

## **The Interim Pacific Economic Partnership Agreement**

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*This paper reviews the negotiation of an Interim Economic Partnership Agreement for the Pacific group of the ACP (PACP). It begins with a summary of the existing trade agreements of the PACPs with their major trading partners, and considers the relative importance of their trade with the EU. It then reviews the various impact assessments which have been undertaken to inform the PACPs' negotiations of an EPA, before turning to consideration of the progress of the negotiations themselves, identifying those issues which were to prove most problematic. It concludes by outlining the Interim Agreement, which was only signed by Fiji and PNG, and assessing the likely prospects of a Final Agreement being achieved by the end of 2008.*

As a result of successful challenges within the WTO to the existing trade concessions offered to the African, Caribbean and Pacific (ACP) group of developing countries under the Lomé Conventions, the successor Cotonou Agreement, signed in 2000, provided for the renegotiation of these concessions by January 2008, when the current WTO waiver expires. The new Economic Partnership Agreements (EPA) was to be negotiated with regional groupings of the ACP states. Although the EU committed itself to introducing trade agreements that would not worsen the position of the ACP states<sup>1</sup> it also required that the new EPAs should be WTO-compatible. While non-reciprocal trade concessions have been offered to the low income developing countries under the

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<sup>1</sup> "a framework for trade which is equivalent to their existing situation" (Article 37.6)

'Everything But Arms' (EBA) initiative since 2001<sup>2</sup>, the ACP group includes both low-income and middle-income developing countries. WTO compatibility therefore requires the replacement of the existing non-reciprocal Lomé trade concessions with a reciprocal agreement.

The interpretation of WTO compatibility has been one of the major sources of disagreement in the subsequent negotiations. Under Article 24 of the WTO any agreement must cover "substantially all trade" between the signatories of a Free Trade Agreement (FTA). Some have interpreted this as referring to the value of trade between the members of the FTA, while others suggest the requirement refers to the coverage of tariff lines. 'Substantial' is also ambiguous, but a minimum figure of 80% of trade between the parties in the previous three years is generally accepted, although any agreement is subject to challenge by other WTO members. There is also the possibility of asymmetric coverage in order to achieve the minimum coverage requirement – i.e. 100 % of EU imports, 70% of ACP imports. The issue of the "substantially all trade" requirement is particularly important for the Pacific ACP States (PACP) since the value of their imports from the evening EU is small and the commodity composition highly variable from year to year. Only case law would provide a clearer indication of this interpretation of Article 24's "substantially all trade" requirement.

Article 24 also allows for an interim agreement leading to the formation of an FTA, but this should take place "within a reasonable period of time". The Understanding on the Interpretation of Article 24 signed at the end of the Uruguay Round suggests that such interim agreements should not exceed ten years except in "exceptional cases". There is also the issue of whether the phasing out of trade barriers is 'front' or 'back-loaded' during the transition period and whether such phasing should be

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<sup>2</sup> Of the 14 Pacific ACP states Kiribati, Samoa, Solomon Islands, Tuvalu and Vanuatu are low income developing countries and will qualify for the EBA.

asymmetrical. As we shall see this is a significant issue in the implementation of EPAs.

Under Article 37.7 in 2004 a review of the negotiations was to take place, at which time alternative trade arrangements could be considered. From the beginning of the negotiations the main alternative to the adoption of the EPA has been seen as some variant upon the existing Generalised System of Preferences (GSP). The EU's GSP, like that granted by other developed countries, offers non-reciprocal preferential rates of duty for imports from all developing countries. As the GSP does not discriminate between developing countries it is WTO compatible. The preferences, expressed as a percentage of MFN duties, ranges from 15% for the most sensitive products to 100% for non-sensitive items. In 2006 the current GSP was introduced, covering 7,200 products from 179 countries. In addition 'GSP plus' was offered to 'dependent and vulnerable' countries. To qualify for these additional concessions countries must ratify 23 international conventions (e.g. human rights, labour standards, etc.) and demonstrate economic dependence<sup>3</sup>, requirements so far met by fifteen countries. While the EBA, which provides duty-free access for all EU imports from low income developing countries, is superior to the existing Cotonou Agreement, the latter provides similar duty-free access for 94% of all ACP exported to the EU. However access under Cotonou is significantly superior to the existing EU GSP scheme and any enhanced GSP scheme could not discriminate between developing countries if it is to be WTO compatible.

Cotonou's Sugar Protocol has been particularly significant for Fiji. 95% of the value of its €100 m. exports to the EU is from sugar, 26% of its total export earnings. The Sugar Protocol committed the EU to importing 165,348 tonnes of sugar from Fiji at EU internal guaranteed prices. In addition an Agreement on

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<sup>3</sup> Dependence is defined as the 5 largest sectors of GSP exports accounting for 75% of total GSP EU exports and being less than 1% of total EU imports under the GSP.

Special Preferential Sugar (SPS) provides for additional imports from the ACP and India based upon predicted shortfalls in the maximum needs of the EU's sugarcane refineries. The price of SPS sugar is 85% of the CAP guaranteed minimum price. Fiji has been allocated 30,000 tonnes (9.3%) under the SPS. The Sugar Protocol has a legal status independent of the Cotonou Agreement but as it is only available to 18 ACP states it remained open to challenge in the WTO. Thus in July 2007 the EU finally denounced the Protocol, with it being phased out by October 2009. It has been estimated that this will cost Fiji €20.9 m. over the phasing out period (South Centre 2007). At the same time from 2006 to 2009 the 'Everything-But-Arms' trade agreement with low-income developing countries will provide for the phasing in of duty-free access for sugar. These quotas will be counted against SPS allocations, slowly eroding Fiji's allocation. The value of the Sugar Protocol is dependent upon the EU guaranteed price, which is also to be reduced by 36% by 2009, but the proposed abolition of EU export subsidies under the Doha round may raise world market prices. Currently Fiji's sugar preference is suspended as part of the EU sanctions following the military coup, but Fiji has the potential to establish an internationally competitive sugar industry if structural reforms are successful.

### *Existing Trade Agreements*

Trade between the 14 members of the PACP<sup>4</sup> Intra-PACP trade is very limited, representing only 2% of their total trade (1% 1995). Nonetheless the foundations have been laid the establishment of a FTA through the Pacific Island Countries Trade Agreement (PICTA). Created in 2003 it provides for trade liberalisation within eight years, although sensitive industries would continue to be protected until 2016. However only the Cook Islands, Fiji and Samoa had commenced trading under PICTA by 2007. In addition, the Melanesian Spearhead Group of Fiji, Papua New Guinea (PNG), the Solomon Islands and Vanuatu committed themselves to move towards trade liberalisation over an eight year period from 2005. Complementing these PACP arrangements is the 2003 Pacific Area Closer Economic Relations Agreement (PACER), a non-reciprocal trade agreement between the Pacific Forum island countries and Australia and New Zealand, the PACP's major trading partners. A key feature of PACER is the creation of a Regional Trade Facilitation Programme. PACER also requires, under Article 6, negotiations to move towards an FTA agreement eight years after PACER comes into force or if the PACP's adopt an FTA with a third party. Such negotiations are likely to be triggered by any EPA. Although PACER does not commit the PACP's to the acceptance of any subsequent proposal, there was acceptance of the principle that Australia and New Zealand should not be disadvantaged in their trade with the PACP's relative to any other developed countries. Any meaningful assessment of the impact of an EPA upon the PACP's must therefore take into account the extension of such trade concessions to Australia and New Zealand.

Further complications arise for the three PACP states (FSM, Palau, Marshall Islands) which have a Compact of Free Association

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<sup>4</sup> Fiji, PNG, Solomon Islands, Vanuatu (New Hebrides), Federated States of Micronesia (FSM), Kiribati (Gilbert Isl.), Palau, Marshall Islands, Nauru, Cook Islands, Samoa, Tonga, Tuvalu (Ellice Isl.), Niue.

with the United States. Again this requires that the US should receive as favourable a market access as that provided to any other country. Thus any EPA assessment must take into account the extension of duty-free access to US exports.

Only Fiji, PNG, the Solomons and Tonga are members of the WTO. This raises a problem for the EPA as the EU requires any final agreement to be WTO-compatible. Thus the EU suggestion that the EPA should employ the WTO dispute settlement procedure would raise serious problems for the non-WTO PACPs.

A further particular interest of the PACPs in the negotiations is the position of the French Pacific Territories – New Caledonia, French Polynesia and Wallace and Fortuna. For some PACP states enhanced access to the high income territories of New Caledonia and French Polynesia is of greater potential significance than the metropolitan EU. While under Joint Declaration 27 of Cotonou the EU affirmed that any trade arrangements would apply to French Overseas Departments this did not extend to French overseas territories.

Article 41.4 of Cotonou envisages the “liberalisation of services in accordance with the provisions of the GATS” under any EPA. However this extension appears to be viewed as a later development and under Article 41.3 requires the EU “to give sympathetic consideration to the ACP states priorities for improvements in the EC schedule, with a view to meeting their specific interests”.

### *EU Trade*

In 2005 the EU15 exported goods to the value of €568 m. to the PACPs, a 79% increase on 2004/5, and imported goods to the value of €1,245 m. But the EU accounts for only 2% of total PACP imports and is a minor source of imports for individual PACPs. By contrast Australia (33% of total PACP imports), Singapore (20%) and New

Zealand (13%) account for between 50% and 80% of individual PACP imports, with the exception of the US 'Compact States'.

Similarly only Fiji (sugar 95% of the value of EU exports) and Papua New Guinea (palm oil 31%, coffee 27%, tuna 10%) have significant exports to the EU. For Fiji the Sugar Protocol is particularly important. In an average year €50 m. of sugar was exported to the EU, at EU guaranteed prices, involving 35% - 40% of its total crop. It also enjoys preferential margins for textile and tuna exports. Nonetheless there are particular exports from other countries which are heavily dependent on preferential access to the EU market. These include canned fish from the Solomon Islands, frozen fish and coconut products from Tonga and Vanuatu. Again exports from the PACP's are dominated by Australia, New Zealand and the USA. Thus 20% of exports from the FSM (1999), 31% from Samoa (2001) and 26% from Fiji (2001) were to the USA. Australia accounted for 29% (2001) of exports from the Cook Islands, 27% from Fiji, 36% from PNG (1993) and 23% from Vanuatu (2001), while New Zealand absorbed 13% of Tonga's exports. Japan is also a significant market for many of the PACP states.

Given the lack of significant manufacturing sectors, services are of particular significance to many PACP states. Tourism is already important in Fiji, the Cook Islands, Samoa, Vanuatu and Palau, and the supply of seamen from Kiribati and Tuvalu. The potential for the further development of the service sectors of the PACP states is of thus of particular importance in the EPA negotiations.

Although as we have seen for most of the PACP's trade with the EU is relatively insignificant nonetheless it remains in surplus. The ratio of exports to the EU relative to imports is 8.9:1 for PNG, 4.94:1 Fiji, 4.8:1 for the Solomon Islands and 2.7:1 for Kiribati. By contrast all the PACP's have bilateral deficits with Australia and New Zealand, exceeding 10:1 for all the PACP states except Fiji (3.2:1).

## **Impact Assessments**

### *Economic*

The first comprehensive impact assessment of an EPA for the PACP's was undertaken by Scollay (2002). While principally a qualitative assessment it nonetheless identified the principal issues of economic concern to the PACP's in negotiating any EPA. In terms of the sectoral impact of an EPA manufacturing is likely to be relatively unaffected. The manufacturing sector is only important in Fiji and PNG, and even here continued protection should be possible while still meeting the 'substantially all trade' requirement. Again, in the case of agricultural production for domestic consumption any EPA is unlikely to present difficulties as many food products already enter duty-free and local fresh food production has a measure of natural protection against competing imports, given high transport costs. Thus the major interest for the PACP's is the potential for improving their export performance in those products for which they may have a comparative advantage.

These products include tree crops, kava, garments, beef (Vanuatu) and fish. The fish industry has been identified as offering the greatest potential for future development with tuna canneries already existing in Fiji, the Solomon Islands and PNG. Under Cotonou these tuna exports enjoy a 24% preference. While fresh fish is exported to the USA and Japan the EU is regarded as a potentially important market for intermediate quality fish. Trade facilitation assistance is regarded as particularly important in the future development of this industry. For Fiji sugar exports are particularly important, however the future of the Sugar Protocol has been excluded from the EPA negotiations by the EU.

Of greater concern is the possible impact upon government revenues of any reductions in import duties. Many PACP's have traditionally relied upon import duties as an efficient form of revenue collection. The potential revenue loss depends upon the

size of the trade flows and the existing tariff rates. Given the relatively low level of imports from the EU any EPA would appear to have very little impact. However, as with any broader economic impact the central issue is the possibility of the extension of any FTA to Australia and New Zealand.

With the adoption of such a wider FTA the risks of trade diversion and the likely adjustment costs are greater, as is the impact upon the PACP's government's revenues. An earlier study by Stoeckel (1998) suggested that such an FTA with Australia and New Zealand would yield significant overall economic welfare gains to the PACP's, although the affect upon the Compact States, with their significant trade with the USA, is less certain. However given the PACP's significant imports from Australia and New Zealand the impact upon government revenues of duty reductions presents more of a challenge. Tonga (import duties 65% of tax revenue), Kiribati (61%), Tuvalu (48%) and Vanuatu (40%) are particularly dependent upon tariff revenues. Three options offer themselves the PACP states – conversion of tariffs to excise duties, introduction of VAT or exclusion of products from the FTA. Samoa, PNG and the Cook Islands are already shifting the burden of taxation to VAT, while Tonga and the FSM are considering its introduction. For Vanuatu the conversion of tariffs to excise duties is an attractive strategy.

Within this context Scollay identified the major issues that would need to be addressed if the PACP's were to realise the development potential of an EPA. Firstly he emphasises the importance of the trade facilitation provisions. As we have seen the fish industry has been identified as offering the greatest potential, but to realise this will require assistance to meet EU phytosanitary requirements as well as the upgrading and expansion of production facilities. Secondly, satisfactory 'rules of origin' (RoO) must be included in the EPA. The Cotonou agreement committed the EU to review its RoO (Article 37.7) as part of the EPA negotiations. Again

RoO are particularly important for fish exports and it was recognised that a number of issues, such as the definition of 'territorial waters', remain unresolved. RoO in fisheries are complicated by the existence of bilateral Fisheries Agreements. Thirdly, the issue of 'safeguard provisions' must be addressed. The Cotonou Agreement (Articles 8 & 9, Annex V) allows the EU to apply 'appropriate measures' where the volume of imports may "cause or threaten to cause serious injury to domestic producers". The Cotonou provisions are less circumscribed in their application than those in the WTO Agreement on Safeguards nor do they provide for reciprocal arrangements for the ACP states, who could argue, under the principle of 'special and differential treatment', for their own more generous safeguard provisions. Again the significance of the safeguard provisions under an EPA would principally be of significance in setting a precedent for any FTA with Australia and New Zealand.

One of the further complications of an EPA for the PACP's is that, unlike other regional ACP groupings, there is no immediate prospect of the creation of a customs union. Thus although the negotiations have taken place on a collective regional basis, the possibility of only a limited number of the PACP states subscribing to the EPA remained. For example, for the five low-income PACP states the EBA provides non-reciprocal duty-free access to the EU market, and as it does not require reciprocal trade concessions will not trigger renegotiation of PACER. But Grynberg and Onguglo have suggested further flexibility could be introduced into a Pacific EPA, to accommodate these diverging interests, through the adoption of 'master' and 'subsidiary' agreements. The 'master' agreement would set out the broad principles of the trade and development relations between the PACP's and the EU, offering the EU market access comparable to that enjoyed by other developed countries. The individual 'subsidiary' agreements, to which PACPs could chose to subscribe, would cover such areas as the trade in

goods, trade facilitation provisions, investment, services (including 'Mode IV' issues) and fisheries. Scollay found resistance among some PACP states to the inclusion of fisheries agreement within any EPA negotiations. From an EU perspective the question arose as to whether there would be resistance to the adoption of such a 'pick and mix' EPA, for although the PACPs are of little economic and political significance to the EU, any unconventional approach to the EPA negotiations might have set a precedent for other more significant regional negotiations.

Scollay concluded by supporting a three-stage negotiating process; ACP wide level, regional level (addressing configuration, structure of EPA) and formal regional negotiations. Assurances could be sought to ensure that PACER negotiations are not triggered until the final stage. For the PACP's the principal issues to be addressed in the formal negotiations were to include rules of origin, safeguard provisions, trade related matters (e.g. competition policy, phytosanitary requirements, labour standards, certification etc.) and additionality of resources (e.g. trade facilitation). The PACP's would also need to develop detailed proposals in regard to fisheries, services and investment and identify products for exemption. There were other issues which lay outside of the EPA negotiations but which determined their context and which Scollay argued the PACP's would need to address. For Fiji the Sugar Protocol was of particular importance, while all the PACP states had a significant interest in any revision to WTO rules during the Doha Round, given the EPA requirement for WTO compatibility. Further, in anticipation of triggering PACER renegotiation, a number of the PACPs would need to develop alternative revenue strategies.

### *Adjustment Costs*

The most comprehensive assessment of the potential costs of adjusting to an EPA for the PACPs was undertaken by Smith (2006).

This study refined the methodology adopted by Milner (2005) in his estimation of the overall ACP adjustment costs associated with an EPA. Milner defined five country size categories, the smallest being populations under 1 million, which included all PACPs. He then identified four categories of economic adjustment costs – fiscal, trade facilitation, production and employment and skill development. Fiscal adjustment and trade facilitation were discussed by Scollay, while production adjustment and skills development would impose costs through support for the unemployed, retraining and restructuring of production lines and closures. His methodology involved categorising countries by the potential degree of adjustment necessary under these four categories and then allocating costs based upon 14 comparable World Bank projects; with costs interpolated for missing cells in the resulting matrix. His study did not address any costs arising from the need for macroeconomic adjustment, e.g. addressing a balance of payments deficit.

The degree of potential fiscal adjustment was proxied by each country's share of tariffs in total tax revenue. Only PNG (25% trade tax) appears in his analysis as requiring medium adjustment; a reflection of his serious data limitations. The need for trade facilitation assistance is proxied by the share of manufactured exports in total exports. Fiji (35%) is classified as requiring low adjustment while the Solomon Islands (4%) and Tonga (4%) are included in the high adjustment group. The share of industrial production in GDP is used by Milner as a measure of the likely need for employment support. Tonga (15%) incurs low adjustment, while Fiji (27%) falls in the medium category. Finally, skills development is represented by secondary school enrolment rates as a crude indicator of human capital; the lower the enrolment rates the greater the need for adjustment support. Vanuatu (28%) appears in the high adjustment category.

His overall ACP estimates totalled €9 bn; €3 n. for fiscal adjustment, €2.3 bn. for trade facilitation, €1.5 bn. for production and employment adjustment and €2.3 bn. for retraining. To provide a check of his estimates he also employed a 'subsidy equivalent' methodology which suggested an overall cost of €6 bn. For the PACP's alone he suggests a total adjustment cost of € 642 m.; with a fiscal adjustment cost of €210 m., export diversification €175 m., employment/production adjustment €82 m. and skills/productivity €175 m. His PACP estimates exclude the Cook Islands, Nauru, Niue and Tuvalu, while data limitations have compromised the classification of the remaining PACPs under particular categories. Questions also remain about his choice of proxies and the appropriateness of the comparative projects underlying his cost estimates. In particular he assumes a high degree of non-linearity (diseconomies of scale) in adjustment costs i.e. smaller states incurring significantly higher costs than larger states. This is particularly important assumption in the case of the PACP's who all fall in the micro state category.

Smith (2006) re-estimated Milner's study with additional and more recent data, including previously omitted countries, resulting in a total adjustment cost of €861 m. However Smith regarded the non-linearity as excessive and, based upon lower per capita cost assumptions for the smaller countries, re-estimated the overall PACP adjustment costs at €430 m. Smith however was also concerned that Milner's project comparators were mainly selected from larger countries which will be of little relevance to the PACP states. He therefore revised Milner's categorisation, drew upon more relevant PACP comparator projects and provided a separate estimate for service sector adjustment.

The PACP states were subdivided into four population sizes, while fiscal adjustment was now proxied by trade taxes as a percentage of total revenue, production employment by manufacturing production as a percentage of GDP and trade

facilitation by total goods exports as a percentage of GDP. His final category of skills development and productivity enhancement was subdivided, with the latter proxied by the cost of enforcing contracts as assessed in the World Bank Cost of Doing Business Study 2005. For the remaining adjustment costs Smith followed Milner's indicators. For the service sector estimates Smith further modified the proxy for production and employment adjustment to utilise data on non-governmental services as a percentage of GDP and for trade facilitation, tourism earnings as a percentage of GDP.

The following table presents Smith's estimates of the adjustment costs for all the PACP's and totals €170 m. incurred over a period of five years. Again the allowance for substantial fixed costs in the nonlinearity assumption may be excessive. If the smallest category of PACP's is excluded then total adjustment costs fall to only €121 m. This is considerably less than Milner's study and may be conservative given the need for some PACPs to adopt more export orientated economic policies.

**Table 5.25: Adjustment Costs by Country and by Adjustment Category (€m)**

Country	Country Size	Fiscal Adjustment	Production & Employment	Trade Facilitation	Skills Development	Productivity Enhancement	Total
Papua New Guinea	V Large	3.1	14.5	7.2	3.3	4.7	32.7
Fiji	Large	2.5	0.0	2.9	5.2	3.0	13.7
Solomon Islands	Large	2.5	1.6	4.5	8.9	7.1	24.6
Vanuatu	Large	4.1	1.6	5.4	2.2	5.9	19.3
Samoa	Medium	0.7	1.8	5.3	1.6	1.7	11.1
Micronesia, FS	Medium	0.7	0.3	3.2	2.1	2.5	8.8
Tonga	Medium	2.0	1.8	3.2	2.1	1.7	10.8
Kiribati	Small	0.6	0.1	3.0	1.6	1.3	6.7
Marshall Islands	Small	1.2	0.1	2.0	2.0	1.3	6.7
Palau	Small	1.2	0.3	2.3	2.0	0.5	6.3
Cook Islands	Small	1.2	0.3	2.3	1.5	0.6	5.9
Nauru	Small	1.9	0.1	1.5	6.4	0.6	10.6
Tuvalu	Small	0.6	0.3	2.5	2.0	0.6	6.1
Niue	Small	1.9	0.1	2.5	2.0	0.6	7.2
<b>Total</b>		<b>24.5</b>	<b>22.8</b>	<b>47.9</b>	<b>43.0</b>	<b>32.3</b>	<b>170.4</b>

From Smith (2006)

Smith also discusses some of the institutional innovations that will be necessary to address the challenges of an EPA. The first aspect he addresses is the need for an enhancement of the national competition authorities, together with an integrated regional advisory service; estimated to cost €15 m. The remaining two initiatives would operate solely at the regional level. An Investment Protection and Promotion Agreement would require support, including the establishment of a regional office of the EU Centre for the Development of Enterprises and ProInvest, technical assistance to support the Foreign Investment Advisory Service and the strengthening of small business advisory services<sup>5</sup>. Smith estimates an additional cost of €6.1 m. Finally, he considers a Human Resources Development Facility, in particular to facilitate a temporary labour mobility scheme (Mode IV)<sup>6</sup>. This he costs at €7.5m.

Thus the overall estimate of the EPA adjustment costs for the PACP's totals €184 m. over five years. This contrasts with the existing €79 m. Regional Indicative Programme for the PACP's under EDF 10, covering the period to 2008. It is unlikely that the gap in funding will be made up through the bilateral National Indicative Programmes. A further enhancement of approximately €100m. in EU aid to meet the needs of EPA adjustment, would therefore appear to be justified. To manage these funds Smith advocates the establishment of a Pacific Regional Development Fund, encompassing a Trade Adjustment Fund. Given the significance of any renegotiation of PACER, as a result of the establishment of an EPA, such a Regional Development Fund would provide a framework for the EU, individual EU Member States,

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<sup>5</sup> For a detailed discussion of investment protection and promotion see Hughes & Brewster (2002)

<sup>6</sup> see Voight-Graf (2006)

Australia and New Zealand, to support the necessary adjustment in the PACP's.

### *Political and Social Impact Assessments*

Scollay (2002) offers a brief assessment of the likely social and political impact of an EPA upon the PACP's. As the largest economies, with substantial rural populations, Fiji and PNG would be most adversely affected by a failure to agree an EPA. For Fiji the future of the sugar industry is of prime importance, estimated to employ 100,000 people and accounting for 10% of GDP. However the Sugar Protocol will not form part of the EPA negotiations. By contrast the future of PNG's exports of tree crops, including palm oil, coffee, copra and cocoa, are heavily dependent upon continued EU market access. The impact of an EPA upon the PACP's urban sectors is likely to be limited, but the extension of trade concessions to Australia and New Zealand under PACER is of far greater significance. The manufacturing sectors of both Fiji and PNG would face significant adjustment costs. In Fiji the loss of preferential access and enhanced competition from other developing countries has already resulted in the decline of the garment industry. In PNG the extremely high rates of urban unemployment would make any structural adjustment socially destabilising.

For the other PACPs the major political challenge will be changing the tax base and moving away from a reliance upon customs duties. While the Cook Islands, Samoa and PNG have already commenced fiscal reform, Kiribati, the Marshall Islands and Vanuatu had yet to overcome substantial opposition to change.

### *The Sustainability Impact Assessment*

In 1999 the EC introduced Sustainability Impact Assessments (SIA) to inform its trade negotiations. These are intended to assess the economic, social and environmental impacts of EU trade policy.

The first application of this approach were the negotiations undertaken under the Doha Round of the WTO, but subsequently PricewaterhouseCoopers (PWC) (2007) were contracted to undertake an SIA of the EPA's.

The priority sectors for study within the EPA negotiating configurations were selected in terms of their significance in trade flows, those that were likely to be influenced by anticipated changes in the trade regime and where there was likely to be a potential impact upon sustainability. PWC then attempted to estimate the likely impact of liberalisation of trade in goods and services, in comparison with the current state of regional integration and trade preferences, utilising a series of indicators.

In the case of the PACPs' fish and fish products, especially tuna, were selected as the case study. Fish exports account for 7% of the total value of exports of the PACP's and are a particular importance to Palau (90% exports), Cook Islands (50%), Vanuatu (50%) and Kiribati (18.5%). Canned fish is also important in the exports of PNG, Fiji and the Solomons. Half of the world's tuna fishery is located in the PACP's Exclusive Economic Zones but 80% - 90% of the vessels involved in the industry are foreign owned. Only one-third of the catch is landed in the region, with 10% of revenues retained in the PACP's (Forum Fisheries Agency) and several tuna species are already over exploited. However, the EU currently has limited involvement in this industry through Bilateral Fisheries Agreements with three PACP states. PWC selected three possible trade measures for impact assessment – market access, phytosanitary requirements, and foreign direct investment. The economic impact was indicated by GDP, government revenues, investment, and impact upon small-scale fisheries; the social impact by employment, wages, poverty, gender equality and food security; the environmental impact through measures of fish stocks, pollution and marine habitat. The qualitative assessment provided a large number of recommendations, ranging from the

detailed, such as the development of a specific regional originating brand-name, to the general, such as the establishment of product standards, the development of strong environmental and social protection and capacity-building for greater value-added in fishery products through such measures as investment protection. The fisheries component of an EPA should be compatible with the reformed Common Fisheries Policy through the adoption of a Regional Fisheries Agreement. In particular PWC recommended a lump sum payment for EU vessel access to a regional body responsible for the promotion of a sustainable fishery through improved monitoring and enforcement, and economic development of the industry through such mechanisms as compulsory landing. However it failed to discuss the important issue of Rules of Origin which currently inhibit PACP fish product exports to the EU caught by non-EU foreign-owned vessels.<sup>7</sup>

Any SIA presents a challenge in terms of adequate data and robust theoretical models that identify the causal relationship between economic, social and environment impacts and in identifying the adjustment process to a new equilibrium. However this study left even many broader questions unanswered, such as the selection of the base and alternative scenarios or even the selection of the fishing industry itself. Some critics have viewed this selection more as a reflection of EU economic interests than PACP priorities in any EPA<sup>8</sup>. Indeed the question of the 'ownership' and purpose of the SIA process itself has been raised. The PWC study even offered relatively little detailed analysis of the fisheries sector and mainly drew upon existing work. But most importantly it failed to address the likely impact of any EPA upon the far more economically significant PACER trade agreement with Australia and New Zealand. Thus unsurprisingly we find that this SIA made little contribution to the wider Pacific EPA negotiations.

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<sup>7</sup> For a detailed discussion of the issues involved in a Fisheries Agreement between the EU and PACPs see Oxfam New Zealand (2006a).

<sup>8</sup> For a critique of the Pacific EPA SIA see Dearden (2005)

## **The Negotiations**

### *The Joint Roadmap*

The first phase of the EPA negotiations were launched in September 2000 at the ACP level and concluded in October 2003, with the commencement of PACP EPA negotiations in September 2004. The agreed Joint Road Map (EC 2004) gives some indication of the EC's thinking. It emphasised the objective of the integration of the PACPs into the world economy, with sustainable development and poverty eradication. To achieve these objectives "the EC EPA must be an instrument for development and the development dimension reflected in all areas of negotiations." The EC also places particular emphasis upon the contribution that an EPA can make to further the process of regional integration. Thus the pace of liberalisation of trade under the EPA will be "a function of the degree of regional economic integration and realised in a flexible and asymmetrical manner".

It specifically recognises the need for special and differential treatment for all PACPs to take account of their differing needs and levels of development. Such differential treatment is not "limited only to longer transitional periods and technical assistance (para.14)" and "may go beyond existing WTO measures". "Flexibility will be built into the *broadly agreed framework* to allow individual countries to adjust the pattern and schedules of implementation". The PIF proposal for a master/subsidiary structure of an EPA thus appeared to be accepted in principle.

However it reaffirms the requirement that the EPA be "compatible with WTO rules *then prevailing* (para. 18)." But it also commits the EU to working with the PACPs to identify and further their common interests in the ongoing Doha Round negotiations, which may change these WTO requirements, particularly in regard to the issues of the definition of 'substantially all trade' and 'special and differential treatment' for the developing countries. The

implications of the EPA for PACER and that of the US 'compact states', is specifically acknowledged in the Joint Road Map and 'will need to be reflected in all areas of negotiations" (par. 17). While acknowledging that adopting an EPA will require significant economic adjustment by the PACP's, no clear commitment is made by the EC to the provision of additional financial resources other than reference to the existing aid support mechanisms such as the EDF.

The structure of the negotiations was to follow the normal pattern with a Ministerial-level Regional Negotiating Team (RNT) supported by Negotiating Groups (NG) addressing specific issues. Each NG was led by a senior Pacific trade official and composed of senior officials and technical experts, supported by the Pacific Islands Forum Secretariat. A Regional Preparatory Task Force (RPTF) was also expected to be created to support the negotiation and implementation of the EPA and to address the link between the EPA and development cooperation. The National and Regional Authorising officers for EDF funding were intended to be members of the RPTF, together with EC representatives of DG Dev, EuropeAid and DG Trade. By contrast in the RNT the EC was represented by the Commissioner for Trade and in the NGs by DG Trade officials. It was anticipated that substantive negotiations would be completed by the end of 2006 with a final draft completed by mid 2007, leaving sufficient time for consultation with other relevant stakeholders.

### *PACP 2006 Proposals*

In June 2006 the PACPs presented their draft EPA text to the EC<sup>9</sup>. It proposed the framework and subsidiary agreement structure that had been outlined by Scollay, despite the EC's preference for a unified EPA. The framework or master agreement covers only the broad principles and does not involve any commitment to

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<sup>9</sup> For a critical review see Oxfam 2006c

reciprocal free trade. However it does include services and investment in the framework as advocated by the EU. It proposes a separate agreement covering Trade in Goods but does not address the issue of the definition of “substantially all trade” nor the phasing of the tariff reductions. However it does focus upon the issue of Rules of Origin (RoO), advocating the use of the change in tariff heading at the six digit level as the criteria. This would mean that any fish caught within the PACPs EEZ would qualify for duty-free free access to the EU. The Draft also proposes a non-reciprocal prohibition on the use of anti-dumping measures by the EU against Pacific exports, together with provisions for temporary tariff protection by the PACP’s where there is a threat of damage to domestic industry or to support the development of an ‘infant’ industry. It also attempted to address the issue of an alternative to an EPA which would still meet the guarantees offered to the ACPs under Cotonou (Article 37.6) by suggesting compensatory payments<sup>10</sup>. At this stage only PNG, Vanuatu, the Solomons and Fiji had indicated their willingness to negotiate a Trade in Goods agreement.

Under Chapter 4 the Draft proposes a trade facilitation and promotion programme for each PACP and financial assistance for the private sector. Similarly for the agricultural sector the PACP’s proposed the establishment of a specific fund to support an Agricultural Development Strategy. However as we will see the EU was to resist additional funding beyond that provided EDF 10. The Draft also called for measures to address the restructuring of the sugar industry, principally of concern to Fiji, the establishment of a Regional Fisheries Agreement and the restoration of a mechanism similar to the abandoned STABEX to compensate for commodity price fluctuations.

While the EU had made it clear that it is seeking agreements on services closely modelled upon the WTO’s General Agreement

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<sup>10</sup> For a discussion of a Pacific attitude to alternatives to the EPA see Oxfam

on Trade in Services (GATS), the PACPs sought to introduce a number of safeguards. These included a clear statement of the rights of governments to regulate in the public interest and the right to delay implementing liberalisation until an appropriate regulatory regime is in place. Further they sought exemption from privatisation for public services such as health care, education and water supply. Labour mobility was included as part of the services chapter but applied only to the movement of skilled workers. As this involved the politically sensitive area of Member States' immigration policies the EU was reluctant to negotiate a collective agreement with the PACP's in this area.

In terms of the investment dimension the PACP's proposed re-orientating the European Investment Bank, ProInvest and the Centre for the Development of Enterprise towards the needs of small and medium-sized enterprises. The PACP's also advocated a model for investment that limited portfolio investment, safeguarded preferences for local companies, required environmental and social impact assessments and transparency in the terms and operation of foreign investment.

The EC response was mixed<sup>11</sup>. While welcoming the proposed EPA structure, with an Annex on the trade in goods to be adopted by interested PACP's, it rejected a number of other important elements in the Draft. The EC again refused calls for additional funding specifically linked to the EPA to assist with any necessary structural adjustment. While expressing their willingness to include transition periods and other bilateral safeguards, they emphasised the long run positive benefits of liberalising trade. The EC regarded the EDF as the appropriate mechanism for linking development assistance to the EPA, and expressed concern that the Regional Preparatory Task Force (RPTF) had not been created. They argued that the lack of an RPTF had seriously inhibited the PACPs' input into the programming discussions for EDF 10. However the PACPs

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<sup>11</sup> see Letter from Karl Falkenberg 20 th October 2006 (12520).

had chosen not to initiate the RPTF specifically to emphasise the need for separate funding for any EPA adjustment, arguing that without such additional funding the RPTF had little purpose.

The call for a separate Regional Fisheries Agreement was also dismissed, the EC arguing that the important elements could be integrated into the EPA. Critics however questioned whether an EPA will be able to address important issues such as local landing provisions, regulating by-catches and the local crewing requirements<sup>12</sup>.

In regard to the PACPs safeguard proposals for the liberalisation of the service sector the EC appeared to be maintaining its hostility to any ACP concessions, as reflected in a November 2006 submission to the 133 Committee that coordinates trade negotiations. For example, it introduces a necessity test for a universal service obligation service in posts and telecommunications. Despite a WTO agreement on services that calls for flexibility in relation to developing countries and commitments to 'special and differential treatment' under Cotonou, the EC appeared to be firmly committed to its call for reciprocal liberalisation of trade in services. The EC's response to the request for enhanced rights of entry of unskilled workers into the Member States was specifically rejected as this lay beyond the competence of the EC. As for the investment proposals the EC emphasises that it will not be able to "redefine what we have already jointly agreed in Cotonou"; the introduction of general principles for the protection and promotion of investment. The EC was more positive in its response to proposals on Rules of Origin, an issue that was still under internal discussion.

Although the EC recommitted itself to achieving the greatest possible market access for Pacific EPA countries and recognised the need to address the problem of sensitive products amongst PACP imports, it nonetheless expressed concern that a number of major issues remain to be addressed, including government

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<sup>12</sup> See Oxfam 2006b

procurement, competition policy and intellectual property rights, “partly already agreed in the Cotonou Agreement”; the ‘Singapore issues’ previously rejected by developing countries in the WTO Millennium Round negotiations. “The submitted draft EPA text will have to undergo substantial amendment before it can become mutually agreeable EPA.” As for addressing the possibility of an alternative to an EPA, this did not appear to be on the EU’s agenda.

The EC also pressed for an acceleration of the negotiating process to achieve the 2008 deadline. But Kalipate Tavola, outgoing chief negotiator for the PACPs, in a letter<sup>13</sup> to the EC’s Director General for Trade, Stefano Manservigi, rejected this demand. “We will not merely rush to conclude negotiations due to the deadline and risk ending up with a bad EPA.” Further he emphasised the importance some PACPs attached to the Mode IV concession (temporary migration) – “If the EPA is silent on this, then we can envisage reluctance on their part to be signatories of any EPA.” But the make or break issue, from his perspective, was the willingness of the EU to enter into a Regional Fisheries Agreement instead of bi-lateral agreements. He regarded it as essential to have EU political engagement, as technical discussions with EC officials would be unlikely to deliver success.

#### *Article 37.4 Review*

Under Cotonou a review of the state of the EPA negotiations needed to be undertaken. At a meeting of the PACP Trade Ministers in November 2006 the Pacific Islands Forum Secretariat (PIFS) was requested to undertake such an assessment. The ECDPM contributed to the internal review (Rampa 2007), with the Joint PACP-EC Review Report being included as an Annex in the overall ACP-EU final Joint Article 37(4) Review adopted in May 2007.

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<sup>13</sup> as reported in Islands Business, Suva, 5 Jan 2007

The ECDPM Report assessed the overall EPA process, unlike the Joint Review which focused on the outstanding issues for negotiation. The ECDPM Report identified the capacity limitations of the PACP's in undertaking the negotiations and the particular challenges of maintaining negotiating coherence over such a large geographical area. There remained, at the time of the review, considerable divergences within the PACP's in regard to their expectations of an EPA, their position on specific topics and their degree of interest in successfully concluding the negotiations. The negotiations appeared to be being dominated by the larger PACP's, who were imposing their national priorities. Fiji, in particular, was seen as pursuing its overriding objective of defending its interests in the parallel Sugar Protocol negotiations<sup>14</sup>. Not only were the smaller state's governments having difficulty participating but so were other stakeholders, including civil society representatives and the private sector. Serious concern was expressed about the lack of meaningful consultation and transparency. There were serious doubts as to whether the PACP's had the capacity and preparedness to complete the negotiations by the end of 2007 and implement any agreement.

From the beginning there were differences in understanding between the PACP's and the EU, in that the former believed that all issues could be raised and discussed informally, although not formally negotiated. By contrast the EC is seen as regarding certain areas as non-negotiable under an EPA. Further difficulties in the negotiation process appeared to the PACPs to have arisen from the slowness of response by the EC and the prevalence of informal 'non-papers' in the discussions.

The Joint Review (PIS 2007) identified five areas where progress was necessary – trade in goods (including RoR), services (including Mode IV), investment, fisheries and adjustment

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<sup>14</sup> "Fiji's position on the EPA is going to be dictated on what will happen to the sugar negotiations" I. Mataitoga, CEO Foreign Affaire and External Trade (Fiji Times 8 Nov 2006)

assistance. At this stage it was anticipated that between six and eleven PACP's might accede to the separate Trade in Goods Agreement. The EC had offered full duty-free quota-free access, subject to certain transitional arrangements for a few sensitive products. The PACP's market access offers emphasised the need for transition periods, appropriate exemptions and safeguard clauses. Both the EC and the PACP's intended to foster trade facilitation through addressing customs reform, sanitary and phytosanitary measures and technical barriers to trade. However in regard to RoO there remained a clear divergence of views. The EC proposed to base RoO on value-added, but in the case of the PACP's this would have required the uneconomic import of intermediate products from the EU or distant ACP regions. Thus, as we have seen, the PACP's had proposed basing RoO on a change of tariff subheading at the six digit level. This would allow the PACP's to source intermediate materials from closer low-cost suppliers and would be easier to administer<sup>15</sup>.

In relation to services the Joint Review acknowledges that under Article 41 of the Cotonou Agreement the EPA is to encompass the liberalisation of services in accordance with the provisions of the WTO's General Agreement on Trade in Services (GATS). The PACP's had indicated a strong preference for adopting the GATS methodology in specifying commitments. Again the PACP's emphasised the importance of Mode IV access to the EC labour market for workers in such sectors as construction, health care and the maritime industry. While the EC, in a Joint Declaration adopted in March 2007, expressed its readiness to support provisions for the cross-border of movement of PACP workers, it again emphasised that temporary worker migration fell within the competence of the Member States. In response to the PACPs proposals for the reorientation the EC's financial and technical support institutions in the region (such as the European Investment

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<sup>15</sup> For a detailed discussion of RoO see Alavi (2007) pp38-48.

Bank and the Centre for the Development of Enterprises) towards small medium enterprises, the EC responded that these institutions fell within the realm of the overall Cotonou Agreement and that the potential support for the development of enterprises was best discussed within the context of the RPTF. On fisheries the EC acknowledged the importance of the industry for the future economic development of the PACPs. A detailed legal text had been submitted by the PACPs in January 2007 guaranteeing long-term access to EU flagged vessels to the PACP's EEZ, and addressing issues such as conservation and the development of the industry. The EC was preparing a reply at the time of the Joint Review.

The issue of additional development assistance beyond that provided for under the EDFs remained a major bone of contention. To emphasise their belief that additional funding will be required, not only had the PACP's failed to establish the RPTF, but they had also declined to discuss trade-related issues such as competition policies, government procurement, intellectual property rights etc. on the grounds that these would be administratively burdensome and therefore would require additional development assistance for implementation. From the perspective for the PACP's EDF resources were already earmarked for important regional priorities and, as the EPA will outlast the Cotonou Agreement, and its associated aid commitments, it was essential that an aid component should be directly associated with the EPA. As we have seen Smith (2006) estimated that adjustment costs of €184 m. will be incurred by the PACP's in implementing an EPA over a five-year period. The indicative budget for the EDF10 Regional Indicative Programme proposed €30 m. for agriculture, forestry and fisheries; €40m. for education and training and €6.2 m. unallocated. In addition there is the possibility of a further 25% enhancement to support regional integration and EPA adjustment. While making no commitment to additional resources the EC indicated it would

support the creation of a regional financial facility to assist EPA adjustment to be funded by EU Member State's bilateral aid and other multilateral donors.

### *Interim Partnership Agreement*

Negotiations were not improved by the perceived threat by the EC to reduce the Pacific EDF10 allocation in the event of failure of the EPA discussions. A meeting of the PACP Trade Ministers in August expressed “gave concern and the disappointment” at a Communication from the EC, which they interpreted as implying a reprogramming of approximately 48% of the Regional Indicative Programme in the event of the failure of the EPA negotiations, or of 26% should a goods-only EPA be negotiated. “Our position remains that EDF10 programming and the EPA are separate processes”. In response the EC confirmed that the funds would merely be diverted from schemes to integrate the regions economies to other projects in the same region. “If no EPA is agreed such assistance will be reassigned to other jointly agreed objectives within the regional support programmes. The total amount of support will not be reduced in any way. At no time has the EU used development assistance as a bargaining chip in EPA negotiations.” (Financial Times August 2007). However, implicit in this response is the threat to reduce the share of the Regional Indicative Programme received by those ACPs that do not participate in the EPA.

By October it was clear that the EC was reconciled to an Interim Agreement, signed by only a limited number of PACP states, being adopted by its January 2008 deadline (Joint Declaration 2 October). But it was agreed that those PACP states that were not initially party to the Interim Agreement would be able to join at any future date upon comparable terms. The Interim Agreement was to include a goods schedules, Rules of Origin and safeguards and, depending upon progress, fisheries, competition and development cooperation provisions. EC had begun to respond positively to PACP proposals on RoO, an ‘infant industry’ clause and dispute settlement provisions. The EC also undertook to continue to support the PACP States in their negotiations with the Member States of the EU to obtain Mode IV access through bilateral

Memoranda of Understanding. The PACP's, for their part, had finally established a RPTF, and the EC confirmed that human resource development would be an important part of EDF10.

Ten PACP's had submitted their goods market access offers in late September 2007, but after intensive negotiations, culminating in a Joint Ministerial meeting on November 14, it was clear that there were too many technical issues remaining to be resolved by the end of the year. The EC therefore resolved "to secure the position of those countries that account for the majority of trade with the EU and who have submitted WTO-compatible market access offers" (Mandelson 20 November). Thus only Fiji and PNG signed a Trade in Goods Agreement on the 29 th November. The market access provisions of the Interim Agreement are to continue in force until a full EPA is agreed.

Both Fiji and PNG are particularly dependent upon maintaining market access to the EU for their exports of sugar and tuna respectively. For Fiji, sugar exports are worth €95 m. per annum and, although their sugar allocation had been suspended for 2007 in response to the coup, it was expected to be resumed in 2008. A replacement for the Sugar Protocol was also required from October 2009 if Fiji was to maintain access to the EU market. In April 2007 the EU had tabled a market access offer for sugar as part of any EPA, with the continuation of current ACP access provisions until 2009 and movement to a quota and tariff free market for ACP sugar by 2015. Thus by signing the Interim Agreement Fiji guaranteed its existing preferences and acquired an opportunity to further expand its exports in the longer term. For PNG tuna exports are worth €40m. per annum and PNGs required continued duty-free access to the EU to maintain its competitive advantage over Thailand and the Philippines. The EPA also offered concessions on the Rules of Origin; thus as long as fish are processed onshore in the PACP the nationality of the ownership of the vessel and crew will no longer be relevant.

In terms of tariff liberalisation the Agreement requires PNG to offer duty-free access for 88% of the value of its imports from the EU. As 76% of its tariffs are already duty-free this commitment involves very little cost in duty foregone and will occur immediately. For Fiji a phased reduction in duties on EU imports will take place over 15 years and will cover 81.6% of EU imports. On the entry into force of the Agreement only 23% of EU imports will be duty-free. The largest reduction in duties, 40%, will occur in years 6 to 10. The remaining aspects of the agreement are similar to those concluded in other interim EPAs. These include the provision for a review of the Rules of Origin after five years, clauses covering Sanitary and Phytosanitary Measures and Technical Barriers to Trade, provisions covering anti-dumping, countervailing measures and safeguards, as well as for infant industry protection, a prohibition on new export taxes and a standstill provision preventing new or increased duties.

## **Conclusion**

The EPA provides for the extension of the Interim Agreement preferences to any other PACP signatory with a commitment to conclude a comprehensive EPA “in-line with the Cotonou Agreement and previous ministerial declarations and conclusions” by the end of 2008. But as the EU has shown considerable reluctance to concede in other areas of interest to the PACP’s, particularly the employment of PACP nationals in EU territories (Mode IV), it is not clear how motivated the other PACP states will be to arrive at a more comprehensive agreement. More problematically the Interim Agreement also introduces a non-discrimination most-favoured-nation (MFN) clause. Thus it would require any additional concessions offered to Australia and New Zealand, arising for example from the renegotiation of PACER, to be extended to the EU. More significantly for the PACP’s the Interim Agreement will almost certainly trigger such a renegotiation. Thus the provisions of the EPA have the potential to undermine the region’s own trade integration initiatives, including the MSG, especially if other PACPs accede to the Agreement.

Further no additional funds have been allocated to meet the needs of EPA adjustment. However the EU’s new Strategy on Aid for Trade<sup>16</sup> might offer some assistance. The EU committed itself to increasing trade related assistance (TRA) from the current €1 bn. per annum to €2 bn. by 2010. The cost of this additional assistance will be borne equally by the Member States and the European Commission. Since the European Commission is already allocating €1 bn. to TRA most of the additional funding will have to be provided from Member States’ aid budgets. This raises an element of uncertainty, as does the ability of the EU to achieve policy coherence in this area; ensuring coordination, harmonisation and alignment. The strategy is also intended to be ‘demand-driven’ and therefore requires potential recipients to be proactive in

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<sup>16</sup> EU Strategy on Aid for Trade: enhancing EU support for trade related needs in developing countries, October 2007.

identifying presenting qualifying proposals. It should also be noted that the TRA funds are available to all developing countries, not just the ACP group.

Although the low-income PACP states<sup>17</sup> will retain duty-free access under the EBA, this does not offer the same Rules of Origin advantages as the EPA. But it still remains questionable whether the remaining PACPs, other than PNG and Fiji, will have the motivation to subscribe to either the Interim or a Final Agreement. There of course remains the question of whether the EU, faced with the rejection of EPAs across a large number of ACP states, will finally address the issue of an alternative. For from the commencement of negotiations many commentators have argued that the EU is required to offer an alternative, other than the current General System of Preferences enjoyed by all developing countries, if it is to meet its commitments under Cotonou.

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<sup>17</sup> Kiribati, Samoa, Solomon Islands, Tuvalu and Vanuatu

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