

## **Activating trade and investment between Australia and Pacific island countries**

### **World Bank Group Submission to Joint Standing Committee on Foreign Affairs, Defence and Trade**

Dear Committee Members,

The World Bank Group (WBG) welcomes the opportunity to support the Government of Australia on promoting greater economic linkages with the Pacific Countries as a means for enhancing development and economic stability.

Greater trade and investment between Australia and the Pacific Island countries (PICs) has the potential to deepen markets and expand social and economic opportunities to those most in need. Greater economic connectivity brings consumers closer to more businesses and job opportunities. Deeper markets and connections promote competition and greater knowledge transfers. They enhance the gains from specialization by both firms and workers and they help promote innovation and more dynamic economies, even in the context of the challenges faced by small island economies including shallow markets and vulnerability to natural disasters.

The successful conclusion of negotiations on 20 April 2017 by the 14 members of the Pacific Islands Forum for the PACER Plus was a tremendous achievement and initial start to this process of deepening economic relationships and economic development in the region.<sup>1</sup> Indeed, Deep and Comprehensive Free Trade Agreements (DCFTAs), such as PACER Plus, have been shown world-wide to be mutually beneficial to all partners by creating a framework for expanding economic opportunities—not just through promoting trade and investment flows, but more importantly for what it implies for knowledge transfers, which is a fundamental building block to faster long-run economic growth for developing countries. PACER Plus has now been ratified by nine of the 14 members of the Pacific Islands Forum that have committed to making it easier for trade in goods, services and investment in support of regional growth. Streamlining border processes will reduce input costs, improve agribusiness and tourism viability and increase the potential to engage in global value chains. Benefits include a more predictable trading environment, consistent and transparent rules on sanitary and phytosanitary measures, technical barriers to trade, and customs procedures, more liberal and product-specific rules of origin and greater certainty around tariffs for exporters. Nonetheless, PACER Plus is just a beginning and greater recognition of the need to build stronger avenues of connectivity, broadly defined to include trade, investment, transport, infrastructure, and people-to-people contact is required.

As seen below in Figures 1 and 2, trade (exports and imports) in goods and services between Australia and the Pacific island countries, as a share of the Pacific country GDP, has declined, except for one country, the Cook Islands, between 2008 and 2018. While trade in goods and services as a share of GDP for the Pacific countries has grown overall, the share going to Australia has largely declined. This is partly due to increased trade between the Pacific and other trade partners, particularly China, but it points

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<sup>1</sup> Members include Australia, Cook Islands, Federated States of Micronesia, Kiribati, Nauru, New Zealand, Niue, Palau, Republic of the Marshall Islands, Samoa, Solomon Islands, Tonga, Vanuatu, and Tuvalu.

toward the opportunities that PACER Plus can provide to Australia with reduced barriers to trade, investment, and greater avenues for labor mobility.

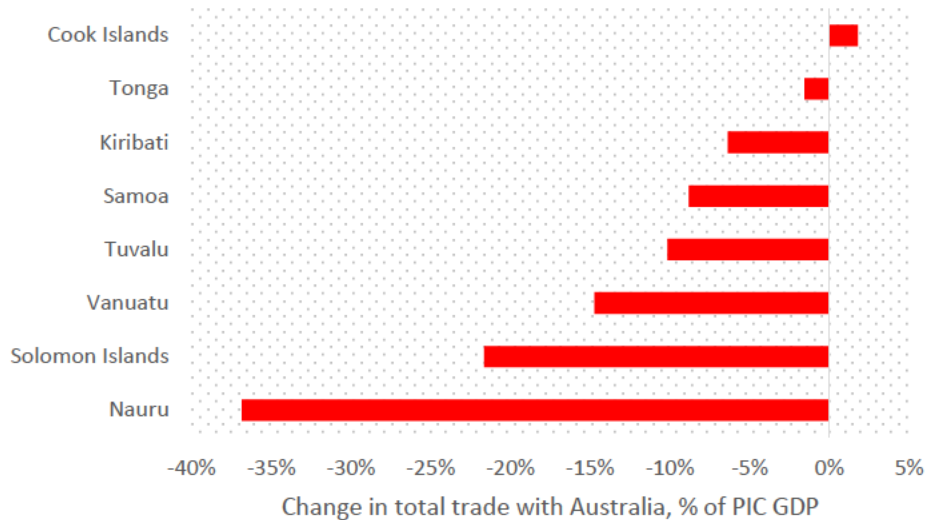
**Figure 1. Total trade in goods and services between Australia and 8 PICs signatories to PACER plus Agreement**



Sources: DFAT Trade time series data; WEO

Note: All PICs signatories of PACER plus Agreement, excluding Niue (data availability) are included in the graph.

**Figure 2. Total trade in goods and services with Australia as a share of country GDP (Change from 2008 to 2018)**



Sources: DFAT Trade time series data; WEO

A key insight from recent analysis on the development impact of trade and investment is that building broad-based connectivity through multiple channels (trade, foreign direct investment, labor mobility, telecommunications, the internet, transportation, and other avenues) is that it facilitates the transfers

of knowledge and technology that are critical to long-term growth and development.<sup>2</sup> While all these forms of connectivity can enhance knowledge and technology transfers, it should be highlighted that person-to-person contact remains an essential part of facilitating business. Managers need to travel for their businesses and trade and investment is facilitated through personal relationships and local market knowledge. Multiple channels of connectivity complement one another because of the tacit (learning by doing), rather than explicit (contained in books or blueprints) nature of knowledge transfers. People-to-people contact through labor mobility including work programs, overseas studies, and tourism, enhances the knowledge spillovers by people transferring information between markets and supporting connections to them. Likewise, the internet and efficient transport links are both necessary for successful e-commerce.

Transfers of knowledge also emerge from linkages between firms in global value chains as well as foreign ownership and management practices that generate local knowledge spillovers. In the Pacific, despite progress made on enhancing connectivity, the region remains among the least connected globally, even when accounting for the physical distance to large markets and other development challenges such as market size and exposure to natural disasters.<sup>3</sup>

While progress made to date on PACER Plus will support greater development and broad-based connectivity in the Pacific region, both developing and developed countries that are parties to the agreement will need to take further joint and unilateral steps to deepen the potential benefits from greater connectivity. For developing countries, this will require enhancing progress toward improving the business climate to attract foreign direct investment, including improving education and health systems for domestic workers, enhanced infrastructure, and clear legal and property rights frameworks, among other factors. While lowering trade barriers and reducing investment restrictions may provide some impetus for foreign investors to view developing Pacific country markets as more attractive for investment, easing trade and investment restrictions may not be sufficient to overcome the lack of transport connectivity, an educated workforce, and a transparent regulatory environment that are critical for improving the investment climate. Deep and comprehensive trade agreements can open the door to greater economic opportunities, but unless complementary activities are taken within developing Pacific Countries to improve the investment climate, this opening will only provide limited economic benefits. Indeed, the World Bank's doing business indicators suggest that the all of Pacific island countries rank in the bottom half of the ease of doing business indicators and much of the region is in the bottom third. Reforms required are broad and will require support for opening access to trade and investment opportunities, but also the most basic investments in education, health, infrastructure, and governance.

The World Bank Group is committed to assisting Australia and Pacific Island countries to deepening economic linkages and promoting development to take full advantage of the opportunities provided by PACER Plus for the betterment of the region.

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<sup>2</sup> Gould, David Michael. 2018. *Critical Connections: Promoting Economic Growth and Resilience in Europe and Central Asia*. Europe and Central Asia Studies; Washington, DC: World Bank. © World Bank. <https://openknowledge.worldbank.org/handle/10986/30245> License: CC BY 3.0 IGO.

<sup>3</sup> World Bank. 2020. *Spatial Development in the Pacific*, Forthcoming.

## Labor mobility

Pacific island countries face unique constraints to economic growth that result from a combination of smallness, isolation, and dispersion. Demographic trends put additional pressure on the job market, with many Pacific island countries, especially those in Melanesia, witnessing rapidly growing populations along with a ‘youth bulge’. In this context, domestic employment growth is not taking place rapidly enough to absorb all new entrants, especially for low-skilled workers who are more likely to be poor (World Bank 2017). In Tonga, for example, there are an estimated 250 – 300 formal sector jobs created annually compared to 2,000 – 3,000 new labor market entrants.

Labor mobility opportunities provide Pacific islanders with a means to gain employment, skills and an income where such opportunities are not available domestically. Labor mobility and migration is not new in the region. Many countries in Polynesia and Micronesia already have a successful history of engaging with labor mobility and migration opportunities. Large overseas diasporas have helped these countries avoid the ‘youth bulge’ affecting parts of Melanesia while also generating remittance income and business opportunities for those that remain. In Tonga, for example, remittances in 2018 were equivalent in value to 35.2 percent of GDP—more significant than in any other country. Studies have shown that remittances in the Pacific alleviate poverty and raise living standards. While temporary migration is not the solution to domestic development challenges, it can be a safety-value for low or under-employment and provide an avenue for skills and future business development.

Temporary migration programs provide overseas employment opportunities to low- and semi-skilled workers who would be unable to migrate through skilled migration channels. These schemes are especially important in countries where other types of migration are limited, such as in Vanuatu and Kiribati. At the personal level, income gains from such programs are several orders of magnitude larger than those generated from domestic employment. The average Pacific island worker participating in the Seasonal Worker Programme (SWP) remits approximately \$A2,200 and transfers \$A6,650 in savings home over a 6-month period (World Bank 2018). These income gains per worker are significantly larger than those of other employment focused interventions (public works programs, entrepreneurship programs etc.). Schemes like the SWP, Pacific Labor Scheme, and New Zealand’s Recognized Seasonal Employer scheme thereby deliver a true ‘triple win’, benefitting both the receiving and sending country, as well as the migrant worker.

With support from DFAT, the World Bank has conducted analytical studies and technical assistance for the expansion of labor mobility opportunities for the Pacific for over the last decade. This work included support for a pilot for ni-Vanuatu to work on New Zealand farms in 2006 forming the precursor to the establishment of New Zealand’s Recognized Seasonal Employer (RSE) scheme and Australia’s Pacific Labor Scheme (PLS). The World Bank’s analytical work has included evaluations assessing the development impacts of Pacific migration (Gibson & McKenzie 2010, 2011; World Bank 2018); sectoral labor market assessments (aged care, for example); and long-term modelling examining the economic and labor market impacts of migration from the region (World Bank 2017). Advisory work has centered on knowledge sharing and regional cooperation; supporting labor migration policy frameworks; female participation; and strengthening institutional capacity through direct hands-on support to labor sending units.

More recently, the Bank has also moved to support labor mobility in its lending and operations. The Skills and Employment for Tongans project supports recruitment efforts with a focus on disadvantaged households, while also funding skills development and training that is relevant (and importantly, recognized) for temporary migration opportunities overseas. There is potential to extend such support to new areas and to other countries. More can be done to increase female participation in labor mobility schemes and to ensure that sending households receive appropriate support. Support for participation of those in remote and rural areas could further increase the poverty alleviation impact of temporary migration schemes, with development partners potentially assisting through financing of pre-departure costs using revolving funds or micro-finance programs. Nonetheless, 39 percent of PLS workers are female, a big improvement on the established and the larger Seasonal Worker Programme, where the ratio is 18 percent. Through these labor mobility schemes, in addition to improving domestic investment climate, the hope is that investment and trade opportunities will expand in the PICs.

### **Infrastructure Connectivity**

For bilateral trade and investment to flourish, countries will need to establish a solid enabling business environment that includes, among other factors, the provision of reliable infrastructure services such as electricity, transport, as well as information and Communication Technology (ICT). The Pacific island countries that are members of the WBG have a combined population of just over 2 million scattered over more than 600 islands. These island countries are known for their remoteness and the infrastructure connectivity is often a challenge. Such remoteness can also be perceived as an obstacle for investors and companies working across major international markets. The outer islands in the Pacific, in particular, have limited access to basic infrastructure, public services and economic opportunities.

*Energy.* The cost of energy services in the PICs is among the highest in the world, energy access rates are among the lowest, as well as being vulnerable to imported fossil fuel products and price volatility. The quality of services is generally poor. Private sector participation in the energy sector is challenged not only by the inadequate policy, legal, and regulatory environment but also by underdeveloped supply chains, and shallow financial markets. However, some of these underlying challenges present opportunities for leapfrogging conventional technology options and delivering affordable, reliable, and sustainable energy services to the people and businesses in the region. The high cost of energy services makes new and innovative technologies to become cost competitive relatively early compared to other countries. Established regional institutions that represent a collective vision for the future of the PICs and partners can coordinate their aid and economic activities around a shared future. Together with other development partners, the WBG has been playing a critical role in providing not only analytical and investment contributions, but also an honest broker role in coordinating activities in the region. For example, in Solomon Islands, WBG has been supporting Tina River hydropower development, which would transform the country's energy supply and cost of doing business. Similarly, in PNG, the WBG, along with Australia and other development partners, are jointly supporting major electrification initiatives.

*Transport.* Transport infrastructure (land, aviation and maritime) plays an important role for tourism, logistics and trade, local economic development, and in providing access to other economic and social activities. As the economies of many PICs are highly dependent on revenue from fisheries, maritime infrastructure is critical for international, inter-state and inter-island trade, and for access to education

and health services to and from the main and outer islands. Although connectivity capabilities among the PICs vary significantly, these countries often face similar challenges: (i) the remoteness and resource constraints that result in high logistic costs and impediment to trade; (ii) insufficient maintenance and lack of construction skills that lead to poor condition of roads, jetties and wharves; (iii) rural and outer island populations lack access to reliable roads and must contend with unsafe jetties and wharves, which results in safety issues and high transportation costs for many farmers selling goods in markets; and (iv) transport sector that is critically exposed to the effects of climate change, including higher extreme and average temperatures, sea-level rise, increased rainfall intensity and an increased intensity of wind from tropical cyclones. Under IDA18 the focus of WB's transport sector engagement has been in the areas of connectivity, safety, security and enhancing infrastructure resiliency to climate change. For example, the maritime transport projects in the Northern Pacific provide improvements to maritime infrastructure, security and safety equipment, as well as emergency response ability. The regional aviation program contributes to strengthening air transport safety and oversight through upgrading and rehabilitation of runway as well as building capacity in aviation operations. Further, a series of resilient transport projects have been effective both in terms of building resilient infrastructure, strengthening regulatory and institutional capacities, and enhancing preparedness to disaster risks.

*Internet Communications Technology.* In Pacific Island countries, digital transformation can accelerate economic growth, facilitate trade, increase social inclusion and provide access to better services. Access to basic telecommunications and Internet services has improved dramatically in recent years in most Pacific countries, despite the remote and dispersed environment of the Pacific. However, overall adoption of digital technologies in the Pacific is relatively low, compared to East Asia or the Caribbean. The low rate of adoption is a symptom of the high costs of reaching small dispersed populations and the relatively delayed rollout of the core backbone submarine cable infrastructure. The last decade has seen sizable financing invested in improving the digital technology infrastructure in the Pacific. The WBG alone has provided more than US\$200M in financing for the sector. When coupled with the adoption of an enabling legal and regulatory environment and strong and effective regulatory institutions, this connectivity layer will encourage the private sector to expand its investments in digital technologies, generate an increase in e-commerce, financial services and help launch a new wave of digital content for Pacific countries. Overall, the development of the digital economy will lead to improved service delivery, reduced business transaction costs, new business opportunities, new job opportunities, greater and more inclusive economic growth, and stronger national and regional integration in the Pacific. In the next phase of investment, the WBG, together with the other development partners, will focus on digital transformation programs that support the client countries in building the foundations for government digital platforms as a basis for enhanced service delivery.

### **Financial connectivity**

Improving financial flows to the PICs supports firms in investing in workforce skill upgrading and improves employment opportunities for local workers. It can also result in technology transfer and enhance the competitiveness of the business environment while contributing to regional and international trade integration and enhancing enterprise networks.

*Capital markets.* The WBG through the IFC is helping develop local capital markets and address the challenge of limited financing options that restrict the entry and growth of private firms of all sizes. Underdeveloped market infrastructure and weak legal and regulatory frameworks leaves little room for

the larger PICs, such as Fiji, to develop deep, vibrant, and efficient capital markets that are necessary for expansion of trade and investment opportunities. In response, the WBG is working with the Reserve bank of Fiji and South Pacific Stock Exchange (SPX) to finalize the regulatory framework for wholesale corporate bonds—which are usually targeted to institutional investors—and coordinate finalization of Companies Act regulations and SPX listing rules, as well as the adoption of prudential requirements. To modernize Fiji’s financial infrastructure IFC is working with Reserve Bank of Fiji to create a sound, efficient, inclusive legal framework to implement a variety of electronic payment instruments (including credit and debt transfers, payments with cards, and e-money instruments), internet and mobile banking, an automated transfer system, and a central securities depository.

*Payment systems.* By developing efficient inclusive national payment systems, the PICs can support further financial inclusion and investment. However, country specific legal frameworks limit Central Banks from building, operating, and overseeing a national payment system, and discourages financial institutions to innovate for more affordable and accessible products and services. The geographical isolation of many Islands—and the exclusion of an estimated one-third of adults from the formal financial sector—highlights the need for a digital financial ecosystem, propelled by the right financial infrastructure, to conduct inexpensive, safe, and reliable real-time transactions. The WBG is working to deliver modern payment solutions, mobile banking, and development of a wider retail access network that benefit business and households (urban and rural), increase access to financial services among underserved and unserved groups (SMEs and women, for example), support government payments and social transfers, and reduce the cost of payment and remittance services.

*Remittances.* The average cost of sending remittances from Australia and New Zealand to Pacific Island countries is among the highest in the world due to small markets and lack of financial sector depth. However, the WBG, though the IFC, is seeking to reduce these costs through innovative programmes. In Tonga, for example, an innovative scheme supported by the WBG advisory project and the Tonga Development Bank (TDB) has lowered the average cost of sending remittances from 9.7% to 4.6% by allowing migrants the option to deposit remittances into a TBD account at a local New Zealand bank. TBD then provides access to these funds at the domestic TBD in Tonga. In a nation where remittances make up over 30 percent of GDP, this represents a tremendous saving on the transactions costs in sending remittances and an important source of funds for Tongan families receiving remittances. Following the successful launch of this project for migrants in New Zealand, WBG is working with the Tonga Development Bank to replicate the model in Australia and is considering how to leverage the model more broadly in the Pacific.

*Regulatory environment.* Job-creating growth in the Pacific is constrained by regulations that make it costly for the private sector to invest, operate a business, and trade. Investment continues to lag under an onerous foreign investment regime, and SMEs in particular suffer from the complex bureaucratic processes involved in establishing and operating a business. To become a more attractive destination for private investment, the PICs must continue to reform the regulatory and administrative framework for investment, in addition to streamlining regulations to improve the ease of doing business. An integrated WBG response is helping improve conditions for private sector growth by helping to increase investment, lower costs for firms, and helping firms adopt and implement good corporate governance practices. IFC is, for example, supporting the development of systematic tools for promoting investment and implementation of the Investment Policy in Fiji, including the review and redesign of Investment Fiji and Department of Immigration processes and procedures. IFC is also supporting establishment of the

“Doing Business” reform unit and develop procedures for the government and businesses to address a comprehensive range of issues to improve competitiveness.

### **Tourism connectivity**

While the Pacific has unique challenges, there are also opportunities in terms of leveraging linkages, such as between tourism and agriculture, for economic growth. For example, stronger supply chain linkages between tourism and agricultural production could help many PICs increase value-added from tourism and increase the incomes of small and medium farmers. For example, hotels in Fiji’s main tourism areas source 52% of all fresh produce through imports (valued at US\$18.8 million per year)<sup>4</sup>, which suggests that there are ample opportunities to increase the use of locally cultivated food. Improving the quality and quantity of produce from smallholders and increasing their access to market would raise farmers’ incomes, narrow the urban-rural income divide, boost productivity, and may promote diversification. It also opens opportunities for export with better phytosanitary standards through PACER Plus. Until better infrastructure links farmers on the outer islands to the major tourist centers, the most immediate opportunity is to increase the amount of fresh produce sourced by hotels from smallholders by strengthening linkages between key positions in the supply chain and improving infrastructure for distributing produce to hotels and resorts. As digital communications infrastructure improves, communication may also improve between rural producers, the government, suppliers, and hotels.

### **In addition to PACER Plus, what can Australia do to deepen the opportunities for greater connectivity with the Pacific Islands?**

In addition to the measures already embedded in the PACER Plus, and support for local development policies in the Pacific Islands alongside development partners, Australia can take additional steps to improve broad-based connectivity with the Pacific region to promote development and long-term stability. Some of these actions include:

- Providing greater people-to-people connectivity through additional easing of visa requirements for educational opportunities and work opportunities. These actions will complement enhancing trade and foreign direct investment opportunities within PACER Plus.
- Improving Pacific island in-country Australian representation and assistance to help local entrepreneurs and firms understand the rules and regulations for trade, travel, work, training, and investment in Australian markets.
- Evaluate ways for simplification and rationalization of trade and non-trade barriers, including rules of origin and phytosanitary measures.
- Create opportunities and fora for businesses in the Pacific Island region to network with business in Australia.

### **Summary**

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<sup>4</sup> See the IFC study by McComb and Cooper (2018).



Greater connectivity through trade, FDI, labor mobility, transport, and ICT holds the promise of supporting economic development and prosperity for Pacific island countries and boosting trade and investment opportunities for Australia and its partners. Nonetheless, the enabling environment in the Pacific is critical to the success of capturing the full benefits of greater connectivity through expanding employment, increasing wages, and widening asset ownership—key drivers in increasing living standards. Australia and development partners, including the WBG, are helping support to economic reforms to reap the full benefits of greater connectivity through initiatives such as PACER Plus and complementary development programs.