Office of the Chief Trade Adviser

INQUIRY INTO THE ROLE OF THE PRIVATE SECTOR IN PROMOTING ECONOMIC GROWTH AND REDUCING POVERTY

Submission to the Joint Standing Committee on Foreign Affairs, Defence and Trade

Foreign Affairs and Aid Sub-Committee

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Introduction

The Office of the Chief Trade Adviser (OCTA) was established on 29 March 2010, and incorporated as a legal entity on 17 March 2011, with the objective of assisting the Forum Island Countries (FICs) in negotiating a free trade agreement with Australia and New Zealand called the Pacific Closer Agreement on Closer Relations (PACER) Plus. The OCTA is a legal entity distinct from its member states, incorporated under the laws of Vanuatu, where it is based. Its membership is comprised of 13 FICs, and it is open to accession by other Forum Island countries. It primarily provides assistance with respect to advice, coordination, facilitation and negotiation to support the participation of the FICs in the negotiations.

The crucial support that the OCTA provides the FICs has been instrumental in facilitating the progress in the negotiations. The OCTA's technical support to the FICs has underpinned negotiations in many subjects, namely: Customs Procedures, Rules of Origin, Sanitary and Phytosanitary Measures, Technical Barriers to Trade, Trade in Goods, Trade in Services, Investment, Labour Mobility, Institutional Provisions, Transparency, Final Provisions, and Development Assistance. An agreement comprising these elements should provide a legal and institutional framework affording the PACER Plus Parties mechanisms to address constraints impeding trade competitiveness in a holistic manner, and offer the private sector a platform to contribute to economic development.

The FICs are mostly countries at very early stages of development, with governments possessing limited financial resources and relying heavily on Official Development Assistance (ODA) to provide basic social services such as health and education. ODA constitutes a substantial part of government revenue for most FICs, the disbursement of which often requires compromises with other national priorities, such as broader trade-related development assistance, which is often necessary for the private sector to engage in productive activities. Australia ranks very high among donors of the FICs, in some cases providing the largest aid. The FICs, the second largest recipients of Australian aid, received about $1.3 billion in 2012-2013, projected to rise to $1.6 billion in 2015-2016.

The ability to secure trade-related development assistance for overcoming supply-side constraints and strengthening the productive capacity plays an indispensable role in enhancing the capacity of the private sector in the FICs to contribute to economic development. The capacity to trade can be undermined by endogenous and exogenous factors militating against productive capacity. Overcoming these constraints requires an overarching framework of not only rules, but also critical trade-related development assistance, comprising the provision of soft and hard infrastructure. The recognition of this at the multilateral level has prompted the WTO task force on Aid for Trade, set up in 2005, to categorise trade-related assistance into five categories, including trade support for policy and regulation, building productive capacity, trade-related adjustment to deal with trade liberalisation, and trade-related infrastructure. In the Pacific region, the Cairns Compact on

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Aid Effectiveness, agreed between governments of Pacific Island Countries and Australia, recognises the importance of high-level dialogue with the private sector to encourage private sector growth and employment generation.

The FICs recognise the importance of trade as a powerful engine of economic growth, but they continue to encounter internal and external barriers in utilising trade as a means to achieve economic growth and sustainable development. The negotiation of trade disciplines under PACER Plus can address some aspects of internal and external barriers to trade. However, internal barriers such as poor infrastructure require a different approach given the limited resources available to the FICs. There is wide acceptance that Aid for Trade can assist developing countries to increase and diversify their export of goods and services and benefit from increased trade and market access, and facilitate their fuller integration into the global economy. In that regard, Aid for Trade is seen an important complement to trade liberalisation undertaken by developing countries.

The FICs are committed to utilising trade as an engine of economic growth and sustainable development as demonstrated by regional and national strategies, which many of them have implemented, or are in the process of formulating, representing a holistic and coherent policy document of a private sector-centred development strategy. In particular, National Development Plans have identified the role of the private sector in accelerating the pace of economic growth and reducing poverty through employment creation. At the regional level, the FICs, as Pacific- African Caribbean States (PACPS), have formulated the Pacific Aid for Trade Strategy, which is aimed at addressing the challenges they face in areas such as private sector development and utilising trade as a mechanism for achieving economic growth and sustainable development. The Strategy affirms the desire of the PACPS to harness Aid for Trade resources to build trade-related infrastructure, and improve the production of goods and services, in order to enhance private sector competitiveness. Its five focal projects include activities which contribute to the capacity of the private sector to engage in international trade, namely facilitating market access for FICs' products by addressing SPS and TBT measures, customs and trade facilitation, services sector development, private sector development, and developing and implementing comprehensive trade policy frameworks.

The Private Sector in Forum Island Countries

The private sector in the FICs is comprised mainly of small and micro enterprises, which employ very small number of workers compared to global standards, but are nonetheless important contributors to economic activities in their countries. A few large companies also exist, such as companies engaged in the production of agricultural raw materials (e.g., coffee plantations) or in the mining sector. In fact, most companies operating in the Pacific are so small that they would be considered as small and medium enterprises in Australia and New Zealand. Considerable challenges prevent the private sector from harnessing opportunities of economic integration, and contributing to economic growth and development of their countries. Overcoming these constraints to private sector development is necessary to

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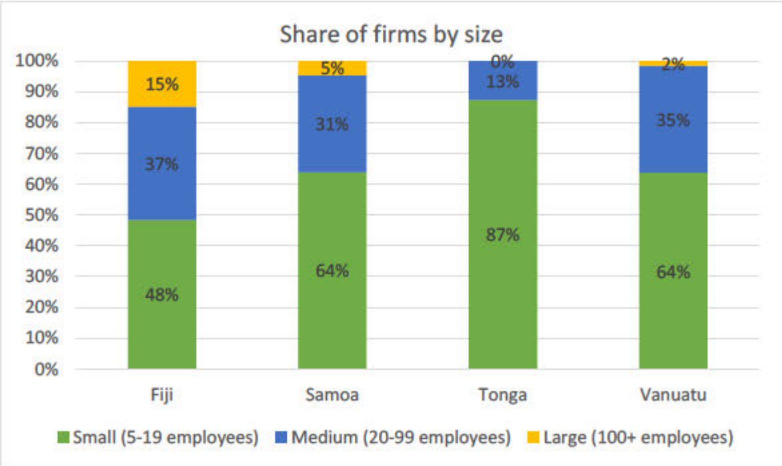
stimulate economic activity, as the private sector is the main driver of economic growth. Vast opportunities exist for the private sector to participate in international trade in the Pacific, including by participating in global value chains. Linking the private sector to regional and global value chains can be fostered by capacity building activities aimed at strengthening the private sector. In this regard, the private sector faces severe constraints in accessing trade finance necessary to provide lending as well as guarantees for import and export transactions.

Research undertaken by the World Bank[1] confirms that most firms in Forum Island Countries are small – defined as having 5-19 employees.[2] For example, 64% of companies surveyed in Vanuatu have less than 20 employees[3], and almost none employs 100 or more people.



Source: World Bank Enterprises Survey, data from 2009.

Businesses in Forum Island Countries are also very small when compared to firms in a number of Asian countries – which are key competitors for many of the region's current or potential export products. This is illustrated by the following chart:

[1] World Bank Enterprises Survey. Data is available for Fiji, FSM, Samoa, Tonga and Vanuatu and was collected in 2009. See http://www.enterprisesurveys.org/.
[2] Smaller firms were not surveyed.
[3] This is equivalent to Australia's definition of "small businesses" (see http://www.abs.gov.au/ausstats/abs@.nsf/0/97452F3932F44031CA256C5B00027F19?OpenDocument).

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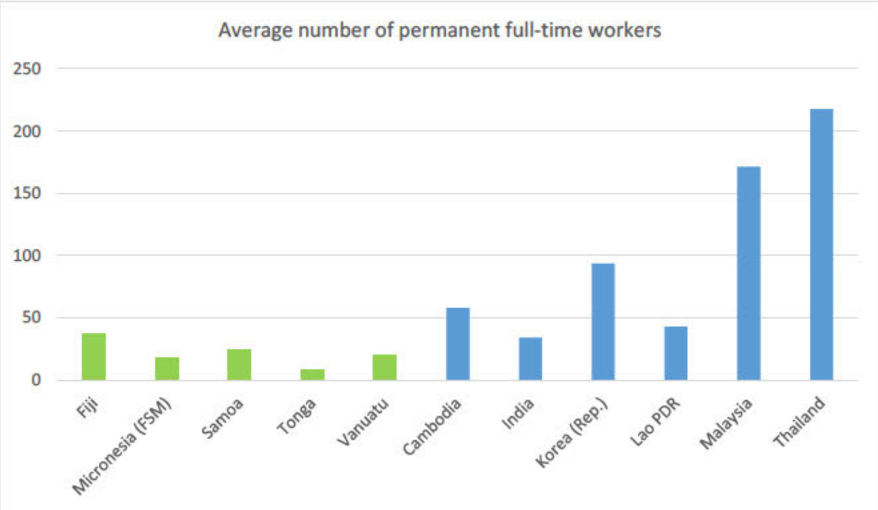

Source: World Bank Enterprises Survey. FIC data is from 2009.

Most firms in FICs are primarily domestically owned, with average domestic ownership shares of 85-90%. Among the surveyed countries, only Vanuatu shows a high share of foreign ownership of around 30%.

Export industries in Forum Island Countries are mainly in sectors such as mining and agricultural raw materials. For instance, in 2012, 94% of Australia's imports from Forum Island Countries consisted of gold, oil and gas – mostly imported from PNG and Solomon Islands. Much of the rest consists of agricultural raw materials. There is, however, a growing number of small and micro enterprises in Forum Island Countries in areas such as processed foods or garments and textiles. The garment industry of Fiji is a prime example of a successful small and micro enterprise in an FIC. While certainly not able to compete in mass production against producers in China or Cambodia, it can cater for niche markets or the market for high-value garments and it profits from being close to Australia, which allows for short delivery times. The sector also still benefits from a tariff preference in Australia, but this is about to disappear – with Australia reducing MFN import duties for textiles and garments from 10% to 5% in 2015, and at the same time extending duty-free access to major producers in Asia.

In a World Bank survey asking companies about their biggest obstacles for business, trade regulation was not identified as a major obstacle in any of the markets that were surveyed.

Somewhat surprisingly, most firms in Forum Island Countries do not export at all. While it is a well-known fact that even most firms in developed countries do not engage in exporting, one would expect that a larger share of firms in markets as small as Samoa or Vanuatu export because the local market is so small. The share of firms exporting is actually smaller than for firms in much larger countries, such as Malaysia or Thailand. As the chart below shows, only

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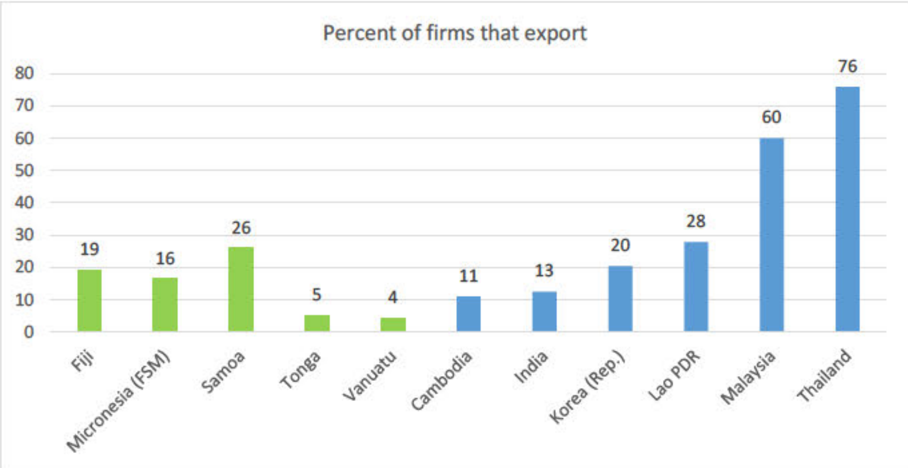
between 4% (Vanuatu) and 26% (Samoa) of FIC firms export, whereas 76% of firms in Thailand do.[4]



Source: World Bank Enterprises Survey. The share refers to the % of firms that export directly or indirectly (at least 1% of sales). FIC data is from 2009.

There could be two reasons for this – firms may face significantly larger obstacles to export (such as transport costs, barriers in potential export markets) or they primarily serve the local market because they are simply not able to compete abroad due to high production costs, and they may enjoy some level of protection in their domestic markets. However, anecdotal evidence appear to suggest that a growing number of firms are able to overcome these barriers and start serving regional markets – supported by trade agreements among FIC or MSG countries – and then start selling to larger markets. Processed food, such as biscuits, is just one example among many. Yet, some of the main barriers for Forum Island Countries' businesses – the small size of their market and the resulting lack in economies of scale and very high transport costs – are not easy to overcome. Targeted assistance by donors, together with enhanced economic integration with other countries in the region – for instance through PACER Plus – can help to address these problems.

The Potential Role of PACER Plus in Private Sector Development

In its advice to, and consultations with the FICs, the OCTA is cognizant of the absolute importance of the private sector as an engine of economic growth. Thus, every effort is being made to ensure that the resulting agreement reflects their main concerns and interests. The main aspiration of the private sector is not only gaining market access for their products and services, but also securing support to enhance their productive capacity to trade and overcome their supply side constraints. This is necessary to enable them translate market access opportunities derived from PACER Plus into a platform to realise economic growth and sustainable development, and reduce poverty. Non-tariff measures remain a formidable

[4] It should be added that such figures need to be carefully interpreted because they may not be fully comparable. For example, the type of firms surveyed may differ quite a bit among countries.

barrier to FICs' export development, and while these are being addressed in the negotiations, a credible solution must consist of a development assistance component.

The OCTA considers that the PACER Plus negotiations presents the Parties with a unique opportunity to strengthen their trade and economic relations and build on the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA) which thus far has failed to promote the trade of the FICs, notwithstanding their exports enjoying duty-free, quota-free treatment in Australia and New Zealand. It is perhaps recognition of this reality that has necessitated a different philosophy in the PACER Plus negotiations, entailing a comprehensive approach which recognises the linkages in diverse components, and the complementarity and synergies they can generate. For instance, there is an explicit recognition of the need to not only address tariff barriers, but also non-tariff barriers by the comprehensiveness of the negotiations, involving Trade in Goods, Customs Procedures, Rules of Origin, Sanitary and Phytosanitary Measures, and Technical Barriers to Trade. The private sector can capitalise on this framework to address the behind-the-border measures impeding their exports in a way not possible under SPARTECA.

The provision of Aid for Trade within the PACER Plus framework is being addressed through the Development Assistance and Economic Cooperation Chapter. Thus far, the negotiations have not progressed much on the scope of the Development Assistance and Economic Cooperation chapter and its associated Work Programme, with the Parties maintaining divergent positions. The FICs' position has been that Development Assistance and Economic Cooperation chapter should be comprised of not only implementation support but also broader trade-related development assistance, which would include the vital element of trade productive capacity building which the private sector could benefit from. Without such a component, it is doubtful whether the FICs will be able to derive any significant benefits from PACER Plus. The provision of such broader trade-related support would enable the private sector to utilise opportunities arising from PACER Plus, and realise the FICs' aspiration for economic growth and poverty reduction.

Australia's Bilateral Support to Forum Island Countries

There is recognition and appreciation for Australia's support to the FICs through bilateral, multi-country, and regional programmes, providing trade-related development assistance such as the Pacific Horticulture and Agricultural Market Access (PHAMA), and the Pacific Regional Infrastructure Facility (PRIF). Support has also been provided to regional institutions such as the Oceania Customs Organisations (OCO), in its customs modernisation work, and the Secretariat of the South Pacific with the aim of facilitating trade. The totality of these supports helps to promote private sector participation in international trade, and to reduce poverty.

The objective of the PHAMA programme is to enhance economic growth in the FICs by facilitating horticultural and agricultural exports to international markets. Its first component provides technical assistance to address market access priorities identified by national

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private-public sector partnerships. It has been implemented in Samoa, Tonga, Solomon Islands, Vanuatu and Fiji. The second component focusses on improving the competence of the Secretariat of the Pacific Community to enhance its engagement on agriculture and forestry issues in the region. The support under the PHAMA programme has resulted in evident benefits in the beneficiary countries, including the establishment of national mechanisms, Market Access Working Groups, in Fiji, Samoa, Tonga, and Vanuatu. It has assisted Samoa to develop commercial breadfruit production systems with a view to facilitating exports to New Zealand. Copra mills in the Solomon Islands have been supported to maintain market access to Australia by assistance to meet accreditation requirements. Tonga has received assistance to reinforce its fumigation services, and Vanuatu has been supported in the reaccreditation of its beef exports to Australia.

Similarly, FICs have benefitted from Australia's support under the framework of the Pacific Regional Infrastructure Facility (PRIF). The PRIF enables multiple donors, comprising of Australia, New Zealand, European Union, Japan, Asian Development Bank, and the World Bank to coordinate the planning and development of infrastructure, with the potential to support trade-related infrastructure. PRIF has supported sector activities in several FICs in the field of energy, telecommunications, transport, water, sanitation, and solid waste management.

Envisaged Support under the PACER Plus Framework

The agricultural sector occupies a central position in most FIC economies, contributing a significant percentage to the GDP, and providing employment opportunities for a significant share of the population. Yet, the agricultural sector faces continuing challenges, including global price volatility and preference erosion. The export earnings of most FICs can increase substantially if investments are made to enhance productivity and efficiency. Such investments can be difficult to realise from domestic savings alone, making the need for external support critical. This is necessary to translate the market access opportunities the FICs benefit from arrangements such as SPARTECA, and potentially PACER Plus, into increased export volumes. To do this, it is necessary to supplement the market access opportunities with the development of productive capacity to trade, to enable the private sector utilise such market access opportunities. Considerable donor support has been channelled into the agricultural sector with the objective of improving market access, and providing trade-enabling infrastructure such as fumigation and post-harvest facilities. These kinds of support are pivotal to enhancing the productivity and efficiency of agriculture, stimulating value addition, and promoting private sector development as a vehicle to realise economic growth.

The OCTA sees merit in intensifying support to build productive capacity to trade, given that several donor-funded programmes have tended to support the development of trade policy and regulation, and trade facilitation, which are doubtlessly important but inadequate. A recent departure from this is the PHAMA project, which has resulted in tangible benefits to

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the private sector in most of the beneficiary countries. The PHAMA builds on past successful programmes such as the Regional Management of Fruit Flies (RMFF) which provided support to deepen the technical knowledge of extension staff on the impact of fruit flies on fruits and vegetables. It also helped to develop new techniques for pre-harvest control of fruit flies, and to strengthen the capacity of quarantine services and industry to overcome quarantine restrictions of fruit flies. This is a good example of the practical support the FICs are seeking in PACER Plus to facilitate trade between them and Australia and New Zealand under the PACER Plus framework.

The prospects of the development of value addition industries lend credence to the need to ensure favourable Rules of Origin (RoO), as most inputs are sourced from non-parties. In this context, in the discussions that have taken place on RoO, Parties have tentatively agreed to adopt a Product Specific Rules (PSR) approach, which allows different RoO methodologies to be applied to different tariff lines. It is envisaged that doing so would enable the production processes in the FICs to be taken into account, with a view to facilitating trade. Australia has provided critical support necessary to undertake capacity-building workshops, which has enhanced the understanding of FICs' officials and the private sector who are now increasingly supportive of the adoption of a PSR approach. Further support is necessary to undertake detailed consultations with the private sector of each FIC to populate their PSR schedules. More importantly, flexibility should be paramount in the development of the schedules to enable recognition to be accorded to the unique circumstances of the FICs' private sectors, which necessitate differential treatment.

Given the inherent limitation of the scope of donor support to the private sector, the OCTA recognises the need to harness foreign capital and investments as a mechanism of encouraging private sector growth. In this regard, the promotion of investments is a seen as pivotal to the development aspirations of FICs. Thus, FICs have tabled a draft chapter on Investment, which has been accepted as the basis for the negotiations. In addition to conventional provisions on the protection of investments, the chapter envisages the promotion of investment through support to encourage Australian firms to invest in the FICs. This is viewed as a practical way of realising the overarching objectives of PACER Plus to achieve economic growth and sustainable development. It is expected that an increased inflow of investments to the FICs from Australia will generate opportunities for the private sector to participate in economic activities, by either the multiplier effects of such investments or creating avenues for engaging in joint ventures, wherever feasible, with Australian investors. However, the economic structure of most FICs may deter investment opportunities, thereby necessitating the adoption of targeted measures to encourage the flow of investments. Thus, commitments are being sought from Australia to encourage its companies to invest in the FICs.

Concluding Remarks

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The need for a robust chapter on Development Assistance and Economic Cooperation in PACER Plus centred on productive capacity building in the FICs cannot be over-emphasised. As seen from the foregoing, the private sector in the FICs is very small and they face a myriad of internal and external challenges that prevent them from taking advantage of market access opportunities in trade agreements. There is evidence on record that some programmes instituted by the Australian Government such as PHAMA has enabled the private sector to meet applicable SPS and TBT requirements in Australia and New Zealand and other markets and as a result increased their exports of primary products. This has had positive spill-overs in terms of job creation and the alleviation of poverty in the FICs. The Seasonal Workers Program has also had a positive impact on the FICs participating in the Program. Apart from remittances, returning workers have been able to utilise the skills acquired in Australia to set up small businesses upon their return. The Australian Pacific Technical Colleges is also an important initiative which has equipped Pacific workers in different fields with the necessary skills and knowledge to function efficiently and effectively. The Australian Youth Ambassadors for Development Program has also been a success in terms of skills and knowledge transfer.

More of such practical initiatives is needed if the private sector in the FICs is to play a leading role in resuscitating the economies of the FICs. Assistance to the FICs to stabilise the macro-economic environment will generate confidence in the private sector and encourage both foreign and domestic investment which is necessary for the long term growth and development of the FICs. Measures to help the private sector in the FICs to access loans on reasonable terms to expand their businesses will generate considerable benefits for FIC economies. Likewise, access to trade financing on reasonable terms will encourage export-oriented firms to expand production and take advantage of market access opportunities under sub-regional, regional and multilateral trade agreements.

Australian Aid Program has been indispensable and assisted the FICs in diverse ways, including improved health care, increased school enrolments, gender equality and the promotion of law and order. PACER Plus offers a unique opportunity to the Australian Government to implement targeted measures that would strengthen the productive capacity of the FICs and enable the private sector to contribute effectively to their long term economic growth and sustainable development.