustainable livelihoods.

PFTAC STRATEGY NOTES BY COUNTRIES

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
SOLOMON ISLANDS	2006-2007 IMF/PFTAC missions outlined a revenue reform option for the Solomon Island's Government. Draft VAT and modernized Income tax laws were drafted together with high level implementation plans. The continual change in Government and Minister of Finance is problematic in obtaining commitment to the reform program. Currently the emphasis is to strengthen the revenue regime in anticipation of future change.		**Feb 2006 Mission - Policy** Mission by PFTAC Advisor and Legislation Drafter – IMF Legal. The mission's purpose was to advise on policy design issues arising from the Minister of Finance tax reform priorities, prepare draft legislation giving effect to the reform and advise on implementation of the reform. **Dec 2006 mission – revenue Administration** A high level revenue reform implementation plan was presented to the authorities of the mission. **May 2007 visit – Revenue Administration** Discussions with the revenue administration to finalise short and intermediate plans. **February 2008 – Revenue Administration** Current state assessment and strengthening of the revenue administration. (first of two part project)	**May 2008 – Policy mission** Second of two part project – identify short term policy for implementation and undertake capacity building to enable implementation of that policy. Encourage the Government to commit on longer term revenue regime.	AusAID (RAMSI) and NZ Aid are providing both advisor and in line positions to the revenue administration.

PFTAC STRATEGY NOTES BY COUNTRIES

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
SOLOMON ISLANDS	The Central Bank of Solomon Islands (CBSI) has supervisory responsibility for three commercial banks (two of which are branches of Australian banks), the Development Bank of Solomon Islands (DBSI), which is in receivership, and the National Provident Fund (NPF). The Governor of CBSI has been assigned interim Commissioner of Insurance, pending changes in legislation to formally bring the insurance sector under the CBSI's supervisory mandate. The supervisory framework for the insurance sector and the insurance act are to be strengthened. CBSI has lost a number of experienced supervisors and is looking to recruit new staff. At some time in the future, it is likely that the BSD Manager will retire from the CBSI. This will leave a significant hole in the Bank's supervisory capabilities. During 2007, there were a number of staff changes and supervisory capacity has been weakened.	Recent amendments to AML/CFT legislation have given the CBSI responsibility for the FIU. The World Bank has provided a grant to provide assistance to update insurance legislation (and legislation in a number of other areas including the Central Bank Act, Financial Institutions Act, Credit Union Act, and Financial Audit Act). The provident fund and credit union Acts have been reviewed and revised and, it is hoped the Government will pass the legislation in 2008. CBSI had hoped the DBSI would be liquidated and closed by end 2006. However, Government wants another bank to take its place. It is likely that CBSI will participate in an attachment program to the Bank of Papua New Guinea to assist in undertaking an on-site examination of Bank South Pacific, whose is the home country supervisor.	No missions were conducted over 2007, however, the Advisor provided on-going assistance to the CBSI from Suva.	A visit with the CBSI has been scheduled for 9 – 22 May 2008 in responded to a request from the authorities for assistance and training to the staff in implementing Basel I and regulatory reporting forms. CBSI has requested assistance to overhaul insurance supervision (e.g. new legislation) following visits by MCM TA advisor.	**AMLAT / AUSTRAC** to provide assistance to the FIU in terms of training and establishing a database. **PALP** has been requested to review Proceeds of Crime legislation.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR/EXPERT VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
SOLOMON ISLANDS	PFTAC review done in early 2003 when the Statistics Office had ceased to function due to "tensions" affecting the country. The Central Bank (CBSI) took over NA during this time and still compiles GDP. Since then the SO has reestablished itself and is now producing CPI, completed an HIES, done substantial development work on GFS and restarted business surveys for national accounts purposes. The CBSI produces BOP (almost totally based on exchange records) and monetary statistics. The senior BOP compiler attended regional BOP course in April 2005. A MCM funded expert has been posted to CBSI and has been requested to assist with improving MFS source data. Signed up to GDDS and metadata has been drafted but not yet sent to Washington, despite reminders. Needs to appoint new coordinator. Key priority areas include: improving sources and methods for BOP statistics; timely dissemination of the rebased CPI; finalize rebase of NA statistics; developing GDP(E) estimates; improving quality and timeliness of NA statistics and related source data (e.g. coverage, public enterprises data); and GFS coverage.	Long term advisor appointed to statistics office (ex PNG deputy GS) for almost two years until late 2006. HIES published late 2006, being used for rebasing CPI and GDP. SO working on the 2007 Demographic and Health Survey, with ADB funding, building on success of HIES. Rebase of the CPI completed, following the HIES and attendance at the Statistics NZ training attachment on price indexes in 2006. New CPI yet to be released. Trade statistics are now being published but quality concerns continue – e.g. little fuel included in imports data for 2004. Editing is being done on missing volumes data. PC Trade still not implemented. Business surveys conducted for 2003 and 2004 to provide base data for national accounts. PFTAC advisor assisted SO to compile draft nominal GDP for 2004 and rebased real GDP series – some work is needed by SO and CBSI to finalize these numbers and incorporate them into ongoing outputs. Advisor undertook missions in: February 2004 to review SO, plan for reestablishing office, funding from Aus AID & NZ Aid, for equipment, and a long term advisor; August 2005 NA, BOP and GFS follow up mission; February 2006 BOP, NA and GFS mission to review the BOP enterprise survey and peer review of BOP and GDP estimates; and February 2007 NA statistics mission to update GDP estimates. Expert missions were undertaken in December 2005 on monetary statistics; and February 2007 on BOP statistics, to improve surveys to reduce reliance on OET.	Advisor: Ad hoc advice provided. Experts: July 2007 – MFS mission to assist move to *MFSM 2000* standards. April 2008 – BOP statistics mission to improve BOP surveys and compilation methods (using BOP expert from Vanuatu). February 2008 - Import price index development project mission (JSA project, using Statistics NZ expert). Other: Attachment to SPC for Access training. Attachment to PFTAC in on NA statistics.	Advisor: • NA statistics mission, including follow up on BOP statistics mission confirmed for May 2008. Experts: Monetary statistics progress on recommendations of September 2007 mission will be monitored and aided by STA. Planned follow-up mission on BOP and IIP statistics methodology and surveys in early 2009. CPI rebase and import price index follow up mission planned for August or September 2008.	SPC on HIES design and operation. Long term advisor at Statistics Office was funded by Aus Aid and NZ Aid, administered by SPC. Ended late 2006. Attachment arranged with Statistics NZ on price indexes as part of the annual attachment programme (two places funded by PFTAC) – March 2006. Aus AID funded PGSP, with ABS/SPC, on project management, strategic and forward work program planning training.

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TOKELAU	**Reform:** Tokelau is dependent on NZ assistance, which makes up 80% of its budget. Most of NZAID's bilateral assistance is transferred directly to the Tokelau budget. Annual funding enables Tokelau to meet the demands of its recurrent budget for services including transport, education and health. However, Tokelau seeks to become more self-reliant, especially through economic development. **Economic/fiscal issues:** Not available. **Capacity:** Not known. **PFTAC PFM missions:** Nil. Primarily due to strong NZAID support and poor transport access. PFM Advisor has visited local office in Apia twice for discussions. **IMF Art IV:** Not a member of IMF.	**Trust Fund:** In 2004, NZAID worked with Tokelau to establish the Tokelau Trust Fund, aimed at enhancing Tokelau's long term self-reliance. Also in 2004, NZAID and Tokelau signed a 3-year agreement, which outlines budget support, and reporting and monitoring arrangements until 2006/07. In addition, NZAID has undertaken to carry out annual joint sectoral reviews in Tokelau, including a review of shipping services and ongoing financial reviews.	**PIFMA Conference Feb '06:** No nominees received due to difficulties in travel. MTBF workshop and Mch '07 PIFMA-one participant each. Could not send participant to PIFMA 2008 due to exigencies of work.	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. **Attachments**: The government has expressed an interest in attachment of one official to PFTAC although a formal request is awaited.	**NZAID:** Support is provided in accordance with NZ's constitutional obligations outlined in the 2003 Joint Statement of the Principles of Partnership between NZ and Tokelau. NZ gov departments supplement the limited resources of the Tokelau Public Services (which may include any area of government activity including specialist areas such as health, education and economic development).

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TOKELAU	Tokelau is very dependent on New Zealand assistance. No PFTAC T/A has occurred in recent years	No engagement	Nil	No immediate plans however PFTAC will continue to look for opportunities to provide technical assistance.	**NZAID:** Meeting constitutional responsibilities

PFTAC STRATEGY NOTES BY COUNTRIES

FINANCIAL SECTOR SUPERVISON ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TOKELAU	Nil	Nil	Nil	Nil	Nil

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TOKELAU	Nil	Nil	Nil	Nil	Nil

PFTAC STRATEGY NOTES BY COUNTRIES

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TONGA	**Reform:** Gov committed in '02 to a Economic and Public sector Reform Program (EPRSP). Key legislation enacted in '03. Focus now on implementation, but slow progress. **Economic/fiscal issues:** Country faces difficult political transition flowing the recent riots in Nov. 06. Concerns over budgetary developments. Overall fiscal balance declined in 2006/7 set to widen further to close to 7% of GDP in 2006/07. Monetary policy tightened but Central Bank has recently relaxed policy to accommodate lending for reconstruction of the capital. **Capacity:** Low PFM capacity, including eco/fiscal policy analysis and reform implementation, despite significant levels of TA over past 10 yrs. Exacerbated by persistent staff vacancies in professional and middle management levels further compounded by recent civil service departures. Lack of HRM capacity is a fundamental constraint to TA sustainability. **PFTAC PFM missions:** 9 since 2000. Most recent July '06. **IMF Art IV:** most recent Art. IV mission April 2008.	**Political uncertainty:** Arising from the 6 week strike of civil servants in July-Aug '05: *parliamentary Kingdom of Tonga National Committee for Political Reform (NCPR) has been established, which Aust and NZ are providing financial support; the PM resigned in Feb '06, and the People's Representative, Fred Sevele, appointed new PM. King dies- Crown Prince appointed King. Riots in Nuku'Alofa shortly after the death of the King devastating large parts of the capital.* **Fiscal pressures**: Over the medium term further corrective action to contain fiscal imbalance of wage settlement. Further tightening of fiscal policy needed. Contain non-priority items, hold wages and large expenditure items. **ADB PIER**, December '05. **AusAID proposed FEMP:** design mission on hold pending demonstrated progress in democratic reform.	**PIFMA Conference** Feb '06. 2 participants. MTBF workshop- no participant due to recent riots. Mch '07 PIFMA-one participant. March 08- one participant. **Feb '05:** Reviewed progress with 2005/06 Budget and PEM reforms. **April: '05** participation on Article IV consultations. **April '05:** attend Donors' Forum arranged by the authorities to discuss TA needs. **June '05:** participation on a joint donor mission. **Nov '05:** short mission to discuss developments since the wages settlement and contribute to the assessment of fiscal impact. **April-June '06 Fiscal Forecasting**, peripatetic adviser provided tax policy and forecasting advise in FY07 budget **July '06** Formal Donors' Conference, attended by new PFM Advisor **Fiscal Forecasting capacity development.** Follow-on training completed March 2007 **Secondment.** Organized secondment of one Tongan official with Fiji MoF. **March 08 Fiscal Forecasting**, peripatetic adviser provided tax policy and forecasting advise in joint mission with PFTAC Statistics Advisor.	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. **Training of CEOs**: At Government request a training for new CEOS on PFM principles (April 2007). Request for a mission to build capacity in line ministries recently received and is being examined>	**AusAID**: L/T advisers (12-24 mths) to assist with the revenue reforms (Tax Adviser, Customs Adviser, Legal Adviser, NRBT Research Adviser);a High Level Budget Adviser (6 pm to end of March '06); funding L/T TA to the Customs. Also for reconstruction. **ADB:** funding TA (6 pm) under an *Integrated Strategic Planning, MTFF and Budgeting* project, through to March '06; and TA to the Public Enterprise Reform Unit. **NZAID:** funding: the implementation of the Revenue Management System and PC/Trade; short-term TA in Tax Compliance; and TA to the Public Enterprise Reform Unit and for reconstruction efforts.

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TONGA	Tonga has made good progress over the last 18 months. Key outcomes are: the passing of new Income tax and Customs Acts, both self assessed; a post implementation review of the VAT and substantial change to the revenue administration as self assessment is truly engaged. Ongoing assistance has been given through PFTAC, NZAID and AusAID and the ADB		**March 2007 mission** PFTAC provided assistance to the Minister of Finance by presenting the supportive arguments to the Tongan Cabinet. The income tax bill has since been passed into law. **March 2008:** IMF/PFTAC VAT research mission to capture the lessons learnt, pro and con from the Tongan experience when introducing the VAT.	Continue high-level overview and TA in selected areas	New Zealand and Australian Governments are providing ongoing assistance to change and modernize the revenue administration and develop self assessment policy and practices

PFTAC STRATEGY NOTES BY COUNTRIES

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TONGA	The NRBT is responsible for the supervision of three commercial banks and the Tonga Development Bank (TDB). Consideration is being given to extending the NRBT's supervisory umbrella to include insurance companies and pension funds. Amendments to the FIA have been to take account of the Basel Core Principles were passed in late 2004. NRBT with assistance from an IMF MFD peripatetic advisor has enhanced its supervision of banks through on-site examinations which focus on credit, liquidity, operational, market risk management. Inspections also address AML/CFT issues. NRBT has been designated as the "FIU" for Tonga. NRBT suffers staff shortages and the former Head of Financial Institutions, RBF, is on secondment to the Bank as Deputy Governor. Staff issues will become of increasing concern as the NRBT assumes supervisory responsibility for insurers and pension funds.	Increasing numbers of money transfer businesses are setting up in Tonga but the NRBT does not have the resources to assess their activities, either from an Exchange Control or AML perspective. Tonga gained membership of the Asia Pacific Group on Money Laundering in **July 2005** and is seeking to hold an awareness seminar in Tonga. Advisor visited Tonga in **February 2006** to assist authorities undertake an on-site examination of a bank. Also includes staff training for new NRBT supervisory staff. Advisor has recommended to authorities that consideration be given to establishing a supervisory framework for pension funds and insurance companies. Proposal provided in **February 2007**.	In **December 2007**, the Advisor to visit to discuss proposal to implement supervisory framework for pension funds. The Government also indicated a desire to supervise insurers. Expert visit in March 2008 to further pension fund supervisory framework.	The PFTAC advisor may be called upon to train new staff if requested. Future visit by the PFTAC Advisor are likely as NRBT expands its supervisory role to include the insurance sector and national provident fund. At present neither sector is supervised and legislation is non-existent.	**AMLAT** is assisting train FIU staff. **PALP** is reviewing aspects of some AML/CFT legislation. **Other donors** may provide assistance to draft legislation for a national provident fund.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TONGA	Overall review in 2002 (refer "The Challenge of Statistical Capacity Building in the Pacific", IMF/PFTAC Nov 2002). NSO has high staff turnover and limited resources, resulting in slow implementation of change or recommendations. Government Statistician position recently advertised. Expected to be filled by June 2008. Previously recommended a long term advisor in 2004 and in 2005. Recommended again in early 2008. Aus AID had previously agreed in principle to funding, but it is up to the Tongan Government and NSO to see this through. GDDS metadata completed and published on IMF DDMS website in 2006. NSO compiles quarterly BOP statistics. Compiler attended regional BOP course in April 2005, but has since resigned. NRBT also compiles BOP (monthly) based purely on exchange transactions data, considerably different from the NSO BOP, but far more timely. Also timely monetary statistics. Considerable scope to improve BOP, GFS and NA statistics.	Advisor reviewed some industries in the NA in September 2004 - recommended revisions, recently implemented. Review requested by IMF on basis of inconsistencies in estimates. The September 2005 mission completed a partial update of review of the official statistical system, requested by FEMP. The April 2007 mission focused on reviewing NSO and NRBT BOP sources and methods, as well as BOP statistics training. Expert missions in April 2004 on BOP statistics and in February 2004 to produce GDDS metadata. Budget cuts in 2006 resulted in staff reductions and reallocation of resources. Capacity in NA and BOP limited. Participant attended the PFTAC half-funded training attachment at Statistics NZ in April 2007 on data editing. Ministry of Finance requested PFTAC to review unemployment data from population census. Advisor discussed issue with NSO acting GS, MOF staff and SPC Director. Requires alternative comparisons with previous census data and agreement to include same questions in 2009 HIES. Tonga has recently requested assistance to redevelop GDP and BOP statistics.	Advisor: March 2008 – BOP and NA statistics mission to review data sources and compilation methods, as well as update NA statistics. Review progress in implementation of previous mission recommendations to improve NRBT BOP compilation. Experts: April 2008 – BOP statistics mission to assist NSO and NRBT in improving use of source data and statistics techniques.	Advisor: NA statistics mission, including follow up on BOP statistics mission tentatively planned for March 2009. Experts: BOP statistics follow up mission, to improve source data and statistical techniques for both NSO and NRBT BOP statistics, tentatively planned for March 2009. Import price index development mission tentatively planned for June/July 2008 (JSA project, using Statistics NZ expert).	SPC have provided some TA in NA. An Australian youth ambassador was providing IT assistance in 2005/06. Census undertaken with TA from SPC. The PFTAC Advisor has encouraged the Ministry of Finance and National Planning to approach Aus AID and NZ AID to request a long-term statistics advisor for 2-3 years under the Institutional Strengthening Program.

PFTAC STRATEGY NOTES BY COUNTRIES

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TUVALU	**Reform.** No overall reform strategy. Weak environment for driving substantial change in PFM. limited demonstrated MoF reform commitment . **Economic/fiscal issues:** pressing need for strengthening PFM: major structural reforms required to bring the fiscal situation into long-term sustainability; lack of fiscal discipline; poor revenue projections and collections, large arrears; low capital budget execution; poor cash management, with continued overdrafts at high interest rates; limited fiscal reporting. **Capacity:** significant PFM capacity constraints – both technical and actual personnel numbers. lack of compliance with existing Act; poor financial management practices. Weak external pressures for accountability: non-functioning of the PAC; lack of publicly available information on the budget and performance; and absence of any media scrutiny. **IMF Article IV:** Not an IMF member.	**August '05:** the PFTAC Project Coordinator sent a letter to CEO Finance outlining PFTAC's position regarding the authorities' various TA requested. It proposed the authorities make an approach to donors for high level discussions on the priorities that should apply to the various TA projects proposed. **Review of the TTF**: joint AusAID, NZAID and Tuvalu review of the Tuvalu Trust Fund (TTF) undertaken in September 2005. **ADB PIER** completed June 2006. **Donor harmonization:** there is commitment by PFTAC, AusAID, NZAID and ADB to agreeing with the authorities a coordinated and appropriately sequenced TA strategy. Numerous informal donors meeting held, with PFTAC participation. Formal donor meeting with Tuvalu authorities held in Suva in June '06, which Ms Adams. Follow-up informal meeting held in Suva, which Mr Joshi attended. Further meetings to finalize performance bench marks due in mid-Sept. 06	**PIFMA Conference Feb '06.** 3 participants. MTBF workshop and Mch '07 & 08 PIFMA-one participant each. **Feb '05:** Scoping study, at the request of the authorities, for possible development of a new Financial Management Act. Mission assessed that given the existing weak reform environment and capacity constraints, development of a new Act was not a priority. Subsequent meetings with donors agreed a coordinated strategy is required. **April '06,** peripatetic, 15 day, Financial Systems Software (ACCPC) expert, to provide urgent training to authorities in the system and migration of data for the FY2006. The project was co-financed with the authorities. The adviser recommended an upgrade of the Payroll system. **Dec 06**- PFTAC assisted in the development of budget data on ACCESS data base. **April 07:** Training of officials of MoF on Access data base.	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009.	**AusAID and NZ's** program supports development priorities through both direct assistance and involvement in the management of the TTF Fund. An AusAID funded LT Budget adviser commenced in Nov '05 for a 2 yr period. **NZAID** providing TA to review operation of the Outer Island Trust Fund. Also consultant to be engaged in early '06 to look at strengthening coordination of NZ/ADB/JICA support under the Education Improvement Program. **ADB** TA project *Improving Public Expenditure Management and Accountability* ended in mid-April '05. The completion report identifies the need for continued TA to further progress planning and PFM reforms incldg in State Owned Enterprises.

PFTAC STRATEGY NOTES BY COUNTRIES

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TUVALU	ADB have facilitated through a firm from Uzbekistan the implementation of the reform of the Tuvalu revenue system. The policy base was the PFTAC report of 2004.		**July 2007:** technical assistance provided with the ADB at the commencement of the project.	PFTAC to work closely with ADB and will look for opportunities to provide niche technical assistance as appropriate.	ADB

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TUVALU	A Financial Institutions Act was drafted by IMF advisor for consideration by authorities which would provide for the establishment of a Financial Institutions Commission which would have supervisory responsibilities for NBFIs as well as banks. From time-to-time there have been discussions concerning the sale of the National Bank of Tuvalu to ANZ Bank.	In mid 2004, PFTAC was asked to review and comment on a proposal to develop an Economic Co-operative Development Programme (ECDP). The proposal would see Tuvalu develop into an offshore business centre or international financial centre of sorts. The ECDP is promoted by foreigners from Berlin. In January 2005, the promoters sponsored an official team from Tuvalu to further discussions in Berlin and meetings with the German Ministry of Finance and the OECD in Paris. A recent edition of Island Business suggests that authorities are to proceed with the proposal. PFTAC has provided comments on proposed amendments to the draft FIA and indicated preparedness to assist authorities.	No visits.	It is likely that PFTAC may be asked to provide assistance to authorities to establish the supervisory authority and implement appropriate supervisory framework based on international standards. The advisor will liaise with IMF MFD as appropriate.	**Forum Secretariat** Forum Secretariat recommended that it and PFTAC identify gaps in Tuvalu's supervisory framework and explore ways to address these gaps. To date, the Forum has not progressed the issue.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATIN	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
TUVALU	Produces a narrow range of economic statistics, including a CPI, more social stats. An overall review done in early 2003. Expert missions have assisted to compile GDP, and prototype BOP and build capacity. No staff allocated to macroeconomic statistics – counterpart from 2003 missions (and attended 2005 BOP regional course) moved elsewhere in Government. NA estimates not updated since 2002. In 2006 repatriation of significant numbers of Tuvalu workers from Nauru.	Compilation of GDP in 2003 and developed a prototype BOP in late 2004, by short term expert (mostly PFTAC funded). Advisor undertook a BOP and NA statistics review mission in August 2006. Established data collection prior to compilation of estimates. NSO needs regular/annual assistance to compile GDP, and further TA to complete the BOP system. Advisor arranged for the Tuvalu statistician to visit Suva to compile GDP and BOP under his direction in November 2006 with some progress made, but the visit was abbreviated by the coup. There is very little capacity in the Tuvalu NSO to pick this work up.	Advisor: Ad hoc advice provided.	Advisor: • Multisector statistics mission, to improve and update BOP and NA statistics, tentatively planned for December 2008.	SPC helped rebase their CPI and run an abbreviated Data Analysis course. Attachment arranged with Statistics NZ on price indexes as part of the annual attachment programme (two places funded by PFTAC) – March 2006. Aus AID funded PGSP, with ABS/SPC, on project management, strategic and forward work program planning training.

PFTAC STRATEGY NOTES BY COUNTRIES

PUBLIC FINANCE ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
VANUATU	**Reform:** Comprehensive Reform Program underway since '97. Formal structure for planning and implementing reforms, involves the Council of Ministers, a Development Committee of Officials, the Department for Strategic Management and the relevant implementing body. **Economic/fiscal issues:** After two years of contraction, output growth recovered in 2003. Growth reached 7 % in 2005 and an estimated 5½ % in 2006. After peaking at 3% in 03, inflation declined to 1½ % in 06. Reserves increased to over 7 months of imports. Budget performance improved with cuts in capital spending and improved tax collection. Budget moved from a deficit of 4% of GDP in 2002 to a surplus of nearly 2 % of GDP in 2005. The increase in civil servants' wages from July 06 led to an expected deficit in 06 of around ½ % of GDP. However, the public debt-to-GDP ratio continued to decline to about 30% from 45% in 2002. **Capacity:** Strong local capacity in Budget office. Local economic policy capacity weak, but supplemented by advisers. **PFTAC missions:** 3 missions during '00-03 assisted with preparation of FTQ and development of an action plan. New Advisor visited in Aug. 06. **IMF Article IV:** Latest Art. IV mission December 2006; staff visit February 2008.	**Joint Australia-Vanuatu Strategy '05-10**, which is guided by the PAA. **Millennium Challenge Account (MCA):** In May '04, Vanuatu was the only PIC country selected by the US Millennium Challenge A 5 yr USD66m compact was signed in Dec '05, primarily for infrastructure projects. **June '06, PEFA assessment,** funded by EU. Identified the main weaknesses relate to: i) the lack of up to date information on state enterprises; ii) the poor link between the budget and policy; iii) lack of effective external scrutiny and audit and availability of information for public scrutiny; and iv) inadequate information on the totality of donor resources.	**PIFMA Conference Feb '05,** 2 participants. MTBF workshop and Mch '07 and 08 PIFMA-one participant each. **August '05:** AusAID requested the PFTAC adviser's participation in a review of the MoF progress with financial management reforms and future needs. However, it was subsequently postponed to Oct when the adviser was unavailable. **Nov/Dec '05:** Independent assessment of various data integrity concerns raised by an EU consultant, and participation on Fund Staff Visit. **Aug. 06-** Visit by new Advisor to finalize TOR and timing of Macro-fiscal consultant. **October 06**- Installation of Macro-fiscal consultant **July 2007**- visit by Advisor at the completion of the work by consultant and attend the donor meeting **February 2008**- visit by advisor to train line ministries on PFM	**PIFMA:** Participants to be invited for workshop in Nov 08 and for fourth PIFMA meeting in Early 2009. **Economic policy and forecasting training:** authorities requested PFTAC funding of a Macroeconomic adviser. Following Advisors mission in Aug 06 both ToR and timing agreed with authorities and consultant installed. Third round of training expected to be completed by June 2007. **Attachments:** One attaché in April 2008 and one in May 2008 to work on developing a training for trainers program. Advisor shall visit in June 2008 to deliver the training for trainers program.	**AusAID**: Ministry of Finance and Economic Management program, '99-04, focused on strengthening PFM and implementation of program budgeting and a new FMIS Included funding budget, accountancy and accounting systems advisors. AUSIAD has recently advertised for an Economics Advisor, a Strategy & Sector Policy Advisor and an OD and Management Specialist. **ADB** US$1.45m TA '04-06 focused on promoting private sector growth. **NZAID:** TA priorities in education, governance and economic dev. Assistance includes advisers working in the MoF.

TAX ADMINISTRATION POLICY ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
VANUATU	In response to loss of revenue from trade liberalisation the Vanuatu revenue administration is considering the introduction of an income tax		**October 2007 mission:** Revenue Administration and Policy mission to consider the viability of an income tax.	Continue to engage appropriately post election in providing policy and administrative T.A.	None known

PFTAC STRATEGY NOTES BY COUNTRIES

FINANCIAL SECTOR SUPERVISION ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
VANUATU	The Reserve Bank of Vanuatu (RBV) has supervisory responsibility for domestic and offshore banks. In December 2003 the RBV was given supervisory oversight of the Vanuatu National Provident Fund (VNPF). Provisions of the Financial Institutions Act provide for the RBV to supervise credit unions if such institutions exceed a size threshold. The Vanuatu Financial Services Commission (VFSC) is responsible for the supervision of insurance companies (domestic and offshore), trust companies and company service providers. The FIU, which reports to the Attorney General, has a mandate under the legislation to conduct compliance audits on financial institutions, and analyze suspicious transactions reports.	Revised insurance legislation enacted in 2005. In August 2007, PFTAC recommended amendments to the Financial Institutions Act. Amendments to AML/CFT legislation passed in November 2005. FIU staff receiving assistance from resident PALP mentor. Authorities likely to consolidate all supervisory functions within the RBV. The VFSC will remain as company registrar and promote Vanuatu's offshore center.	The PFTAC advisor visited Vanuatu in **August 2007** to review prudential guidelines and Liquid Assets Requirement and KYC policy in light of FTRA amendments. Advisor also drafted operational risk guideline and guideline requiring enhanced disclosure of fees and interest rates. Advisor also worked with FIU and provided draft guidelines for insurers and money changers.	MCM to provide on-going TA to assist in the development of insurance supervision function. This function is likely to be transferred from VFSC to the RBV. RBV also requires on-going TA in a number of other areas, including reserve management and central bank accounting. MCM has been advised of these needs.	**AMLAT** to provide on going assistance to the FIU and a database. **PALP** also providing assistance to FIU and law enforcement agencies. **FIRST** has agreed to provide on-going assistance to VFSC to finalize legislation for TCSP sector. **ADB** is providing TA to assist the VFSC update Companies legislation. **EU** has indicated that it will provide TA to update any legislation administered by the VFSC not being reviewed/updated by other donors.

PFTAC STRATEGY NOTES BY COUNTRIES

STATISTICS ADVISOR

	CURRENT SITUATION	RECENT RESULTS AND OUTCOMES	ADVISOR/EXPERT VISITS – 2007/2008	STRATEGY/ FUTURE VISITS	OTHER DONOR ACTIVITY
VANUATU	GDP is compiled by the NSO – Government Statistician recently left for ADB position and another senior statistician deceased. Several capable staff but not enough numbers to develop new statistics. An experienced staff member is seconded to SPC as PRISM manager. Office developed well following from Institutional Strengthening Programme (ISP), but is constrained by number of staff. NSO produces annual GDP, real and nominal - needs a rebase (desperately) as does the CPI. The Reserve Bank of Vanuatu (RBV) compiles quarterly BOP and IIP in line with *BPM5* standards. Two capable staff (both attended regional BOP course in April 2005). Three expert missions on BOP in 2003 and 2004. Good monetary statistics. Ministry of Finance produces GFS on a quarterly basis (TA from PFTAC 2003). Able to do this continuously and with live data. All three organizations have capable staff with good motivation and high expectations. GDDS metadata are published.	NSO has funding from EU for an agriculture census in 2007, funding from NZ Aid for an HIES in 2007 – seriously straining capability (the national accountant was the project manager for the HIES). This will lead to rebasing NA and CPI, but both need some maintenance in the meantime. The HIES completed in late 2007, and work on the NA and CPI rebase is expected to commence soon. An Aus AID funded ABS TA on economic statistics has spent a couple of months in the NSO assisting with NA compilation and training staff. However, absorption is constrained by pressures of other work on the senior staff, e.g. HIES and Agriculture Census. ABS has been providing considerable assistance to senior management on mentoring, and strategic planning. Advisor missions have included: Mid-term review of ISP in August 2004; and peer reviews of NA estimates in June 2005 and June 2006. A PFTAC expert mission on BOP statistics was undertaken in February 2004.	Advisor: Ad hoc advice and assistance provided. Experts: None.	Advisor: BOP and NA statistics review mission tentatively planned for February 2009. Experts: Possible TA to assist in the CPI rebase. Other: Attachment for BOP statistics development with Statistics NZ.	Aus AID/ABS programme on strategic planning and management underway. ABS provided TA in economic statistics in 2006 and 2007. EU funded project on medium term expenditure mgmt in Min Finance. IMF funded project for database to facilitate bank supervision (FRED).