

# **CHALLENGES AND OPPORTUNITIES IN MULTILATERAL AND REGIONAL TRADE POLICY ENVIRONMENT FOR COMMODITY-BASED DEVELOPMENT OF PACIFIC ISLAND COUNTRIES**

Paper prepared by

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## **Summary**

*Pacific Island countries (PICs) face difficult challenges of export diversification in the changing world trading system. The challenge is all the more important for them as trade occupies central place in their income generation process while they are confronted with an increasingly vulnerable trading environment. The heavy dependence on a limited number of export commodities and markets characterize those economies, which render their economic situation vulnerable to external shocks. While a few PICs are Members of World Trade Organization, multilateral disciplines and commitments undertaken by their major trading partners who are WTO Members has significant bearing on their economies as these affect the conduct of trade policy of major trading nations, thereby influencing trading environment in which PICs conduct their trade. Multilateral disciplines in the WTO of particular relevance to PICs include the Agreement on Agriculture (AoA), the GATT 1994, the Agreement on Textiles and Clothing (ATC), and the Agreement on Subsidies and Countervailing Measures. On the one hand, these agreements have increased market access opportunities for exporter of relevant commodities. They however also resulted in side-effects being posed on small PICs in terms of the erosion of preferences so far enjoyed and increased market competition against more competitive third countries. Furthermore, some trade barriers persist in the form of tariff peaks and escalation, which are of particular relevance to export diversification of PICs, non-tariff barriers (tariff quotas, product standards or contingency measures most notably special and transitional safeguards in AoA and ATC). On the other hand, the WTO Agreements have locked in stringent policy disciplines on the use of domestic and export subsidies and investment measures, which may result in limiting the policy flexibility that may be needed to encourage development of down-stream processing industries, which PICs may be interested in to promote export diversification. Reduction commitments made in AoA have in parallel been resulted in increased price for net food importers, which may pose adverse effects in some of PICs. Apart from multilateral trading rules, various preferential and regional trade schemes are providing another avenue for export expansion and diversification. Those schemes of relevance to PICs include the GSP, the ACP-EU Cotonou Agreement, special LDC preferences, SPARTECA, PARTA and other regional agreements. While the overall importance of each schemes for PICs may differ depending on their membership and trade involved, it may be useful for PICs to fully explore those opportunities provided under those schemes and limit adverse impact therefrom by taking appropriate measure in pursuing their export diversification strategies. Against the background of ongoing and forthcoming multilateral and regional trade negotiations, PICs could pursue their interest in those negotiations with a view to securing a more enabling environment for the diversification of their export structures.*

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## INTRODUCTION

The Pacific Island Countries (PICs) cover the following countries and territories: American Samoa, Cook Islands, Federated States of Micronesia, Fiji, French Polynesia, Guam, Kiribati, Marshall Islands, Nauru, New Caledonia, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. International trade is important for these PICs as their economies are heavily reliant on such trade for generating national income and government revenue. However, the PICs are very minor players in international trade. Their share in world trade accounts only for a tiny proportion of less than 0.01 per cent of world trade. Moreover, this share is on a declining trend, reflecting slower trade expansion of PICs as compared to developed countries and developing countries in other regions. The export structure of PICs is characterized by the concentration in a small number of export commodities and export markets. Export diversification in terms of both export commodities and markets hold thus key importance for their long-term economic development.

Given these features, PIC economies are highly vulnerable to the international trading environment. Among the key issues for export diversification for the PICs are market access conditions of major export markets (often on a preferential basis) and price volatility of primary commodities of export interest to them.

In this context, the PICs face a variety of challenges and opportunities in the evolving world trading system and regional trading arrangements. While a few PICs are Members of World Trade Organization (WTO), multilateral disciplines and commitments undertaken by other WTO Members hold a significant bearing on their economies as they affect conduct of trade policy of major trading nations, thereby influencing trading environment in which the PICs also conduct their trade. Multilateral disciplines in the WTO of particular relevance to the PICs include the Agreement on Agriculture (AoA), the GATT 1994 (covering industrial products), the Agreement on Textiles and Clothing, and the Agreement on Subsidies and Countervailing Measures. Apart from multilateral disciplines, various preferential and regional trade schemes are providing other avenues for export expansion and diversification by PICs.

Those trading schemes of relevance to PICs include the Generalized System of Preferences (GSP) of major developed countries, the ACP-EU Cotonou Agreement, special trade preferences for Least-Developed Countries (LDCs), the South Pacific Regional Trade and Economic Co-operation Agreement (SPARTECA), the emerging Pacific Regional Trading Agreement (PARTA) and other regional trade agreements. They are of particular importance for PICs as the bulk of their exports are traded within these preferential arrangements. It follows that other trade policy factors affecting such preferential market access conditions (most-favoured national (MFN) tariff reduction, formation and expansion of regional trade agreements) are also of relevance to PICs. While the overall importance of each schemes for the PICs may differ depending on their membership and the size of the trade involved, it may be useful for the PICs to fully explore those opportunities provided under those schemes and limit adverse impact therefrom by taking appropriate measure in pursuing their export diversification strategies in a consistent and coherent manner.

Against the background, this paper aims to examine various market access opportunities available to the PICs and various related trade policy with a view to promoting the expansion and diversification of their export structures, taking into account their respective economic specificities and regional and multilateral trade policy contexts. It will be argued that within the context of ongoing and forthcoming multilateral and regional trade negotiations, the PICs could

pursue their trade interest in those negotiations with a view to securing a more enabling environment for the diversification of their exports through improved market access conditions.

The paper is organized as follows: chapter I reviews the economic and trade performance and characteristics of the PICs. Chapter II discusses some trade and industry policy issues arising from the effort aimed at export diversification by developing countries in general. Chapter III examines market access opportunities available under various preferential schemes, regional trade agreements and WTO Agreements, as well as multilateral disciplines affecting market access conditions. Then, based on these chapters, Chapter IV seeks to identify negotiation issues for the PICs in the context of ongoing and forth coming regional and multilateral trade negotiations in terms of securing greater market access for their products and greater policy flexibility to implement measures for export diversification. Finally, the conclusion summarizes the main recommendations of the paper.

## **Chapter I**

### **ECONOMIC AND TRADE PERFORMANCE OF PICs**

Under various preferential trading schemes, major markets for PICs such as Australia and New Zealand, but also EU, Japan and US absorb the bulk of exports by PICs. The PICs<sup>1</sup> combined global trade is estimated at US\$ 3,969 million in 1999, accounting for an extremely small fraction of world trade at less than 0.1 per cent (0.07%) and of developing country trade at 0.22 per cent (see table 1). In addition, the expansion of PICs' international trade on average has been growing slowly in the 1990s at an annual rate of 3.6 per cent (which was significantly slower than the growth rate both of world and developing country trade, respectively at 6.6% and 9.0%). This generally modest trade performance experienced a major setback in 1996-1998, with particularly strong slowdown experienced of between 10-14 per cent decline, presumably owing to the Asian financial crisis. The slower pace of PICs' trade growth, combined with the shock of the late 1990s, has resulted in a steadily declining share in not only world trade but also in the developing country trade during the last decade. This presents a risk that the PICs could be increasingly marginalized in the increasingly integrated global economy.

The trade figures also reveal strongly unequal character of Pacific trade according to individual countries, as trade performance and scale widely varies among the PICs. The dominant players in the PICs are Papua New Guinea (PNG) and Fiji. PNG accounts for more than a half of PICs exports (on the basis of available data), while Fiji's share in Pacific exports is 16 per cent. Accordingly, they are significantly bigger exporters than Cook Islands, Kiribati, Samoa and Tonga. In contrast, a faster trade growth was recorded by Kiribati (14.3%), Samoa (13.0%) and French Polynesia (11.4%) marking clear contrast with Nauru, Tonga and Cook Islands where trade contracted during the 1990s. On average however, as stated above, the trade performance of PICs has been declining.

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<sup>1</sup> The trade data for the PICs pertains to the Forum Island Countries minus Marshall Islands, Federated States of Micronesia, Niue, Tuvalu, but including the territories of American Samoa, Guam, French Polynesia, New Caledonia.

**Table 1: Value (millions of US dollars) and share of PIC exports in world and developing country exports**

	1985	1990	1995	1996	1997	1998	1999	Av. growth rates (%): 1990-99
American Samoa	201	311	320	399	440	309	340	1.1
Cook Islands	3	5	5	3	3	4	4	-2.9
Fiji	307	497	623	750	620	510	590	3.5
French Polynesia	41	111	194	254	224	256	270	11.4
Guam	58	60	85	68	56	54	54	-0.4
Kiribati	5	3	7	6	9	8	9	14.3
Nauru	-	60	30	35	24	19	19	-10.6
New Caledonia	268	480	471	534	527	586	600	3.8
PNG	928	1177	2654	2529	2163	1775	1877	3.8
Samoa	16	9	9	10	15	15	20	13.0
Solomon Islands.	70	70	168	162	175	126	140	7.9
Tonga	5	12	14	9	11	8	10	-4.3
Vanuatu	31	19	28	30	35	34	36	8.3
<b>Total</b>	<b>1933</b>	<b>2814</b>	<b>4609</b>	<b>4790</b>	<b>4302</b>	<b>3704</b>	<b>3696</b>	<b>3.6</b>
<b>Developing country total</b>	<b>496873</b>	<b>830178</b>	<b>1418586</b>	<b>1534491</b>	<b>1646364</b>	<b>1543917</b>	<b>1648787</b>	<b>9.0</b>
Share in DC export	0.39%	0.34%	0.32%	0.31%	0.26%	0.24%	0.22%	-
<b>World total</b>	<b>1971640</b>	<b>3481497</b>	<b>5120452</b>	<b>5297789</b>	<b>5547414</b>	<b>5464755</b>	<b>5620665</b>	<b>6.6</b>
Share in world export	0.098%	0.081%	0.090%	0.090%	0.078%	0.068%	0.066%	-

Source: UNCTAD Handbook of Statistics 2000.

Such trade landscape, however, is not a correct measure of national income and the degree of economic development. On a gross domestic product (GDP) per capita income basis, the highest is recorded in Palau (US\$8,204), Cook Islands (US\$5,269), Niue (US\$3,522) and Nauru (US\$3,355) (see table 2). The two major trade players among the PICs only ranked among the middle range at US\$2,565 for Fiji and even among the lowest income countries, lesser than some of region's LDCs, at US\$1,239 in the case of Papua New Guinea. The least developed of the PICs with a GDP per capita barely exceed US\$1,000, are Kiribati (GDP per capita of US\$651) (Kiribati), Solomon Islands (US\$720), Samoa (US\$1037), Tuvalu (US\$1107) and Vanuatu (US\$1,411).

**Table 2: Economic characteristics of the FICs: GDP, per capita and population**

	Nominal GDP (US\$ million)	GDP per capita (US\$)	Population (thousand)
Cook Islands	99.3	5269	18.3
F.S. Micronesia	215.8	1976	109.2
Fiji	1981.6	2565	772.7
Kiribati	51.1	651	78.5
Marshall Islands	102.1	1738	58.7
Nauru	35.9	3355	11.2
Niue	8.1	3522	2.5
Palau	145.1	8204	17.7
Papua New Guinea	5130.8	1239	414.8
Samoa	175.3	1037	169.0
Solomon Islands	284.5	720	395.2
Tonga	145.4	1492	99.0
Tuvalu	11.1	1107	9.5
Vanuatu	237.6	1411	168.4

Source: Scollay (2000)

As regards regional trade, currently there is little trade among the Forum Island Countries (Forum Secretariat, 2000). Only a nominal 2 per cent of total Forum Island Countries (FICs) exports are destined for other FICs.

Internal trade in the South Pacific region, i.e. FICs plus Australia and New Zealand, is estimated at 12,012 million Australian dollars (Forum Secretariat, 2000). The existing regional trade agreements, namely SPARTECA (providing preferential access for FICs exports into Australia and New Zealand) and ANZCERTA (free trade between Australia and New Zealand), result in a large portion of this trade being traded duty free. An estimated A\$9,671 million, or 80 per cent of internal South Pacific trade, is already traded duty free. As to imports, over 46 per cent of FICs imports are sourced from Australia and New Zealand. However, despite the substantial preferences, FICs exports to Australian and New Zealand remain marginal. Such exports are dominated by Fiji and PNG which together account about 93 per cent of FICs exports to Australia and 72 per cent of FIC exports to New Zealand.

Nevertheless, international trade (both imports and exports) has greater importance for the PICs. As regards imports, Scollay (2000) notes that tariffs account for very important proportions of total government revenue and tax revenue for PICs. Kiribati and Vanuatu rely for more than half of tax revenue on tariffs (see table 3). Vanuatu is dependent on tariffs for 58 per cent of tax revenue, which also provides a substantial portion, about 50 per cent, of total Government revenue. The corresponding figures for Kiribati are respectively 65 per and 22 per cent, implying that there are other sources of revenue other than tariffs. Fiji, Marshall Islands and Tonga also rely heavily on tariffs as a source of government revenue (21.9%, 23.7 % and 21.2% respectively). The share of tariff revenue in total tax revenue for Tuvalu also reaches almost 50 per cent, while for Marshall Island, Samoa, Fiji, Toga, the importance is in the order of 30 and 40 per cent. For relatively diversified economies such as Papua New Guinea, tariff revenue accounts for 18 per cent of total government revenue.

**Table 3: FIC Tariffs**

	Tariff as % of imports (implicit tariff rate)	Tariff as % of tax revenue	Tariffs as % of total revenue
Cook Islands	11		
F.S. Micronesia	1	24.0	3.3
Fiji	14	32.8	21.9
Kiribati	28	64.1	22.2
Marshall Islands	9	35.3	23.7
Nauru	0	1.0	0.0
Niue	9		
Palau	5	20.0	5.0
PNG		22.3	18.0
Samoa	22	34.0	16.4
Solomon Islands	12	23.7	14.3
Tonga	18	30.7	21.2
Tuvalu	13	30.7	21.2
Vanuatu	29	57.5	48.1

*Source:* Scollay (2000)

The higher dependence on tariff revenue for government revenue is a reflection of higher import duties applied by a number of PICs as is the case with Fiji (the average implicit tariff rates as measured by the ratio of tariff revenue to value of imports being 14%), Kiribati (28%), Marshall Islands (9%), Samoa (22%), Tonga (18%) and Vanuatu (29%) (Forum Secretariat, 2000, Scollay 2000). PICs are therefore highly vulnerable to import liberalization with government resources depending highly on revenue corrected through import duties.

Equally, as regards exports, the PICs are faced with particularly vulnerable trading environment stemming from their export structure. In general, PICs' export is highly dependent on a bundle of small number of commodities and export markets (see table 4). Thus, the diversification of export and production structure of those economies hold a key to successful integration into international and regional trade and promotion of development of PICs.

Primary commodities occupy a central place in the export structure of PICs, although it is worth noting that services trade is becoming increasingly important for a number of them. However, the variety of commodities exported by PICs is often limited and sometimes those countries are heavily reliant on those few products as a source of foreign exchange earnings. According to the available data, agricultural, mineral, fishery and forestry, as well as textiles and garments are the main products exported by the PICs. For Fiji, sugar and honey are the main product categories exported but textile and clothing products, as well as fishery products, together account for an equally important share of its export. Copra and fishery products are central to Kiribati's exports of goods, while fishery license fees and transport are much more import sources of its earnings. Papua New Guinea enjoys much wider and more divers export structure. Mineral (crude oil, base metal ores, gold), forestry, tropical beverages (coffee, cocoa), staple foods (oil seeds) and fish and shellfish products are its major export products. Other than exports in travel, business and transport services, coconuts and copra are the major export products for Samoa. Fishery exports are also important for Samoa. Solomon Islands' exports are heavily dependent on forestry and fishery products, with other important commodities including some vegetables, oil seeds and beverages. Oil seeds account for an important share of Vanuatu's export (44.22%), followed by other primary products like fish, vegetable materials and woods, tropical beverages while some manufactures appear also among exported products (ships, boats, other manufactured goods).

As for export destinations, major developed markets include most notably New Zealand, Australia and Japan, but also the EU, absorbs the bulk of PICs exports. New Zealand is the main export market for Niue and Samoa. For Niue, the quasi-totality of its exports is directed to New Zealand, while one half of Samoan exports goes to the same market. Japan is dominant in exports of the Federated States of Micronesia (78.1%) and Tonga (50.3%). Kiribati relies heavily on the EU as export market (57.3%). For other PICs, the situation is somewhat attenuated and more diversified markets exist for their export, but nonetheless two to three markets dominate. The Cook Islands' exports flow primarily to New Zealand (25.5%), US (24.4%) and Australia (21.1%). For Fiji, Australia (26.0%) and the EU (23.7%) are the two most important markets while the bulk of Solomon Islands' exports are directed to Japan (36.3%) and the EU (24.3%). For Papua New Guinea, Australia (41%), EU (18%) and Japan (13%) are important. Only Vanuatu maintains a relatively diversified export destination structure. It is worth noting that Bangladesh absorbs the largest portion of Vanuatu's exports (30.9%), followed by EU (21.6%) and Japan (16.2%).

The export concentration in both exportable commodities and export markets means that PIC economies are highly vulnerable to external shocks arising from international trading environment and natural temperate conditions. This fact generates important policy issues, as for instance, commercial policy changes in major trading partners market access conditions or export subsidies. Such actions can affect the trade prospects of the PICs. On the import side, the PIC economies are dependent on tariffs as a major source of government revenue, thus the eventual reduction of such tariffs would inevitably hold important socio-economic. Hence, international trade policy is of particular relevance for commodity-based development of PICs.

**Table 4: Major export commodities, and major export destination and import sources of PICs (share of total trade: per cent)**

PICs		1	2	3	Other
<b>Cook Islands</b>	Export destination	NZ (25.5);	US (24.4);	Australia (21.1);	Japan (14.6)
	Import sources	NZ (70.9);	Fiji (10.8);	Australia (7.2)	
<b>Fiji</b>	Commodity exported (HOS:1997-1998 values)	Sugar and honey: (24.75%);	Outer garments knit non-elastic (14.30%);	Men's outwear non-knit (10.35%);	Gold, non-monetary not elsewhere specified (nes) (8.22%); Under garments knitted (5.08%); Women's outwear non-knit (4.51%); Textile articles nes (3.54%); Pulpwood, chips, woodwaste (3.51%); Fish, fresh, chilled, frozen (3.20%); fish etc prepared, preserved nes (2.83%).
	Export (1995):	Australia (26.0);	EU (23.7);	Other (16.4)	
	Import (1995):	Australia (38.8);	NZ (15.9);	Other (18.8)	
<b>Kiribati</b>	<b>Goods and services exported: LDC Report</b>	License fees and royalties (58.8);	copra (18.1);	transport (9.0);	travel (4.5); fish products (1.8)
	Export (1996):	EU (57.3);	US (12.9);	Hong Kong (8.5)	
	Import (1996):	Australia (45.8);	Fiji (18.4);	Japan (8.5)	
<b>Marshall Islands</b>	Export (1995):	US (51.1);	Other (24.0);	Guam (14.6)	
<b>F.S. Micronesia</b>	Export: (1995)	Japan (78.1);	Guam (12.5);	US (7.7)-	
	Import: (1995)	US (39.6);	Guam (28.5);	Japan (14.9)	
<b>Nauru</b>	Export (1997):	Other (99.7);	FICs (0.3)		
	Import (1997):	Australia (92.0);	JPN (4.9);	FICs (2.2)	
<b>Niue</b>	Export (1995):	NZ (97.7);	Fiji (2.3)		
	Import (1995):	NZ (91.0);	Fiji (9.0)		
<b>Papua New Guinea</b>	Commodities exported	Crude petroleum (24.82);	Other wood rough, squared (17.52);	Base metal ores, concentrates nes (13.89);	Coffee and substitutes (11.45); Gold, non-monetary nes (10.87); Other fixed vegetables oils (8.60%); Cocoa (2.77%); Seeds for other fixed oils (2.67%); Fish, fresh, chilled, frozen (2.16%) Shell fish fresh, frozen (0.87%).
	Export (1997):	Australia (41)	EU (18)	Japan (13)	
	Import (1997):	Australia (51)	US (14)	Singapore (8)	

<b>Samoa</b>	<b>Goods and services exported</b>	Travel (47.7);	business services (22.6);	coconut products (11.3);	transport (2.5); copra (1.9)
	Export (1996):	NZ (48.1);	EU (17.3);	American Samoa (15.3)	
	Import (1996):	NZ (38.3);	Australia (22.1);	Fiji (14.2)	
<b>Solomon Islands</b>	Commodities exported	Other wood rough, squared (41.62);	Fish, fresh, chilled, frozen (26.76);	Other fixed vegetable oils (9.33);	Fish etc prepd prsrvd nes (6.52); Seeds for other fixed oils (5.56); Cocoa (4.07); Wood, shaped, rail sleepers (1.21); Shell fish fresh, frozen (0.83); Petroleum products, refined (0.73); Crude animal materials nes (0.58);
	<b>Goods and services exported</b>	Timber products (41.8);	business services (22.7);	fish products (15.0);	palm products (6.7); copra (3.0)
	Export (1995):	Japan (36.3);	EU (24.3);	Other (19.2)	
	Import (1995):	Australia (41.0);	Other (15.0);	Japan (11.8)	
<b>Tonga</b>	Export (1996):	Japan (50.3);	US (17.5);	NZ (14.6)	
	Import (1996):	NZ (37.5);	Australia (29.7);	US (11.3)	
<b>Tuvalu</b>	Export: (1996)	Australia (30);	Japan (29);	Other East Asia (4)	
<b>Vanuatu</b>	Commodities exported	Seeds for other fixed oils (44.22);	Special transactions (17.27);	Fish, fresh, chilled, frozen (13.06);	ships, boats, etc (5.98); Crude vegetb materials nes (4.81); wood, shaped, rail sleepers (4.61); meat, fresh, chilled, frozen (3.00); cocoa (1.89); shell fish fresh, frozen (1.55); other manufactured goods (0.75).
	<b>Goods and services exported</b>	Travel (28.3);	business services (17.3);	transport (10.0);	copra (9.1); beef (3.6)
	Export (1996):	Bangladesh (30.9);	EU (21.6);	Japan (16.2)	
	Import (1996):	Australia (43.3);	Other (19.0);	NZ (11.5)	

**Source:** Compiled from UNCTAD Handbook of Statistics 2000; UNCTAD, The Least Developed Countries 1999 Report; and Scollay (2000).

\* For LDCs of which data is available (Kiribati, Samoa, Solomon Islands and Vanuatu), data on both of major export goods and services are compiled.

## **Chapter II**

### **POLICY ISSUES FOR EXPORT DIVERSIFICATION IN INTERNATIONAL CONTEXT: WTO, REGIONAL TRADE AGREEMENTS AND PREFERENTIAL SCHEMES**

It has been recognized that the diversification of export bases and export destinations involve two strategies: the development of domestic downstream higher-value added processing activities and the exploration of niche market (UNCTAD 1997, 2000c). Historically greater efforts are placed on the former strategy through most notably import substitution development strategy, which was pursued by many developing countries during last decades. Today, it has been argued however that the most promising and more profitable diversification comes from the latter mode of diversification, namely through the exploitation of niche category of markets. For instance, in agricultural commodities, the supply of off-season Temperate Zone products or relatively higher-value added vegetables have been suggested in literature.

These two strategies for export diversification by developing countries raises important policy issues for national trade and development policy. On the demand side, governments could seek better market access conditions for products of actual or potential export interest to them through international negotiations, be it at the multilateral, regional or bilateral levels. Market access conditions are important because, despite the successive international efforts to reduce barriers to trade, there still persist significant import barriers to major developed and developing country markets in the forms of high tariff rates (tariff peaks), tariff escalation, lack of preferences or limited utilization of preference despite an erosion of preferences, and various non-tariff barriers (NTBs). On the supply side, governments have pursued export diversification through supply-side capacity building activities including export strategies, and the promotion of targeted industry development by way of import protection, export restriction of raw materials, and industrial policy, most notably through subsidies and investment promotion.

While the diversification of export structure and markets hold a key to successful economic development and a more stable and secure trading environment, the PICs face various economic and policy constraints in their efforts on both the demand and supply-side policy fronts. Under the evolving multilateral trading system, there are disciplines and rules, which influence those two factors in export diversification. As a result of the Uruguay Round of multilateral trade negotiations (1986-1994), major changes have taken place in the world trading environment and rules. On the demand side, that is on the market access front, major reduction of market access barriers in industrial products in major import market countries as well as increased transparency in most WTO Members have taken place. This is also the case for agricultural and textile products as agriculture was for the first time in the history of GATT included in the multilateral disciplines as was the case for textile products. Furthermore, the revival, intensification and resurgence of regional trade agreements, including in the Pacific represents important avenues to liberalizing market conditions and in turn increase market access opportunities.

On the supply side, new disciplines under the WTO have been instituted on trade-related (distorting) domestic industrial policy measures, which have been utilized other things at diversifying export and production structure of commodities. This includes the prohibition of export and industrial domestic subsidies under the Agreement on Subsidies and Countervailing

Measures (ASCM), the reduction commitments under the Agreement on Agriculture (AoA) for domestic support and export subsidies, and performance requirements for investment in production of goods under the Agreement on Trade-Related Investment Measures (TRIMs).

Most traditional industrial policy tools, namely import protection of infant industries, have also come to be limited in their applicability as a result of multilateral and regional tariff reductions. Export restriction including export taxes of raw material with a view to encouraging downstream value adding processing industries have also come under increasing scrutiny by major WTO Members (see box 1). Import protection as a development policy tool is increasingly being diminished owing, *inter alia*, to reciprocal reduction commitments assumed by developing countries in the context of the WTO market access conditions and accession to WTO negotiations, or regional trade agreements. Furthermore, new trade policy concerns such as environment protection has increasingly affected trade policy flexibility of developing countries. Those concerns are particularly relevant for PICs in the field of subsidies in fishery sectors and export restriction in forestry products.

**Box 1: Export taxes by Solomon Islands of forestry products**

Development of forestry and fish industries is at the core of sectoral industrial policy of the Solomon Islands. Trade and investment measures have been designed to promote downstream processing of these resources. Such policies include export taxes on unprocessed timber and fish, as well as efforts to make fishing and logging licenses conditional upon domestic processing. It has been cautioned that those policies, which tax the unprocessed activity, risk creating economically inefficient downstream industries reliant to continued government support (WTO, 1998b). Export taxes are seen as compounding the anti-export bias inherent in the country's tariff and other economic policies that contribute to high – cost nature of the economy, as well as undermining conservation of fishery and forestry resources by reducing domestic prices for the unprocessed product. Such views have been contested that the policy granting exemptions from export taxes to down stream processors, given particular market structure of the Solomon Islands, caused very little problem and little to distort production (Grynberg (b)).

While only a few PICs are Members of the WTO, multilateral disciplines on various aspects of international trade policy as well as commitments undertaken by WTO Members under Uruguay Round of multilateral trade negotiations have major impact also on the PICs. This is also the case for non-WTO Members, as policy changes (or non-change) induced consequent to WTO negotiations and commitments have significantly affected trading environment and export competitiveness of PIC products in international and major export markets. In parallel to WTO, major regional trade initiatives underway in or involving the region are also of major importance for PICs, in particular in terms of preferential market access and policy flexibility. They include the expected launch in January 2002 of negotiations aimed at the formation of PARTA, negotiations under Cotonou Agreement with EU for the post-Lomé trading arrangement starting officially in September 2002. The existing preferential schemes such as GSP, SPARTECA, the Melanesian Spearhead Group trade agreement and the trade regime of the Cotonou Agreement<sup>2</sup> hold significant importance for PICs as the bulk of their exports are traded under those preferential schemes.

Table 5 below summarizes different membership to those agreements by the PICs. Apart from those agreements and arrangements appearing in the table, most PICs are eligible beneficiaries of GSP schemes of major developed countries.

<sup>2</sup> The Cotonou Agreement provides for the continuation of the Lomé-type non-reciprocal preferences for ACP States for a preparatory period from 2000 till December 2008, after which time new WTO compatible trading arrangements would have been negotiated by ACP and EU and launched for implementation from 1 January 2008.

**Table 5: Membership of PICs in regional and multilateral trade agreements**

Pacific Forum/ SPARTECA Members	Pacific ACP States	Melanesian Spearhead Group	Compact Free Association Members	LDCs	WTO (acceding countries)
Fiji	Fiji	Fiji			Fiji
Kiribati	Kiribati			Kiribati	
PNG	PNG	PNG			PNG
Samoa	Samoa			Samoa	(Samoa)
Solomon Islands	Solomon Islands	Solomon Islands		Solomon Islands	Solomon Islands
Tonga	Tonga				(Tonga)
Tuvalu	Tuvalu			Tuvalu	
Vanuatu	Vanuatu	Vanuatu		Vanuatu	(Vanuatu)
F.S. Micronesia			F.S. Micronesia		
Marshall Islands			Marshall Islands		
Palau			Palau		
Cook Islands					
Niue					
Nauru					
Australia					
New Zealand					

## Chapter III

### MARKET ACCESS CONDITIONS FOR PICs

#### 3.1. TARIFF PEAKS AND TARIFF ESCALATION

The efforts of developing countries, including PICs, to advance export expansion and diversification towards a more value-added downstream processing segment of industries has often been constrained by market access barriers in their major markets. One such obstacle is the existence of tariff peaks and tariff escalation. Tariff peaks are defined as those tariffs of more than 15 per cent *ad valorem* in developed countries. Tariff escalation happens when processed products are charged with higher tariff rates than those applied to primary commodities, thereby providing higher protection to domestic processing industries. In those markets where tariff escalation persists, the importation of primary commodities are encouraged while imports of processed products are discouraged.

The tariff reductions of the Uruguay Round of Multilateral Trade Negotiations has been estimated to be more significant for trade in particularly industrial products of export interest to developed countries. Such reductions will nonetheless reduce significantly developed countries' MFN duty rates for imports from developing countries (and countries in transition). The average MFN duty rates for industrial products should fall to between 3.7 per cent (US) and 7.1 Canada (Canada). Also the total removal of tariffs (zero-for-zero) for steel, pharmaceutical, beer, furniture, pulp and paper, construction and agricultural machinery, toys and various other products will essentially remove risks of trade and investment diversion for those exports (UNCTAD 1997). Further liberalization is being implemented for information technology products under the Information Technology Agreement.

As most developing countries (and countries in transition) enjoy almost duty free entry under the GSP for a large number of their industrial products, the effective reduction of risks of trade diversion will relate more to products not covered by that scheme or benefiting only of

small GSP margins. Average post-Round tariffs for such products will remain at about 12% *ad valorem* (some 10% of the tariff universe of Quad countries<sup>3</sup>), with tariff peaks attaining 20 to 30% (and more) for individual products of the food, footwear or clothing industries (14-20% of the tariff universe of Quad countries).

In specific sectors of particular export interest to developing countries, which correspond to a large extent to "sensitive" products, risks of trade diversion remains significant over the short and medium-term. They account for an important share of many developing countries exports to North America and the EU. Also, the reduction of the level of protection through tariff cuts or quota elimination is small in the short and medium-term for temperate zone and Mediterranean agricultural products, fishery products, clothing, textiles, shoes, leather and leather goods, and some industrial products (including many low-tech manufactures).

Clothing and textiles producers are still protected by high tariffs and stringent quantitative restrictions on imports from developing countries. The preferential rates for clothing under the EU's GSP scheme is less than 11.9%. The US excludes most textiles and clothing from its GSP scheme and its MFN rates range from 14 to 32% for most synthetic, wool and cotton clothing.<sup>4</sup> Canada applies MFN rates of 18%. Japan's GSP rates range from 6-11%.

Developing countries face high tariffs in the footwear, leather and leather goods in developed country markets. The US has no GSP preferences for these products. Its MFN rates range from 38-58% for certain sport shoes (from rubber, plastic or textiles). Canada also has no GSP preferences for the products. Its MFN rates range from 16-20% for all footwear. In the EU, its GSP rate for these products is 11.9% and the MFN rate is 13%. The Japanese MFN rates reach 30% for all leather 140% for a pair of leather shoes priced at \$25; GSP imports are subjected to a ceiling.

Peak tariffs are frequent for agricultural products, particularly dairy products, sugar and cocoa, canned fruits and vegetables. Agricultural tariff peaks are quite high, exceeding 60%, for those products that have been tariffed under the WTO Agreement on Agriculture. In the EU, these include chilled bovine meat (86%), frozen (boneless) bovine meat (215%), grape juice (215%), fresh bananas (180%), milk with less than 3% fat (113%), milk in powder without sugar (66%) and milk in powder with sugar (54%), maize (84%), wheat (84%), dried manioc (75%), raw cane sugar (73%), white sugar (71%) and smoking tobacco (75%). In the US, these include stemmed and stripped tobacco (350%), smoking tobacco (310%), shelled or roasted ground-nuts (132%) and peanut butter (132%); milk with less than 3% fat (66%), milk in powder without sugar (55%) and milk in powder with sugar (179%). In Canada, these include whole, frozen chicken meat (238%); milk with less than 3% fat (241%), milk in powder without sugar (243%) and milk in powder with sugar (243%); raw cane sugar (70%), and white sugar (70%). In Japan these include frozen pork (66%), prepared pork hams (110%), milk with less than 3% fat (280%), milk in powder without sugar (80%) and milk in powder with sugar (85%); dried peas (640%), dried beans (460%), maize (60%), milled rice (550%), shelled ground-nuts (550%), raw cane sugar (73%), cane molasses (95%), prepared or preserved pineapples (110%), coffee preparations and extracts (130%), tea preparations, essences and extracts (180%).

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<sup>3</sup> Canada, EU, Japan and US.

<sup>4</sup> The US GSP preferences for sub-Saharan African countries has been improved under the African growth and Opportunity Act.

## **3.2. PREFERENTIAL MARKET ACCESS CONDITIONS FOR THE PICs**

### ***3.2.0. Erosion of Preferences***

Most PICs' products are traded under various preferential trade regimes, including unilateral (non-reciprocal) preferential schemes as well as reciprocal regional integration agreements. The non-reciprocal preferences include the GSP, the temporary trade regime under the ACP-EU Cotonou Agreement, the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA) and the Australia-PNG Trade and Commercial Relations Agreement (PATCRA). Furthermore, Pacific LDCs are also eligible for more advantageous preferences recently offered by major GSP preference-giving countries, most notably the EU.

These non-reciprocal schemes differ from each other in their country coverage, product coverage, depth of margin of preferences, as well as their legal status in the WTO. In general, preferences granted to a selected group of countries (i.e. Cotonou Agreement and SPARTECA) offer more benefits in terms of wider product coverage and deeper preference margin. They are also more legally secure without arbitrary changes by the preference-giving countries, than those offered under GSP which are unilateral. Notwithstanding their mostly voluntary nature, LDC preferences offer the most advantageous benefits to LDCs by virtue of both product coverage and preferential margins (for the most part, duty free).

Non-reciprocal preferences are derogation to the general non-discrimination principle embedded in GATT/WTO, namely the MFN principle (GATT I:1). Thus, such preferences are normally covered only by a GATT/WTO waiver. The GSP and LDC preferences (to the extent that they are offered by developed countries on a generalized basis) have been made GATT-consistent with the inclusion of "Enabling Clause" in 1979. PATCRA is exceptionally covered under rules covering regional integration, namely GATT XXIV (as it was notified to the GATT in 1977 i.e., prior to the coming into existence of the Enabling Clause in 1979).

Although those preferential schemes provide important market access opportunities for developing countries in general and PICs in particular, which would otherwise not be available to them, the commercial value of preferential market access in general is decreasing as the margin of preferences are eroding for many schemes (see box 2). The erosion is taking place as the MFN tariff liberalization progresses and other parallel and more beneficial preferential schemes are put in place by preference-giving countries to a group of countries in the form of unilateral or reciprocal preferential schemes (i.e. regional trade agreement). It has been estimated that, as a result of Uruguay Round negotiations, there has been average loss in preferential margins for all GSP receiving imports from non-LDC beneficiaries of about 2.9 percent (1.4% for LDCs) in the EU, 2.6 per cent (4.1% for LDCs) in Japan and 2.8 per cent (2.7% for LDCs) in the US (UNCTAD 1998).

The erosion of preferences for PICs is observable most notably in the US with the provisions of special preferences to Caribbean countries under the Caribbean Basin Initiative (CBI); to Andean countries under the Andean Trade Preferential Act (ATPA); and to Sub-Saharan African countries under AGOA. Market opportunities in the US and Canada markets are being affected by preferences provided by Canada to Caribbean countries under its CARIBCAN preferences, and the formation of NAFTA. The eventually realization of the Free Trade Area of the Americas (FTAA) will further reduced any competitive edge enjoyed by PICs under the GSP of the US and Canada. In the EU, PICs will face greater competition from products being sourced by EU from markets created through the formation of an extensive

network of regional trade agreements with East and Central European countries, Mediterranean Basin countries, and with selected countries in Latin America.

**Box 2: Preference erosion for canned tuna from Solomon Islands**

The Solomon Islands, an LDC and a member of ACP group of States, depends heavily on fish exports. Fisheries sector is an important source of foreign exchange for the Solomon Islands, contributing 8 per cent of GDP in 1995. The fisheries export is mainly of processed chilled, frozen, canned and fresh tuna. The fisheries accounted for well over 18 per cent of total export in 1996. However the international competitiveness of both industries is under threat. Processed fish exports (mainly canned tuna) rely heavily on preferential EU access to the United Kingdom market under the Lome Convention. Erosion of these preferences, as well as their extension as of 1 January 1998 to other LDC competitors, may be expected to intensify competitive pressure on the industry. (WTO, 1998b)

**3.2.1. Non-reciprocal: GSP, LDCs, Cotonou Agreement, SPARTECA, PATCRA**

- **Generalized System of Preferences (GSP)**

Most PICs are eligible beneficiaries of GSP schemes granted by major developed countries, most notably the Quad countries. GSP preferences are offered to all developing countries with certain criteria fixed by each preference-giving country. The eligible products are granted preferential market access, often free of duty or substantially less than the MFN rates, to the concerned developed market provided that they meet rules of origin requirements and other conditions. Preference giving countries also grant more beneficial treatment for exports of eligible LDCs (discussed below). GSP preferences have in some cases where they were effectively utilized have contributed to promoting exports of the beneficiary countries, and for certain economies heavily dependent on a limited number of export products, provided valuable instruments to access important export markets.

However, there are several caveats to be born in mind, and experience has shown that exports of GSP beneficiaries have not fully benefited from the preferential treatment, and their degree of diversification has been limited. A number of factors limit results obtained from the utilization of GSP schemes. These include the voluntary nature of GSP schemes, the limited longevity of the scheme requiring periodical renewal, heavy administrative requirements and more often a lack of awareness of the availability of the preferences among Government trade officials and private sector representatives. Another reason for the poor utilization of GSP schemes has been the linking of eligibility criteria to non-trade concerns such as respect for human and labour rights or environmental standards. Moreover, beneficiary countries can face graduation (out of the preferential scheme), in certain products or all products altogether if certain criteria linked to market share of the products in question or economic development indicators are met; there may be ceiling or quota limiting the quantity imported; product coverage is sometimes not appropriate (to the export potential of beneficiaries), as often sensitive products including agriculture, textile and clothing, or footwear are granted limited preferential margins or excluded altogether from the GSP schemes (as discussed earlier); and the application of non-tariff barriers such as trade remedies (anti-dumping, safeguard and countervailing measures) or too stringent product standards and sanitary and phytosanitary measures have hampered the importation of products benefiting from GSP treatment.

The GSP schemes most relevant to exports of the PICs are those provided by Canada, Japan and the United States and to a lesser extent in EU, as the most important export market for most PICs, namely Australia, New Zealand, provides more advantageous preferences under

SPARTECA. The EU also provides extensive benefits to a number of Pacific ACP States under previous Lomé Convention, now converted into the Cotonou Agreement. For those PICs not party to the ACP Group, namely the F.S. of Micronesia, Marshall Islands, Palau, Cook Islands, Niue, and Nauru, the GSP remains a potentially important path to accessing the EU market. Nonetheless, these countries currently they export little if any to the EU market, partly reflecting their lack of trade preferences.

- *LDCs (Kiribati, Samoa, Solomon Islands, Tuvalu and Vanuatu)*

Over and above trade preferences granted under GSP schemes to developing countries in general, additional preferences in terms of wider product coverage and deeper margin of preferences are available to LDCs. In the context of a High-Level Meeting on Integrated Initiatives for Least-Developed Countries' Trade Development held in October 1997 in Geneva (Switzerland) under the WTO's auspices, as a follow-up to the First WTO Ministerial Conference in Singapore (9-13 December 1996) where it was recognized that there was a need to enhance market access conditions for LDCs, market access initiatives have been taken by major developed countries to provide special treatment for LDCs under the existing GSP schemes. In March/April 2000, as part of a set of "confidence building measures" following the setback at the Seattle WTO Ministerial Conference (November 1999), a joint proposal was submitted to the WTO Membership by the Quad countries as follows<sup>5</sup>:

- (i) Developed Country Members shall provide least-developed Members with enhanced market access by according and implementing tariff-free and quota-free treatment, consistent with domestic requirements and international Agreements, under their respective preferential schemes, for essentially all products originating in least-developed countries so far as they remain in that category; and
- (ii) Developing country Members shall, to the maximum extent possible, also provide least-developed Members with enhanced market access including by extending tariff-free and quota-free treatment consistent with domestic requirements and international Agreements, or by providing preferential treatment for essentially all products originating in least-developed countries as far as they remain in that category.
- (iii) Members will notify, without delay, their actions taken consistent with their domestic requirements to the Committee on Trade and Development.

As most LDC products already enter major industrialized markets free of duty under various existing preferential schemes, the real issue for LDCs has been to what extent additional benefits are to be drawn by an inclusion of products of their export interest so far excluded from duty-free treatment by major developed countries. These include for example textile in the United States and Canada's GSP schemes, and fish in Japan's GSP scheme.

The EU has been proactive in this regard. For example, it had extended commercial treatment provided to LDCs members of the ACP Group to all LDCs (i.e including also non-ACP LDCs in Asia) from 1 January 1998. In the Cotonou Agreement, the EU (and ACP States) agreed that the EU would provide duty-free treatment to essentially all products exported by LDCs over a period starting in 2000 and ending by 2005. Then in view of the Third United

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<sup>5</sup> "Draft Decision Establishing a Plan of Action in Favour of Least-Developed Countries and A Revitalized Program for Technical Cooperation" in **Elements for rapid action in the WTO** (31.3. 2000, Quad countries).

Nations Conference on LDCs (Brussels, May 2001), the EU approved an initiative to grant duty-free and quota-free treatment for all imports from LDCs, except for arms. This everything but arms (EBA) initiative entered into force on 5 March 2001. Under the EBA, the EU would provide duty and quota free access to the EU markets to all goods exported by the 49 LDCs established as such by the United Nations, with the permanent exception of arms and munitions (25 tariff lines). Three sensitive agricultural products, namely banana, sugar and rice, would be gradually liberalized by stages. The duties on bananas will be gradually eliminated by a 20 per cent annual reduction, starting on 1 January 2002 and reaching complete liberalization on 1 January 2006; duties on rice would be phased down between 1 September 2006 and 1 September 2009 and sugar between 1 July 2006 and 1 July 2009. The EBA brings liberalization to agricultural products considered sensitive in the EU and that have been highly protected; these include in particular meat and dairy products, beverages and milled products. Other developed countries have been requested to follow the EU example. Canada has announced that from 1 September 2000, it has extended duty-free treatment to an additional 573 tariff lines from LDCs, raising the share of duty-free imports from LDCs from 82% to 96%. Similarly, other developed countries including Norway, Japan and US have taken measures in favour of LDCs.

Some developing countries have also undertaken to grant preferential market access to LDCs including Egypt, Morocco, and the Republic of Korea. These South-South preferences, i.e. preferences given by developing countries to LDCs, are provided WTO coverage with a waiver from the MFN clause of GATT Article I.1.

- ***EU-ACP Cotonou Agreement: Fiji, Kiribati, PNG, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu***

The Partnership Agreement between the members of the African, Caribbean and Pacific (ACP) Group of States on the one part, and the European Community and its Members on the other part, was signed on 23 June 2000 in Cotonou, Benin. The Cotonou Agreement replaces the Fourth Lomé Convention which expired on 29 February 2000 after being in existence for 10 years. The four Lomé Conventions have formed a model of North-South development co-operation for over 25 years, since the first convention was signed in 1975.

The Cotonou Agreement aims to change and improve ACP-EU cooperation in social, political and economic areas to bring about poverty reduction in the ACP States. One of the objective as regards trade relations has been to convert the previous non-reciprocal preferential system which necessitated requesting GATT/WTO waiver to be WTO consistent, into a new fully WTO compatible regime. A lack of agreement among the parties to the modalities of the new trading arrangements led them to agreed under the Cotonou Agreement (Article 36) to continue for a preparatory period until 31 December 2007 the system of non-reciprocal preferences. This means that all industrial products and most agricultural products will enter the EU duty free as was the case under the Lome Convention. For purposes of maintaining the non-reciprocal preferences during this preparatory period, another WTO waiver is needed. Thus the EU with the ACP States, submitted to the WTO a new waiver request in March 2000.<sup>6</sup> By September 2001, the waiver had not yet been granted by the WTO.<sup>7</sup>

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<sup>6</sup> WTO document G/C/W/187, 2 March 2000.

<sup>7</sup> The waiver is seen as critical to validating the Cotonou Agreement including the preferential treatment of agricultural products. See discussion by Isikeli Mataitoga, "Priority Issues for Trade in Agriculture under the Cotonou Agreement and the Review Negotiations under Article 20 of the WTO Agreement on Agriculture: A Pacific Perspective" (Paper prepared for UNCTAD in November 2000).

Improvements have been made with additional product coverage over previously-excluded agricultural products: new tariff lines are added to the list of agricultural products eligible for preferential treatment, increasing the number of tariff lines by 32 per cent, from 1,669 under Lomé Convention to 2,209 under Cotonou Agreement. The share of tariff lines with zero tariffs among all agricultural products benefiting from preferences have grown from around one half under Lomé to about two thirds under the Cotonou Agreement (Tangermann 2000). Under the Lomé Convention, all industrial products under chapters 25 to 97 of the Combined Nomenclature (CN) are exempted from customs duties; 80 per cent of agricultural products under chapters 1 to 24 of the CN are totally liberalized. Thus, together around 92 per cent of products originating in ACP States enter the EU free of duty. The special protocols for sugar and beef under Lomé Convention also remain in force, while the rum protocol has expired, and the banana protocol was not renewed but a separate regime is being implemented. The protocols provided important benefits to the beneficiaries (see box 3). The sugar protocol has an independent status but its effectiveness, as with other protocols, is being affected by the gradual process of multilateral liberalization including under the Agreement on Agriculture.<sup>8</sup>

### **Box 3: Sugar exports of Fiji**

Agriculture, forestry and fishery together account for about 20 per cent of Fiji's GDP and more than half of its exports. Sugar production and subsistence agriculture are Fiji's dominant agricultural activities. Fiji's sugar industry makes up 40 per cent of total merchandise exports and 11 per cent of its GDP. About 90 per cent of raw sugar production is exported with more than half sold under preferential agreements, mostly to the EU under the Lomé Convention (and now the Cotonou Agreement) and to Australia and New Zealand under the SPARTECA. The main government support measure for sugar is tariff protection. The State-owned Fiji Sugar Corporation (FSC) is the sole buyer of sugar cane and manufacturer of raw sugar.

The world sugar market since 1994 has been marked by the overproduction with surplus amounting up to 4 million to 5 million tonnes, or in excess of 40% of annual world production or over 130 million tonnes. The world's largest producer of sugar, namely Brazil, doubled its production, and other major producers including the United States, India and Pakistan also increased their production. This led to world prices fluctuating between 4 and 7 cents a pound, their lowest levels for 12 years, the level none to the world's sugar producers could cover their costs. The ACP preferences under Sugar Protocol therefore continue to hold great importance for Fiji's sugar exports. (WTO, 1997b, UNCTAD 2001b).

The Cotonou Agreement also provides for a general framework and modalities for further negotiations with a view to devising permanent WTO-compatible trading arrangements after the preparatory period. These arrangements will include Economic Partnership Agreements (EPAs). The EPAs are to be negotiated during the preparatory period, starting September 2002, and would take effect from 1 January 2008. The EPAs will entail reciprocal trade agreements between EU on the one hand and individual or sub-grouping of ACP States on the other.<sup>9</sup> For those ACP States that do not accept an EPA arrangement, then alternative trading arrangements would be established for them by the EU in consultation with them. The alternative arrangement could include improved GSP preferences. Finally, the ACP LDCs or for that matter all LDCs can benefit from the special preferences provided under EBA.

<sup>8</sup> For an assessment of the Sugar Protocol and links with the liberalization under the WTO Agreement on Agriculture, see Michael S. Matsebula, "ACP-EU Sugar Arrangements: Their Nature, Importance and Prospects" (Paper prepared for UNCTAD in November 2000).

<sup>9</sup> It should be noted that as in the previous Lomé Convention, "reverse preference conditionality" applies under the Cotonou Agreement. This means that PICs entering into reciprocal trade agreement with other developed countries, eventually with Australia and New Zealand under proposed PARTA protocol, would be obliged to open their markets to products from the EU to the same extent.

- ***South Pacific Regional Trade and Economic Co-operation Agreement (SPARTECA)***

The SPARTECA is a non-reciprocal trade agreement under which Australia and New Zealand grant duty free and unrestricted or preferential market access for virtually all products originating from the FICs. SPARTECA was signed by most Forum countries at the Forum's Eleventh Meeting in Kiribati on 14th July, 1980, and came into effect for most FICs from 1 January 1981. Its objectives include accelerating FICs' development through expansion and diversification of their exports to Australia and New Zealand. The current list of FIC signatories to SPARTECA includes the 14 FICs. The Agreement includes provisions for general economic, commercial and technical cooperation, safeguard provisions relating to anti-dumping and countervailing measures, suspension of obligations and provisions for general exceptions, as well as for impact on fiscal revenue. The Agreement also provides for special treatment and assistance to be extended to the Smaller Island Countries (SICs) with regard to Cook Islands, Kiribati, Nauru, Niue, Tonga, Tuvalu and Samoa.

Under the agreement, since 1 July 1986, FIC exporters have been eligible for free and unrestricted access to the Australian market except for textiles, clothing and footwear, and sugar. Australia removed the limitation from 1 March 1993 on TCG products and on sugar from 1 July 1997 when it eliminated its sugar tariffs. New Zealand provides duty free and unrestricted access to all products originating in the FICs. The rules of origin are set out in SPARTECA to qualify for the duty-free and unrestricted or preferential access benefits. These rules require the last process of manufacture to be carried out in the country claiming the preference, and for products to have at least 50 per cent local content in that country. Inputs from any FICs as well as Australia and New Zealand are also counted as local content (cumulation) up to 25 per cent of the required 50 per cent minimum.

- ***Australia PNG Trade and Commercial Relations Agreement (PATCRA)***

PNG and Australia have established since the independence of the former in 1975 a non-reciprocal free trade area providing duty-free access of all exports of PNG to Australia, with some exceptions. The excluded goods include certain sugar imports, beverages, tobacco and mineral fuels (Schedules A and B). For PNG all products are excluded (Schedules C and D).

### ***3.2.2. Reciprocal regional trade agreements (RTAs)***

Another avenue for preferential market access is through reciprocal regional trade agreements. The PICs are increasingly members of one or more RTAs. The benefits that could be drawn from such regimes are the same as unilateral trade preferences, except that reciprocal preferences are to be granted, thus the markets of the exporting countries are also to be opened to preferential access to their trading partners. Potentially, reciprocal opening of markets offer economic efficiency gains as long as these cause more trade creation than diversion. Increased import competition within the liberalized area also contributes to increasing competitiveness of domestic industries by enabling provision of cheaper and wider range of products available to domestic consumers and industries. However, reciprocal market openings may have costs in terms of structural adjustment of production structure of a country with attendant de-industrialization and heavy social costs.

- ***PNG/Fiji Trade Agreement***

The agreement was formed by the two countries in August 1996 (noting that both countries are also members of the MSG (see below)). The agreement covers 45 agricultural and manufacturing products, including chilled or frozen mackerel as well as certain dairy products including cheese; fruit such as pineapples; tea and other beverages; spices such as chilli; cement; wood and wood articles; and clothing. Negotiations are ongoing aimed at expanding the product coverage. Eligible Fijian goods enter PNG at zero tariff but are levied a 10 per cent VAT (value added tax). Most eligible agricultural products from Fiji are subjected to quarantine approval.

- ***Melanesian Spearhead Group (MSG) Trade Agreement: Fiji, PNG, Solomon Islands and Vanuatu***

The MSG was formally launched in 1988 to promote political cooperation among members. In 1993, the MSG Trade Agreement was concluded among the founding members. It initially covered duty-free entry of only three commodities, one from each member: tea from PNG, beef from Vanuatu, and canned tuna from the Solomon Islands. Revenue collected on eligible imports are not to exceed those applied to similar goods if produced domestically. Safeguard provisions allow any member to suspend obligations should imports increase so as to cause serious damage to existing industries. Furthermore, parties may abrogate their obligations should they decide to develop new industries. There are other clauses that allow parties to rescind obligations including restrictions for BOP and anti-circumvention reasons. Members are committed in principle to extending the coverage to ensure that duties and other trade restrictions are eliminated between the parties. In 1995, the coverage of eligible products was extended to 140 tariff lines, and an agreement, yet to be ratified, was reached in 1997 to expand the list to 150 items. Eligible products now include edible fruit and nuts, coffee, coconut-milk powder, jams, cement, and certain wooden furniture. Fiji has not been given the same preferences as other members, but has had to negotiate them on a bilateral basis.

- ***Asia Pacific Economic Co-operation (APEC): PNG***

The PIC member of APEC is PNG. It joined APEC in 1994. APEC economies are committed to the Bogor objectives of voluntarily achieving free trade and investment in developed economies by 2010 and by 2020 for developing members. Liberalization is to be comprehensive by including agriculture and services, and non-discriminatory based on the concept of "open regionalism." Food, chemicals and transport sectors are proposed for the so-called "Early Voluntary Sectoral Liberalization (EVSL) initiatives."

- ***Pacific Regional Trade Agreement (PARTA)***

At the 1997 Forum Economic Ministers Meeting (FEMM), the establishment of a free trade area in the Pacific was endorsed. The creation of a reciprocal free trade area was based on the perception that unilateral preferences granted under SPARTECA had not led to export growth and economic development, marking a sharp contrast with the success of Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA). Since then, negotiations have been pursued by Forum members to conclude the PARTA agreement. Currently, the negotiations are aimed at the adoption of the final legal text of an Umbrella Agreement including the FICs and Australia and New Zealand, and a Forum Island Country only Free Trade Area (FIC-FTA).

The negotiations cover the schedules of liberalization, negative lists and rules of origin under the FIC-FTA legal text. The Pacific Regional Trade Agreement is expected to commence in January 2002. The PARTA would have a negative list of sensitive products that are to be subject to gradual liberalization to provide those industries with a “breathing space” for adjustment necessary to effectively compete with regional suppliers after phase-in period. The PARTA would include some safeguard measures. The Umbrella Agreement is a trade and economic co-operation agreement between the Forum Island Countries and Australia and New Zealand. The FIC-FTA will establish a free trade area amongst the 14 Forum Island Countries, following a transition period of 10 years. The PARTA is expected to supersede the MSG agreement and the other bilateral trade agreements.

A rationale for the Pacific Regional Trade Agreement is the need to prepare for the changes in evolving world trading system, avoid marginalization in the global economy and overcome difficulties inherent in PICs such as smallness and remoteness, as well as resulting lack political influence by the individually small countries. For smaller economies such as Kiribati and Tuvalu, the benefits would derive from the enlargement of boundaries in the form of freer movement of goods and eventually of natural persons. In the past, smaller states have benefited mostly from trade in labour and their access to bigger and richer markets as has been the case with Kiribati in Nauru and Micronesians in America and Polynesians in New Zealand.

Another rationale for PARTA is the EU proposal to negotiate economic partnership agreements (EPAs) with ACP countries in the context of post-Lome trade arrangements. These negotiations are scheduled to begin in September 2002. While the initiative to form a PARTA predates the EU proposal for EPA, the PARTA is expected to form a regional basis for the PICs members of the ACP Group to negotiating EPA as a group, which would be necessary for retaining existing preferential access to the EU market beyond 2008. Exports of tuna, for instance, may lose its access to the EU without preferential treatment.

The RTA route raises various challenges for PICs and among the most important is the likely impact on government revenue, in the backdrop of a decrease in aid flows to developing countries and which has affected many of the aid dependent economies of the Pacific region. The declining aid is likely to have a major impact on the budgetary resources of governments, because at the same time, the revenue sourced from tariffs will decline in the light of the liberalizations measures under various RTAs. These include commitments taken by APEC countries to eliminate tariffs (affecting only PNG at present), the post-Lomé EPA trading arrangements, the MSG trade agreement and the bilaterals (Fiji-PNG). The impact will be further compounded by the unilateral and World Bank-IMF induced liberalization measures have been pursued by most PICs. A careful analysis of the various options is needed by PICs.

### **3.3 NON-PREFERENTIAL MARKET ACCESS CONDITIONS: WTO AGREEMENTS**

Apart from preferential market access, some exports of PICs are traded on an MFN basis. This is the case with products excluded from any preferential schemes in major developed country markets, and with trade with other developing countries (e.g., Vanuatu’s export to Bangladesh) provided that MFN rates are applied to non-WTO Members by importing countries. Even without direct applicability, disciplines and commitments undertaken by WTO Members would affect indirectly and, in some instance, significantly, the trading environment and market access conditions of PICs. Therefore multilateral disciplines and the attendant market access conditions are relevant to the PICs.

There exist several multilateral disciplines affecting commodities and commodity-based processed products of export interest to PICs. The general rules on trade in goods are provided by GATT 1994, basic commodity and processed agricultural products are governed by the Agreement on Agriculture (AoA), and textiles and clothing sector, newly emerging manufacturing sector of interest to some PICs (e.g. Fiji), are governed by Agreement on Textiles and Clothing (ATC). As regards primary commodities, the major commodity categories fall within the purview of the AoA, but fishery and forestry products are not covered by the AoA and general rules under GATT 1994 are applicable to these commodities.

### ***3.3.1. Basic commodities and processed agricultural products: Agreement on Agriculture***

The Agreement on Agriculture (AoA) is the multilateral discipline governing agricultural commodities and process agricultural goods, including processed foods, dairy products and some garment products. It contains multilateral disciplines most relevant to commodity diversification of Pacific Island countries in terms of market access, export competition and domestic support, as well as food security and non-trade concerns. Products covered by the Agreement, as defined in its Annex 1, include not only basic agricultural products such as wheat, milk and live animals, but the products derived from them such as bread, butter and meat, as well as all processed agricultural products such as chocolate and sausages. The coverage also includes wines, spirits and tobacco products, fibres such as cotton, wool and silk, and raw animal skins destined for leather production. Fish and fish products are not included, nor are forestry products.

Under the AoA, WTO Members have committed themselves to converting existing quantitative restrictions (quota) into tariffs by calculating tariff equivalent (tariffication) and reduce the amount by an agreed proportion (36% for developed and 24% for developing countries) by the end of implementation period (by 2000 for developed and by 2004 for developing countries). The AoA prohibits the use of agriculture-specific non-tariff measures including quantitative import restrictions, variable import levies, minimum import, prices, discretionary import licensing procedures, voluntary export restraint agreements and non-tariff measures maintained through state-trading enterprises. In any tariff lines, Members are required to reduce at least 15 per cent for developed and 10 per cent for developing countries. The LDCs were exempted from the obligation to reduce tariffs (as well as domestic support and subsidies) while required to bind all tariffs. The products subject to “tariffication” include major temperate zone agricultural products. The tariffs resulting from the tariffication process account, on average of the developed country Members, for around one fifth of the total number of agricultural tariff lines. For the developing country Members, this share is considerably smaller. Following the entry into force of the AoA in 1995, the tariffs on virtually all agricultural products traded internationally are bound in the WTO. Many developing countries have bound their previously unbound tariffs at “ceiling” levels, i.e. at levels higher than the applied rates prior to the WTO.

As part of the tariffication process, WTO Members were required to maintain, for tariffied products, current import access opportunities at levels corresponding to those existing during the 1986-88 base period. Where such “current” access had been less than 5 per cent of domestic consumption of the product in question in the base period, an (additional) minimum access opportunity had to be opened on a most-favoured-nation basis. This was to ensure that in 1995, current and minimum access opportunities combined represented at least 3 per cent of base-period consumption and are progressively expanded to reach 5 per cent of that

consumption in the year 2000 (developed country) or 2004 (developing country), respectively. Current and minimum access opportunities are generally implemented by tariff rate quotas. For products subject to tariffication, special safeguard measures are applicable in the case of increase in import volume or decrease in price level, provided that Members reserved the right to such effect in their schedule of concessions.

### ***3.3.2. Fishery and forestry products: GATT 1994, SCM/TRIMs, and Trade and Environment***

The AoA explicitly excludes fish and forestry products. Those sectors fall within the purview of general rules under GATT 1994, and presumably to the Agreement on SCM. Therefore the general multilateral disciplines on trade in goods, including MFN and national treatment obligation, prohibition of quantitative restrictions, and reduction and binding of industrial tariffs under GATT 1994. For some developed countries, the fishery sector is seen as a “sensitive sector”, being characterized by the extensive use of production subsidies, and import tariffs remains relatively high (e.g. in the EU). Being outside the AoA, the fisheries sector is subjected to GATT 1994, thus the use of subsidies in the sector is supposed to be governed by the general rules on subsidies, namely the Agreement on Subsidies and Countervailing Measures, which provides stricter disciplines on subsidies than those in AoA. While agricultural subsidies, be it domestic and export, are subject to reduction commitments under SCM, certain subsidies, in particular export subsidies, are prohibited, and certain specific subsidies if found to be trade distorting are also forbidden or subjected to countervailing duty action by trading partners. Given the extensive use of subsidies in fisheries sector, however, it is not clear how the existing strict rule on subsidies for industrial products are applicable to fisheries sector. At the very least, it has been established that those fisheries subsidies have resulted in global over production of fishes and undermining sustainable management of fishery resources. This aspect of fishery subsidies is subject to discussion in WTO Committee on Trade and Environment.

The forestry sector has been proposed for accelerated tariff reduction, and the United States has been seeking accelerated liberalization in the framework of APEC’s “Early Voluntary Sectoral Liberalization (EVSL) initiatives”. However, such initiative has also be subject to criticism from the environmental group for national reservation concerns. There has been a proposal to establish stringent rules on export restrictions or export tax policies from the perspective of sustainable forestry resource management.

### ***3.3.3. Textiles and clothing: Agreement on Textiles and Clothing***

Textiles and clothing are the promising manufacturing industry for some of PICs, notably Fiji (see box 4), in the diversification of their export structures. The WTO's Agreement on Textiles and Clothing (ATC) has taken over from the Multifibre Arrangement. By 2005, the sector is to be fully integrated into normal GATT rules. The ATC is the only WTO agreement that has an in-built self-destruction mode. In particular, the quotas will be eliminated by the time, and importing countries will no longer be able to discriminate between exporters according to their origin, depending on quota allocation. For those PICs relying on preferential market access or already enjoyed access under quota under MFA, the dismantling of quota system poses challenges in terms of erosion of preferential market access.

**Box 4: Fiji's clothing sector**

Clothing is Fiji's main manufacturing export. Fiji has developed the manufacturing sector and the clothing sector now constitutes the country's main manufacturing export, accounting for 30 per cent of total export. The sector was assisted by Fiji's Tax Free Factory exemption scheme, which grants tax exemptions on income from exports. Some two thirds of employment are registered in foreign firms. Clothing production increased fivefold between 1986 and 1995. Exports have more than doubled since the late 1980s, accounting for 30 per cent of manufacturing exports. Most clothing exports are traded under SPARTECA and Lomé Convention, but the preferences are gradually being eroded as they reduce their tariffs on a MFN basis under the ATC. (WTO 1997)

The integration of all textile quotas into general GATT rules has been agreed to proceed progressively and be accomplished by the end of the year 2004. However, after almost 6 years in effect of the ATC, the committed progressive phasing-out of quotas has not yet materialized. The implementation of quota dismantling has been slow, and raised concerns on the part of developing countries. So far, only a few quota restrictions (13 out of 750 by the United States; 14 out of 219 by EU; and 29 out of 295 by Canada), have been eliminated, leaving the great bulk of restrictions still in place (UNCTAD, 2001c). Developing countries, including small suppliers and least-developed countries, have not received commercially meaningful increases in their access possibilities. Conversely, major developed restraining countries have applied a number of trade restrictive non-tariff measures through (i) transitional safeguard actions, (ii) changes in rules of origin, (iii) customs administration, and (iv) anti-dumping actions. A large number of safeguard actions have been taken as a way of new restrictions, involving exports from small suppliers.

### ***3.3.4. Other rules governing non-tariff barriers***

WTO Agreements also contains rules governing non-tariff barriers, and other trade-related policy fields, which affect or potentially affect market access conditions of the PICs. These include the Agreements on anti-dumping, safeguards, subsidy and countervailing measures, rules of origin, technical barriers to trade, sanitary and phytosanitary measures, trade-related investment measures and trade-related aspects of intellectual property rights. Unilateral trade preferences are governed by Enabling Clause in the case of GSP schemes and LDC preferences, and by waiver in the case of non-generalized preferences such as the Cotonou Agreement and SPARTECA. Regional trade agreements are subject to disciplines of GATT Article XXIV in the case of RTAs (covering trade in goods) involving one or more developed countries, and the Enabling Clause in the case of those RTAs comprising only developing countries (trade in services agreement are covered by Article V of the general Agreement on Trade in Services).

Of particular relevance for the PICs' export prospects and market access conditions is the WTO Agreement on Sanitary and Phytosanitary Measures, as the arbitrary application of stringent sanitary and phytosanitary measures by importing countries often function as important non-tariff barriers to developing countries exports. The SPS Agreement sets out the basic rules on the application of sanitary and phytosanitary measures. It allows countries to set their own standards. But it also requires those regulations to be based on scientific evidence. They should be applied only to the extent necessary to protect human, animal or plant life or health. They should not arbitrarily or unjustifiably discriminate between countries where identical or similar conditions prevail. WTO Members are encouraged to use international standards, guidelines and recommendations where they exist. However, Members may use measures, which result in higher standards if there is scientific justification.

## **Chapter VI**

### **POLICY OPTIONS FOR COMMODITY-BASED DEVELOPMENT OF PICS AND “POSITIVE AGENDA” FOR FUTURE MULTILATERAL AND REGIONAL TRADE NEGOTIATIONS**

For years to come, the an PICS will face evolving international trading environment where their market access conditions and domestic polices aiming at diversification of its export structures may be significantly influenced. In such a trade policy context, it would be in the interest of the PICS to evaluate the existing market access opportunities and other policy implication under the WTO, the various regional trade agreements and preferential schemes, and explore those possibilities available to them with a view to expanding their exports while ensuring diversification of production capability and export markets. While preferential schemes are of particular importance for the PICS as a bulk of their exports are traded on a preferential basis, multilateral trade disciplines also affect their trade interest directly or indirectly, most notably through the erosion of preferences and other changes in rules governing preferential schemes which may hinder policy flexibility such as for industrialization.

Against this background, ongoing and forthcoming multilateral and regional trade negotiations offer both opportunities and challenges for the PICS in pursuing and protecting their trade interest with a view to securing a more enabling environment for the diversification of their export structures within the commodities they have competitive advantage in. Some policy options and negotiating issues are discussed below in this light.

#### **4.1. ENHANCED MARKET ACCESS CONDITIONS FOR LDCs**

The Pacific LDCs (Kiribati, Samoa, Solomon Islands, Tuvalu, Vanuatu) are entitled for special LDC preferences granted by major developed countries. Priority could thus be placed by these countries on ensuring that maximum benefits is drawn from those schemes by their exporters. The LDCs as a group could possibly negotiate with preference giving countries to ensure that all products be given duty and quota free access, in particular the products of export interest to LDCs (the only exceptions being those permitted under general GATT exceptions with strict application); that all developed countries offer duty-free and quota-free market access to all LDC exports; and that able developing countries also offer LDC preferences.

Another aspect concerns improving the utilization of preferential market access opportunities. Under the existing GSP schemes, the utilization of available preferences are often in the order of only 40-60 per cent in the case of non-LDC developing countries and 50 to 70 per cent in the case of LDCs, meaning that eligible developing country exporters often fail to seize preferential market access opportunities available to them (UNCTAD 1998). Often, non-trade conditionalities, stringent rules of origin, and various administrative requirements hamper effective utilization of preferences (as discussed earlier).

Furthermore, the long-term security of LDC market access conditions possibly could be guaranteed through binding those preferences under GATT/WTO. The lack of legal security and predictability of preferences is often found at the root of the low utilization of available preferential schemes for developing countries, as the lack of long-term security makes long-term production and investment planning difficult. One way to attain this objective is to agree on a

legal instrument mostly possibly under GATT/WTO and to render all commitments made in favour of LDCs legally binding and contractual obligations for developed Members of WTO.

#### **4.2. EU-ACP negotiations for EPAs under Cotonou Agreement**

The most prominent challenge facing the Pacific ACP States (Fiji, Kiribati, PNG, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu) is the forthcoming negotiations with the EU for the successor trade arrangements that replace current non-reciprocal preferential arrangements. The Cotonou Agreement provides a built-in agenda firstly to negotiate new WTO compatible and appropriately flexible trading arrangements defined as “economic partnership agreements” (EPAs) between the ACP States and the EU, during the preparatory period up to 31 December 2007 to take effect on 1 January 2008 (Article 37:1). Negotiations will be undertaken by ACP States that consider themselves in a position to do so, i.e. not necessarily all ACP States; at a level they consider appropriate and in accordance with the procedures set by the ACP Group (Article 37:5). The intention is to establish the new EPAs with non-LDC ACP States, as least developed ACP would be eligible for unilateral special LDC preferences. The EPAs shall aim to progressively removing barriers to trade between the concerned ACP States and EU in line with relevant WTO provisions on reciprocal regional trade agreements. However these agreements shall also be as flexible as possible in establishing the duration of a sufficient transitional period, the final product coverage, taking into account sensitive sectors, and the degree of asymmetry in the timetable for dismantling tariffs (Article 37:7). Moreover, the EU and ACP States are committed to defending the “flexibility” aspects of the EPAs in the WTO (Article 37:8).

Formal negotiations on the EPAs is scheduled to commence in September 2002. In 2004, the EU will assess the situation of non-LDC ACP States, which after consultations with the EU, decide not to enter into EPAs and will examine all possible alternatives of a trade framework which is equivalent to their existing situation and compatible with WTO provisions (Article 37:6). The most likely alternative is an enhanced GSP option. Thus the Cotonou Agreement provides a built-in agenda to secondly elaborate, via consultations, alternative trading arrangements for those non-LDC ACP States that do not wish to enter into EPAs with the EU. In 2006, a formal and comprehensive review of the new trading arrangements will be carried out by ACP States and EU although regular reviews could be conducted in the interim period (Article 37:4). Then by 31<sup>st</sup> December 2007, the negotiations on EPAs would have been concluded. Thus starting in 2002 with the launching of official negotiations, and every two years thereafter, the ACP States and EU will jointly review and adjust the process of negotiations on EPAs.

One particular issue of relevance for the PICs is the choice of options under the Cotonou Agreement: EPAs, enhanced GSP or LDCs preferences. As presumably the preferences to be granted under the EPAs would be more beneficial than those provided under GSP, in purely market access terms the EPAs would appear more beneficial for many PICs, in particular those heavily dependent on EU market for its few export commodities (sugar, canned tuna etc.). However, those benefits have to be weighted against possible adjustment costs to be incurred as a result of corresponding market opening on the part of PICs. If the assessment shows that the cost of market opening outweigh the benefits from market access to the EU, the enhanced-GSP may appear more suitable for some non-LDC ACP countries (Fiji, PNG and Tonga).

The question remains for LDCs that would be granted most preferential unilateral market access by EU, as they would have less incentive to join any EPA for reciprocal market opening,

apart from benefits accruing from reciprocal liberalization with other PICs. One possible advantage is that the EPAs, due to their presumed legal certainty, would provide legally and commercially more secure market access to EU (without no agreement reached for LDC market access conditions at the multilateral level as yet). In the case of PICs opting to form an EPA with the EU as a part of PARTA or other regional groupings, it could be ensured that the LDCs among the PICs be granted no less favourable treatment than would be the case under LDC preferences i.e., the EBA.

Another negotiating issue for Pacific ACP countries is to secure as flexible an agreement as possible in terms of market opening schedule, product coverage, rules of origin and other related rules in trade between two regions. Flexibility is inherent in any regional trade negotiations, in particular among countries with different level of development, and asymmetric liberalization has been widely practiced in those RTAs formed between developed and developing countries. Agricultural products are often treated differently from industrial products and liberalized to a lesser degree. The Pacific ACP countries could explore such flexibility and can bargain in such a way as to ensure market opening and access that would be most conducive to their increased integration in multilateral trading system and sustainable development. Technical assistance and financial facilities in coping with transition costs and stabilization of export earnings with a view to more equitable sharing of benefits may deserve consideration such as those previously existed under the Lomé Convention (e.g. STABEX, SISMIN, EDF etc).

Another immediate task for Pacific ACPs is that during the preparatory period, they should build up their capacity for competitiveness and regional integration, as provided under the Cotonou Agreement (Article 37:3). They should also make effective utilization of the transitional non-reciprocal preferences. These are critical requirements for ACP States and their enterprises to participate fully in a liberalized trading environment.

### **4.3. REGIONAL TRADE NEGOTIATIONS: PARTA**

Negotiations aimed at the formation of PARTA are underway. The prospects of these negotiations are partly influenced by the EU-ACP negotiations in the context of the Cotonou Agreement, as PARTA may form a basis to negotiate a possible EPA with the EU. In such a case, one policy issue arising from asymmetrical membership is the treatment of non-ACP PICs with the negotiations of EU, namely the Federated States of Micronesia, Marshall Islands, Palau, Cook Islands, Niue and Nauru. The other issue would be the treatment of Australia and New Zealand if PARTA also forms a free trade agreement with the two ANZCERTA countries. While PARTA is estimated to be considerably welfare improving if ANZCERTA is included in the agreement (Forum Secretariat 2000; Scollay 2000), this may affect the prospects of reciprocal market openings with the EU.

Regional trade agreements could play an important role in expanding intra-regional trade and thus diversifying export structure, market and production basis. A viable RTA could enable small economies to develop economies of scale, enhance competitiveness of domestic industries and adjust to increased import competition. This is exemplified by the MSG trade agreement which had stimulated development of industries based on the products liberalized and traded among member countries. As PICs are all developing countries, the future PARTA may well be subject to less stringent disciplines under the Enabling Clause. However, the Forum leaders' preferences for GATT XXIV could be justified in view of a possible EPA with EU, which may be necessitate to be compatible with more the more stringent disciplines under GATT XXIV.

#### **4.4. WTO ACCESSION**

At present, three PICs are on the process of WTO accession, namely, Samoa, Tonga and Vanuatu. Accession to the WTO has increasingly become difficult for developing countries, especially for LDCs. One of the major difficulties has been that acceding countries are obliged to accept higher level of obligations than the current WTO Members. Another is that developing countries are often not allowed to benefit from the S&D treatment incorporated in the WTO Agreements. Acceding developing countries often face an apparent reluctance of some WTO Members to automatically extend to them the S&D provisions, including those for LDCs to acceding LDCs. This implies that acceding LDCs must negotiate with WTO Members to benefit from such provisions on case-by-case basis. For instance, Vanuatu, an LDC, was requested to join the plurilateral (optional) Agreements on Government Procurement and Trade in Civil Aircraft as a condition for its WTO accession, while the S&D provisions available to 30 LDCs original Members of the WTO were substantially curtailed. This has led Vanuatu to consider withdrawing its application from WTO accession.

#### **4.5. ONGOING AND FUTURE MULTILATERAL TRADE NEGOTIATIONS UNDER WTO**

Mandated multilateral trade negotiations are underway under the Agreement on Agriculture (Article 20) and the General Agreement on Trade in Services (Article XIX). In parallel, a possible launch of a new round of multilateral trade negotiations is under consultations by WTO Membership in the context of the preparations for the Fourth WTO Ministerial Conference, scheduled for 9-13 November 2001 in Doha, Qatar.

##### ***4.5.1. Redefinition of S&D: Recognition of Small Island Developing States within WTO***

The redefinition of special and differential treatment (S&D) for developing countries in such a way as to allow for differentiation among developing countries of “small island developing States (SIDS)” has been part of discussion in the WTO since 1997, and is reflected in the 1998 Geneva Ministerial Declaration. However, there has been no acceptance on the part of other WTO Members including developing country Members on the institutionalization of population-based category other than LDCs. Therefore, the existing S&D provision as it currently stands applies to all developing countries or to LDCs, and no special case has been established for SIDS as yet.

The Pacific WTO Members (Fiji, PNG and the Solomon Islands) have raised the issue with 7 other WTO Members during the preparatory process for the Third WTO Ministerial Conference in Seattle in 1999, and emphasized the following areas for further action: (a) encouragement of regional trade agreements; (b) various measures in agricultural trade such as assistance in case of natural disaster, assistance for diversification into high-value added products, rapid implementation of the Decision on Least-Developed and Net Food-Importing Developing Countries, market access for small economies’ agricultural products, technical and financial assistance to increase productivity, and a mechanism to provide concessional facilities when food prices exceed a certain ceiling or food products falls below a certain level; (c) technical and financial assistance for adjustment in textile and clothing; (d) more favourable tariff cuts and bindings for small economies; (e) raising of the *de minimis* level for actionable subsidies; and (f) various aspects of trade in services (removal of barriers in sectors of export

interest to developing countries; incentives to improve access to technology, distribution channels and information networks, and capacity building measures (WT/GC/W/361).

#### **4.5.2. *Level of tariff protection***

Given that in most SIDS including PICs, customs revenues still constitute a high proportion of total government revenue, any decline in the level of such revenues arising from further tariff reductions may cause a large number of governments to curtail their budget expenditure. One area that has been raised for special treatment of SIDS within WTO is the flexibility in reducing tariff levels in such a way as to keep with their development and financial needs. It has been proposed that SIDS are not required to make further commitments to reduce tariffs and to bind the reduced rates beyond what they consider realistic and consistent with their trade, development and financial needs.

#### **4.5.3. *Agriculture***

Given that SIDS in general and PICs in particular are heavily dependent on agricultural production and exports of a few commodities on a limited export markets, ongoing negotiations on agriculture holds paramount importance for PICs. On the other hand, account should be taken of the fact that many SIDS are also heavily dependent on food imports in meeting their basic subsistence requirements and are thus particularly vulnerable to price and supply fluctuations which may result from full implementation of current and future commitments undertaken by major WTO Members. Therefore, for PICs it is of paramount importance to ensure an enabling trading environment through negotiations under AoA that would guarantee stable and predictable export earnings.

In concrete terms, it has been proposed by PICs and other SIDS WTO Members that emerging rules on agriculture include: (i) measures at international level to assist these economies whenever they are adversely affected on account of any natural disaster; and (ii) assistance for feasible and sustainable diversification of production in products which have potential for higher value-added.

Another issue of interest for PICs are food security, as many SIDS are net food-importing countries. In this regard, the effective implementation of the 1994 Marrakesh Decision in favour of the least developed and net food-importing developing countries holds vital importance to them. Many interested Members have estimated that the Decision has not fully been implemented.

Furthermore, it has been suggested that the following elements be included in any future Agreement: (i) the need to give priority consideration in future agricultural trade liberalization to market access for their products; (ii) the provision of technical and financial assistance by major agricultural exporters and development institutions to improve agricultural productivity; and (iii) the establishment of a mechanism to ensure that, whenever food prices exceed a particular ceiling or whenever domestic food production drops below a certain threshold, concessional facilities are made available.

#### **4.5.4. Subsidies: fisheries and forestry products**

The rules governing use of subsidies in the industrial sector, including fishery and forestry sectors, as contained in the Agreement on Subsidies and Countervailing Measures (SCM), generally prohibits the use of export subsidies on those products. Developing countries are provided with a transitional period of eight years (i.e. up to January 2003) to implement these rules. Further, some flexibility is provided in the agreement as per Annex VII countries who are exempted from restrictions on export subsidies. The list however does not include SIDS as such. Therefore, it has been proposed that this same flexibility be afforded to SIDS as a group. Another proposal is to raise the *de minimis* level of permissible subsidies for developing countries in general (currently fixed at 2% in the value of a product calculated on a per unit basis), under which level subsidies are deemed to be non-actionable by countervailing measures. The same flexibility for SIDS is suggested as regards the Agreement on Safeguards.

#### **4.5.5. Agreement on Textiles and Clothing (ATC)**

As textiles and clothing industries hold a key to successful diversification into the manufacturing sector of SIDS and PICs, the ATC is relevant to these countries. The issue relating to the ATC is the slow pace of implementation and persistent barriers existing in major restraining developed countries. On the supply-side, the following measures aimed at supply capacity building have been proposed: (i) the provision of concessional loans by the World Bank and other financial institutions for upgrading/rationalising/rehabilitation of their production units with the adoption of most up-to-date and appropriate technology; and (ii) the provision of technical assistance for the adaptation of production to the changing trends in designs and fashions and for the marketing of such products.

## **CONCLUSION**

The PICs are heavily dependent for their export earnings on the exports of a few commodities destined to a limited number of export markets. Export diversification holds therefore a key to their successful integration into the global economy and for their trade and development. The preferential market access to major developed country markets under the GSP, Lomé Convention (and now Cotonou Agreement) and SPARTECA have been of paramount importance for those economies, although the utilization of these preferences have not been totally effective. While the Uruguay Round of multilateral trade negotiations and the resulting tariff reduction commitments have increased market access opportunities in general, they however resulted in increased market competition against more competitive third country exporters, as trade preferences so far available to them are being eroded as well. For most PICs, their exports enter the major developed county markets either on the basis of preference schemes, thus the tariff reduction on a multilateral basis inevitably reduces the margin of preferences between PIC exporters and third country exporters. The recent proliferation of regional trade agreements involving developed countries further accentuates this problem. On the other hand, some trade barriers persist in the form of tariff peaks and escalation, which are of particular relevance to the export diversification of the PICs. Furthermore, despite the progress made in the reduction of nominal tariff rates, non-tariff barriers persist in the form of tariff rate quotas, product standards or contingency measures most notably special and transitional safeguards in AoA and ATC.

The WTO Agreements have locked in stringent policy disciplines on the use of domestic and export subsidies and investment measures, which may result in limiting the policy flexibility that may be needed to encourage development of down-stream processing industries, which PICs may be interested in to promote export diversification. The reduction commitments made in AoA have in parallel been resulted in increased price for net food importers, which may pose adverse effects in some of PICs.

In such a trade policy context, it would be necessary to evaluate the existing market access opportunities and other policy implication under WTO, most notably factors that may affect conditions for export competition, and explore those possibilities available to PICs with a view to utilizing these instruments for diversification of their commodity exports. Apart from multilateral disciplines, various preferential and regional trade schemes are providing another path for export expansion and diversification. Those schemes of relevance to PICs include the GSP, the Cotonou Agreement, the special LDC preferences, SPARTECA, PARTA and other regional agreements. They are of particular importance for PICs as a bulk of their exports are traded on a preferential basis. It follows that other trade policy factors affecting such preferential market access conditions (MFN tariff reduction, formation and expansion of regional trade agreements) are also of relevance and need to be monitored. While the overall importance of each schemes for PICs may differ depending on their membership and trade involved, it may be useful for the PICs to fully explore those opportunities provided under those schemes and limit the adverse impact therefrom by taking appropriate measure in pursuing their export diversification strategies. The ongoing and forthcoming regional and multilateral trade negotiations are the occasions to address those issues with a view to creating an enabling trading environment for diversification of PIC exports.

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