Pacific Institute of Public Policy

PACER Plus: the art of negotiation[1]

Informal meetings between Pacific island trade officials and their Australian and New Zealand counterparts have been underway since mid 2008. Behind closed doors, trade officials have sought to define a mutually acceptable structure to commence formal discussions. Australia and New Zealand are evidently frustrated at the pace of proceedings. The Pacific island countries, without the same hang ups about time and potentially more at stake, are adamant there should be a phased approach to entering into negotiations. In the public arena, the debate has forged ahead with many interpreting PACER Plus as a free trade agreement. Others simply argue against any new trading arrangements between the Pacific islands and their bigger regional neighbours. This paper attempts to focus the discussion to address the fundamental question: What should a Pacific Agreement on Closer Economic Relations between the Pacific island countries, Australia and New Zealand entail?

Key messages:

- PACER Plus is essentially a blank canvas waiting to be painted jointly by FIC and ANZ parties.
- Pacific island trade officials want to be fully prepared before sitting down at the bargaining table.
- Australia and New Zealand consider it essential to commence formal negotiation talks sooner rather than later so as to give a political mandate to talks.
- A notable lesson from the EPA negotiations with Europe was that the Pacific island countries should have been much better prepared in terms of trade policy and defining national priorities.
- To date the public debate on trade issues has been influenced mostly by a select group of non-governmental organisations that ardently oppose trade liberalisation.
- Capacity building and research support are welcome initiatives, but will only have tangible results if there is Pacific ownership and political will behind them.
- Freer trade is not a panacea.

Background

By now most people are aware that by entering discussions with the Europeans on an Economic Partnership Agreement (EPA), the Pacific Forum island countries (FICs)[2] have triggered an obligation to commence negotiations with Australia and New Zealand (ANZ) under the Pacific Agreement on Closer Economic Relations (PACER). This is what is now being termed PACER Plus – although no one has yet defined what the 'plus' is to include. The original PACER agreement was signed in 2001 and came into force in 2002

> *as a framework for the gradual trade and economic integration of the economies of the Forum members in a way that is fully supportive of sustainable development of the Forum Island Countries and to contribute to their gradual and progressive integration into the international economy.*[3]

Moreover, at the 2005 Pacific Island Forum Trade Ministers Meeting it was agreed to move beyond the existing South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA)[4] between Australia and New Zealand and the Pacific island countries, towards a more comprehensive framework for trade and economic cooperation to foster economic growth, investment and employment in the Pacific region.

All talks to date on PACER Plus have centred on the architecture of future talks – and not on the content of the future talks. PACER Plus is essentially a blank canvas waiting to be painted jointly by FIC and ANZ parties. As with any painting, first the artist needs to have an idea of what they want to paint, then sketch it out (often many times) and finally, start applying the paint to canvas. Essentially, ANZ want to start painting now. The FICs are in some cases still formulating ideas, and in others going through the process of sketching out these ideas.

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1. *The Art of Negotiation* is the title of the book by Gordon Rule (1962).

2. Cook Islands, Fiji, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu.

3. Pacific Agreement on Closer Economic Relations (PACER), Nauru, 18 August 2001.

4. SPARTECA entered into force in 1981, providing duty and quota-free access to Australia and New Zealand for the 14 Pacific Forum island countries; subject to rules of origin requirements.

Informal meetings

The fourth informal meeting of trade officials to discuss PACER Plus was held in Port Vila from 13-15 May 2009 following previous meetings in Adelaide (February 2009), Nuku'alofa (November 2008), and Auckland (May 2008). These meetings have focused on drafting a 'road map' to progress the discussions towards negotiations between ANZ and the FICs. At the Adelaide meeting officials from the Solomon Islands presented a 'phased approach' to undertaking negotiations as follows: (1) informal consultations, (2) national consultations and research, (3) formal consultations and (4) negotiations. At the Port Vila meeting it also became evident that the FICs are also seeking flexibility to allow them to select specific chapters/ protocols of any PACER Plus agreement to allow the flexibility to decide when they are ready to progress from one phase to the next.

A key sticking point appears to be in the terminology used: specifically, what is the difference between 'informal talks' and 'negotiations'? Understandably, Pacific island trade officials want to be fully prepared before sitting down at the bargaining table. Australia and New Zealand consider it essential to commence formal negotiation talks sooner rather than later so as to give a political mandate to talks. It is anticipated that the 'road map to negotiations' will be presented to the Pacific Islands Forum leaders at the meeting to take place in Cairns in August, 2009. Whatever the language of this meeting outcome, it is important to reflect on the fundamental elements of negotiation: good faith and flexibility[5]. In 2001, the PACER parties agreed to negotiate towards the broad objective of greater regional integration. Despite the absence of detailed position papers, it is obvious that differences of opinion or disagreement exist – for if they did not there would be no need for a negotiation. But negotiation should not be viewed as an adversary proceeding - where one party wins and the other loses. The Forum island countries have consistently argued for a phased approach to negotiations, based on milestones rather than time limits, in order to carefully consider and strategise what is in the national interest. The draft 'road map to negotiations' implies both good faith (a commitment to get to the formal negotiation table) and flexibility (providing the space for the parties to be adequately prepared when they get there).

Getting prepared – sketching the ideas

Chief Trade Advisor

A key determinant to the progress of the PACER Plus talks, and which is now seen as a key factor to when to start formal negotiations, is the establishment of a Pacific Chief Trade Advisor to be adequately resourced to provide expertise and technical advice to the FICs throughout the PACER Plus discussions. The importance of an Office of Chief Trade Advisor (OCTA) cannot be understated. Such an office will not only support the preparation of individual FICs national positions, but will also be required to synchronise these positions into a collective bargaining bloc. It is understood that at the recent informal gathering of Trade Ministers in Auckland (8-9 May, 2009), the Ministers from Australia and New Zealand both confirmed a willingness to fund the establishment of an OCTA. It is evident, however, that there is no clear agreement on how the funding would be applied or the structure and operation of the OCTA. Little wonder, as we have an extraordinary situation where donor funds are to be applied to a facility that will ultimately be involved in a bargaining process between funders and beneficiaries. The FICs have called for 'more than an arm's length' approach in how ANZ funding be applied to the OTCA, or suggest sourcing from another party. Australia and New Zealand demand some role in auditing the use of their taxpayers' funds, and do not support outside financial input. Funding the OCTA through the Pacific Islands Forum also poses potential conflict of interest issues. It is a tricky situation, that may be best resolved by ANZ funding a third party, independent body to set up the OCTA including establishing terms of reference (to be agreed by FICs) and recruit the staff. This would invariably add to existing costs estimates as it would need to include a management fee to oversee the setup and monitor performance. Monitoring reports would be different for FICs (i.e. measuring performance of the OCTA) and ANZ (i.e. general compliance with the contract).

National trade policy research and consultation

A notable lesson from the EPA negotiations with Europe was that the Pacific island countries should have been much better prepared in terms of trade policy and defining national priorities. Part of this preparation should have included widespread public consultation to inform and build an understanding of the national policy position.[6] This time around the FICs are calling for space to get prepared. The call for a "phased approach" to negotiations is understood to include national consultations and further research to determine national interests. This may come as a surprise to many, including ANZ officials, having assumed the FICs would have completed these tasks during the EPA experience.

To date the public debate on trade issues has been influenced mostly by a select group of non-governmental organisations that ardently oppose trade liberalisation. The Pacific Network on Globalisation (PANG) and Oxfam New Zealand rightly point to potential revenue consequences from tariff reductions, but PACER Plus is more than just a free trade agreement, and in a shifting global economy, just saying 'no' is not enough. Putting forward a realistic alternative agenda, tailored to the region, would enable informed discussions to enlighten national trade policies.

A number of studies[7] demonstrate that lowering import tariffs on ANZ goods, where most Pacific imports originate, could lead to big tariff revenue losses – in the order of US$110 million across the FICs. The biggest losers would be Cook Islands (6-12%), Kiribati (14-15%), Samoa (12-14%), Tonga (17-19%), and Vanuatu (17-18%)[8]. In addition, the Compact Countries of Palau, Federated States of

5. G. Rule (1962)

6. Pacific Lessons from the Economic Partnership are detailed in PiPP Briefing Note 1, June 2008

7. E.g. Watergall (2007) and Nathan Associates (2007)

8. Range of estimates by Nathan Associates (2007) & Watergall (2007).

Micronesia, and the Republic of the Marshall Islands do not trade extensively with ANZ, but would have to extend any PACER-Plus tariff preferences to the United States, where a substantial amount of imports originate. The tax bases of the tiny Pacific administrations are already vulnerable – and some are tax-havens. They will struggle to establish and collect new revenues. Preparing for tariff reductions, including undertaking studies into alternatives is not to concede the immediate abolition of import duties. It does present as a wise strategic move as the Pacific islands position themselves in a changing global context.

In the region most countries run a trade deficit with Australia and New Zealand. The exceptions are Papua New Guinea and Samoa exports to Australia. In PNG's case this is due to the outflow of oil and other mining products. With respect to Samoa, it is the Yazaki company, which employs well over 1,000 workers and assembles harness wire for export to the automotive industry in Australian. In order to protect the Samoan assembly plant from closure, an exemption was granted to the SPARTECA Rules of Origin (RoO) on value adding. Remove Yazaki exports and Samoa also has a trade deficit with Australia. So as a case in point, will PACER Plus offer the same modified RoO or better to enable companies like Yazaki to survive?

Tariffs and the massive trade imbalance in goods between the FICs and ANZ do not, however, represent the whole picture of the regional trade and economic relationships. A number of island countries (notably Fiji, Vanuatu, Samoa, Cook Islands) are significant exporters of services to Australia and New Zealand, mainly through tourism[9]. A greater appreciation of the role of the services sector in the economy may help Pacific island governments identify the most suitable strategies for future revenue generation. Watergall (2007) notes that 'many pacific nations have up until recently had predominantly production based tax regimes, which were maintained due to misguided notions of development via industrialisation'.

The unmitigated success of the New Zealand Recognised Seasonal Employment (RSE) scheme led Canberra to follow suit. Pacific Ministers lobbied hard but failed to get labour access under the EPA negotiations with Europe. FIC governments now want temporary labour mobility arrangements to be formalised and possibly extended to other industries for fear of these privileges being removed in the event of political changes in Canberra or Auckland. Temporary movement of people would be a huge gain for the Melanesia states, but of little or no new gain for those FICs that already enjoy labour market access to the USA or New Zealand. There is no one-size-fits all model for the Pacific. The leaders of the Smaller Island States (SIS) have noted that for PACER Plus to be relevant to all parties, consideration needs to be given to a wide pool of improvements, including labour mobility, development cooperation and human resources development[10]. The SIS, which rely heavily upon aid flows, also noted the need to review the trade-off between aid and governance as part of a developmental approach to PACER Plus.

9. Nathan Associates (2007)

10. SIS meeting in Tonga, October 2007. The SIS are: Cook Islands, Kiribati, Nauru, Niue, Marshall Islands and Tuvalu.

Addressing capacity constraints, research needs and political will

Of particular concern for Pacific officials is the lack of trade baseline or other such studies that look at the situation from a microeconomic viewpoint and then build up, in order to inform necessary fiscal and administrative adjustments. In addition to funding the Office of the Chief Trade Advisor, additional technical and financial assistance is expected from both Australia and New Zealand. The terms of the PACER document signed in 2001, stipulates both ANZ countries ensure adequate level of funding to "promote timely implementation of the objectives of the agreement including trade facilitation programmes". PACER also establishes a framework for a programme of Regional Trade Facilitation (RTFP) designed to enhance the effectiveness and benefits of trade liberalisation among Forum members. The RTFP so far covers customs, quarantine and regional food standards, although its effectiveness in addressing the issues of island exports to meet the tough ANZ standards has yet to be realised.

New Zealand allocated an initial contribution of NZ$250,000 towards financial and technical assistance under PACER Plus, to go largely towards trade facilitation work and provided a commitment for a further NZ$500,000 to fund RTFP activities for 2008-2009. Australia has committed AUD 65,000 for each FIC to conduct national level research (known as the Pacific Trade Research Activity - PiPP is one of six approved regional research institutions under this Activity) and has also supported training programmes for Pacific officials through the University of Adelaide over the last 12 months. The uptake of the research grants has been slow, perhaps due to the enormity of the task.

Capacity building and research support are welcome initiatives, but will only have tangible results if there is Pacific ownership and political will behind them. The ANZ position of bringing forward formal negotiations has some merit in terms of giving political weight to discussions, by having regular ministerial dialogue. However, achieving political buy-in will be difficult. Watergall (2007) found that

> *the major challenge in accommodating the necessary changes resulting from trade agreements will be neither economic nor financial but political. Fiscal and administrative change cannot occur in isolation, and without a political mandate such changes rarely work. The polity in the Pacific has observed that bold leaders willing to effect change may suffer electorally, especially if the change was forced, rushed or implemented in a fashion that involved too much short term pain for the longer term gains … it was evident in most countries that there was little or no political desire for wholesale fiscal reform.*

Protecting the national interest

The oft-cited position of Australia is that

> *the more the Pacific nations are integrated with the wider global community, and the freer the flow of goods, services and investments within the Pacific, the better the prospect of genuine, stable and long-term economic growth in Pacific communities.*[11]

11. The Hon Duncan Kerr MP, Parliamentary Secretary for Pacific Island Affairs, 22 February 2009; and The Hon Simon Crean MP, Minister for Trade, 16 February 2009; and The Hon Stephen Smith MP, Minister for Foreign Affairs 7 August 2008.

New Zealand's PACER National Interest Analysis states

> *New Zealand's involvement, while aimed at promoting our trading interests, is informed by the growing Pacific population in NZ and the importance of fostering an economically prosperous region. PACER will enhance New Zealand's trade and economic relationship with our immediate region, and provides a mechanism for on-going Ministerial attention to fostering the economic and broader relationship with Forum Island Countries.*[12]

Establishing the architecture for deeper regional integration is clearly the over arching goal of both ANZ. Building a new form of Pacific regionalism will take time, and perhaps this is why both Canberra and Wellington are so keen to get started – to lay substantial foundations that can survive electoral cycles. By signing up to PACER in 2001, the Pacific island countries signalled similar intent to promote regionalism, with the Agreement 'leading over time to the development of a single regional market'. It also goes without saying that each party to PACER is out to get the best for the peoples and businesses of their country. For Australia and New Zealand, trade with the FICs is negligible in relation to their global commercial deals. But even so, in 2007-08 New Zealand and Australian exports to the Pacific were approximately NZ$786.5 million and AUD$2.1 billion respectively[13]. Excluding crude oil and gold exports from PNG, in 2007-08 the Pacific islands exports to New Zealand were approximately NZ$88.1 and to Australia AUD$285 million[12]. It will take a major shift in productive capacity to be able to capitalise on market access to Australia and New Zealand. In the absence of a timely country specific trade baseline study or comparative/competitive advantage strategy it is understandably difficult for individual Pacific island countries to formulate and articulate their national interest. Especially as most have not kept up with the shifting global economic environment.

Giving time and space for the FICs to formulate national strategies is ensconced in the guiding principles of the PACER framework signed in 2001, as is the notion that any trade arrangements are intended to provide "stepping stones" to allow the gradual integration of FICs into a single regional market and the international economy.

Moving forward – painting the canvas

It is not yet clear what a PACER Plus version of Pacific economic integration will look like, but two issues look set to dominate discussions: first, labour mobility; and second, how much, if at all, governments will be compensated for import tariff revenue losses. Whilst the establishment of new job opportunities under PACER Plus presents an opportunity – albeit a slim one that will mainly benefit the Melanesian states that for so long were excluded from ANZ labour markets – many island governments worry about the costs of the agreement. The negotiating capacity of Pacific island governments is so limited that they will probably succumb to the demands of their bigger neighbours on tariffs. This is unlikely to be catastrophic. The islands will maintain market access to Australia and New Zealand, even if this is increasingly worthless owing to preference erosion. Further, any tariff cuts by the island governments are likely to be gradual and may be back-loaded by up to 10 years. Other than people, the islands have very little to export, meaning that the upside is limited. After more than a decade of trade liberalisation, resulting in broad-ranging goods market access, most regional countries continue to run trade deficits, as they have since independence. Poor infrastructure, unreliable transport, limited access to credit, and growing social inequalities all restrict the development of productive capacity in both goods and services. In this woefully under-developed environment, new foreign competition will do little to generate growth.

Freer trade is not a panacea. If Auckland and Canberra really want to 'put substance to the Plus' they should at the very least formalise access to jobs in their own countries. In addition, they should invest in infrastructure, fund financial institutions, and enact measures to combat inequality. Also required will be improved and more effective aid delivery in line with the Paris Declaration and Accra Forum. For their part, Pacific governments need to look beyond the massive imbalances of today and yesteryear to best position their countries in the ever shifting global political and economic landscapes. Nation building requires political foresight to guide the government officials charged with the task of delivering the services and environment to improve the standard of living of the population. Against the backdrop of protecting the national interest, the fundamental challenge for Pacific governments will be how, and over what time frame, to introduce the necessary economic and structural adjustments to maximise future opportunities.

It will take time, hard work and creative thinking, but through the fine art of negotiation, PACER Plus offers all parties an opportunity to turn a blank canvas into a collective masterpiece that the region can be proud of.

12. Source: New Zealand Ministry of Foreign Affairs and Trade

13 & 12. Sources: New Zealand Ministry of Foreign Affairs and Trade and Australian Department of Foreign Affairs and Trade

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The Pacific Institute of Public Policy (PiPP) is an independent, non-partisan and not- for-profit think tank based in Port Vila, Vanuatu and exists to stimulate and support policy debate in Pacific island countries.

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