

# CHAPTER THREE

## **Australia's economic relations with PNG and the Pacific**

3.1 Bearing in mind the histories and rich cultures of the region, the fundamental question the Committee posed throughout its inquiry was how does Australia contribute to achieving economic sustainability for these countries so that they are able to reach a stage where they are no longer so dependent on aid? The Committee is concerned that some economies in the Pacific are micro-economies which, in their own right, may not be, by modern standards, sustainable.

3.2 It is the view of the Committee that, if a basis for sustainable economic development is evident or capable of being achieved, countries will have a basis for tackling other problems like poverty, law and order, the development of a government structure that is capable of creating a greater sense of democracy in the future (and so on).

3.3 The Committee received a substantial amount of evidence regarding current and future economic relations, the state of economic development and challenges to economic development. In this chapter, the Committee has considered the following issues:

- the current economic climate in the Pacific region;
- Australia's economic relations with PNG and the Pacific;
- Australia's promotion of economic self sufficiency;
- constraints and impediments to development;
- development of the tourism industry; and
- Into the future: Are 'Dollarisation', a Pacific Economic Community and labour mobility the answers?

### **The current economic climate in the Pacific region**

...the policy environment in the PICs [Pacific Island Countries] has generally not been conducive to growth of production. Extensive regulatory controls on prices, exchange rates, the operation of the informal sector, etc., have impeded private investment and employment creation. This in turn has exacerbated social problems. Government involvement in private commerce has crowded out private investment while drawing resources away from the provision of public services, which is so necessary for growth of private enterprise. Poor property rights to land, insecurity of debt contracts, unsustainable budget deficits, and political and policy instability have all raised the risk premium on investment, resulting in high grading of

investment opportunities. The above are issues that the PICs themselves will have to address.<sup>1</sup>

3.4 The above description paints a somewhat bleak economic climate for Pacific island countries. The Australian Trade Commission (Austrade) paints a more optimistic picture, describing the markets of the Pacific region as “ranging from the highly affluent and quality conscious, to developing markets with wide-ranging import needs and strong price sensitivity”.<sup>2</sup>

3.5 The economies of all the island nations of the region, including PNG are relatively small. The total combined GDP of the fourteen island country members of the Pacific Islands Forum<sup>3</sup> amounts to around \$17 billion (excluding Australia and New Zealand).<sup>4</sup> Of this, 83 per cent is accounted for by Papua New Guinea and Fiji.

3.6 Australia's trade in goods with PNG and the other Pacific island countries generated more than \$2.3 billion of export revenue in 2001, representing slightly less than 2 per cent of the total value of Australian exports. Trade in services with Forum Island countries contributed a further \$1 billion.<sup>5</sup>

3.7 PNG dominates Australia's export markets in the Pacific region as the twenty-third largest export market but other important markets include Fiji, New Caledonia, Samoa, Tonga and French Polynesia.

3.8 However, as discussed above, economic growth for most of the Pacific countries has been weak or declining in recent years and the Department of Foreign Affairs and Trade (DFAT) advised the Committee that this is expected to continue. DFAT also advised the Committee of the following other developments in the region:<sup>6</sup>

- export earnings for Papua New Guinea, Fiji, Solomon Islands and Vanuatu have declined;
- domestic instability has had a direct impact on tourism; and
- investment levels have declined to the levels of the early 90s, reflecting poor investor confidence in the region.

3.9 As highlighted by the Australia Fiji, Australia Pacific Islands and Australia PNG Business Councils (the ‘Business Councils’), in considering the current

1 Satish Chand, *Impact of rich country policies on the Pacific Island Countries*, June 2003, pp. 27–28.

2 *Submission 25*, p. 5 (Austrade)

3 The members of the Pacific Islands Forum are: Australia, the Cook Islands, Fiji, Nauru, New Zealand, Tonga, Samoa, Niue, Papua New Guinea, Kiribati, Tuvalu, Vanuatu, Solomon Islands, Republic of the Marshall Islands, the Federated States of Micronesia, and Palau.

4 *Submission 33*, p. 18 (Department of Foreign Affairs and Trade (DFAT))

5 *Submission 33*, p. 19 (DFAT)

6 *Submission 33*, p. 18 (DFAT)

economic climate in the region, it is important to note that a number of Pacific island countries have populations and national budgets less than small Australian regional centres. For example, PNG's budget is less than either the Northern Territory or the Australian Capital Territory but PNG has a population approximately seventeen times greater than either territory.<sup>7</sup> This is particularly relevant in analysing development performance and prospects.

3.10 Generally, Pacific economies are characterised by a dependence on the production of raw materials such as minerals, timber, copra and coffee and in the case of Fiji, sugar. Such dependence is becoming problematic as raw commodity prices decrease in response to trade becoming increasingly liberalised. With the exception of PNG and Fiji, the economies are small, domestic purchasing power is not strong and there is a strong dependence on external markets with intra-regional trade being nominal (although, with the introduction of the Pacific Island Countries Trade Agreement (PICTA, discussed below) this may increase). Geographic isolation from external markets generally means that Pacific countries are disadvantaged in a competitive market because of the high cost of transportation, and lack of a coordinated service collectively servicing the region.

3.11 Countries such as Fiji have had some success in manufactured exports, particularly textiles and clothing. However, this industry is reliant on the import of raw materials such as cotton and as preferential access to the European market comes to an end (see discussion of Cotonou Agreement below), Fiji's textiles and clothing industry may not be competitive.

3.12 In addition, the economies of PNG and the Pacific island countries are typically small, open economies with limited capital market access and a high dependence on imports. Increases in expenditure in the domestic economy, especially through deficit budgeting, can spill over into a higher demand for imports and instability in the country's external accounts. Persistent deficits are reflected in exchange rate depreciation and the erosion of international reserves under a floating exchange rate regime.<sup>8</sup>

3.13 The Committee accepts and is concerned that there may be serious implications for Australia if economies in the region collapse. This has already been demonstrated to a large extent in the Solomon Islands. The Committee considers it very much in Australia's commercial and political interests to continue to build sustainable and culturally acceptable economic relations with PNG and all the Pacific island countries.

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7 *Submission 75*, p. 3 (Business Council of Papua New Guinea and the Institute of National Affairs)

8 See *Submission 86*, p. 5 (The Treasury)

## Australia's economic relations with PNG and the Pacific

### *Bilateral trade and investment relationships*

3.14 Australia is the major trading partner of most Pacific Island countries and enjoys a sizeable share of imports into the region (more than 30 per cent overall).<sup>9</sup> DFAT's recently released Foreign and Trade Policy White Paper, *Advancing the National Interest*, explains that Australia's economic interests are substantial with Australian merchandise exports to the South Pacific (excluding New Zealand) valued at \$2.5 billion in 2002 and direct Australian investment stock estimated at \$2.3 billion.<sup>10</sup> Across the region, Australia has a favourable balance of trade (with the exception of PNG and Samoa) and holds significant market share in many of these economies.

3.15 The economies of the Pacific islands region have also attracted significant Australian investment over more than a century, estimated to be between \$4 and 5 billion in PNG and up to \$2 billion in Fiji. Australia is also the largest source of foreign investment in Melanesia and a significant investor in a number of other countries across the rest of the region.<sup>11</sup>

3.16 Several submissions outlined Australia's trade and investment relationships with the region.<sup>12</sup> The following overview is drawn from those submissions:

- Papua New Guinea: PNG has a positive balance of trade with Australia. Australia's trade relationship with PNG totalled \$2.3 billion in 2000–01 (Australian exports<sup>13</sup> \$1.03 billion, PNG exports \$1.24 billion). The contraction of the Papua New Guinea economy in recent years has seen the value of bilateral trade decline with the five-year trend since 1995–96 showing a 15 per cent reduction in Australian exports and a 30 per cent growth in imports from PNG (dominated by crude petroleum and gold). In 2001, Australia exported \$380 million worth of services to PNG, which represents 1.2 per cent of Australia's

9 *Submission 33*, p. 18 (DFAT)

10 Department of Foreign Affairs and Trade, *Advancing the National Interest*, Foreign and Trade Policy White Paper, Chapter 7. See also, *Submission 15*, pp. 5–6 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

11 See *Submission 15*, p. 5 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

12 See for example, *Submission 15*, pp. 5–6 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council); *Submission 25*, pp. 8–26 (Austrade); and *Submission 33*, pp. 19–21 (Department of Foreign Affairs and Trade. Unless otherwise stated, all figures are in Australian dollars.)

13 Australia's principal exports are refined petroleum and oils, industrial machinery, transport equipment, processed foods, civil engineering and specialized equipment, and computers and computer parts. Imports from PNG are dominated by crude petroleum. Non-monetary gold and agricultural products, particularly coffee, are other notable imports.

total service exports. It is estimated that Australia's investment in PNG is approximately \$4 billion.

- Fiji: The Fijian economy is resilient and has recovered well from the damaging effects of the coup in 2000. Two-way trade in goods in 2001 amounted to \$832 million (Australian exports \$592 million; Fiji exports \$240 million). Two-way trade in services was valued at \$452 million in 2000, with Australia's imports of services from Fiji valued at \$355 million. Australia is Fiji's major market for manufactured goods, mainly garments. Australia's share of Fiji's market is around 45 per cent. Australian investment in Fiji is around \$2 million.
- Solomon Islands: The Solomon Islands economy contracted by 14 per cent in 2000 and a further 25 per cent in 2001. Per capita GDP halved in the last five years to approximately \$120 in 2001. Australia's exports to Solomon Islands in 2001 were worth \$61 million, compared with almost \$100 million in 1999 before the crisis. Identified exports were largely comprised of petroleum, tobacco and cigarettes. Australia's imports from Solomon Islands over the same period totalled \$2.5 million.
- New Caledonia: Nickel accounted for 88.7 per cent of exports in 2001. Australian merchandise exports totalled \$230 million in 2001, with 16.3 per cent market share (second to France). Australia's identified exports to New Caledonia are dominated by petroleum (increased by about 90 per cent since 1992), coal, mining equipment and agri-business products. Imports to Australia totalled \$56 million and consisted largely of iron and nickel ores. Australia's market share was around 7 per cent but changes in the last decade to reduce the EU preferential arrangements mean the economy is becoming more accessible to Australia companies.
- French Polynesia: Australian merchandise exports to French Polynesia in 2001 totalled \$222 million (of which 73 per cent were petroleum and other energy products). Australia's market share was around 7 per cent; preferential arrangements for EU products and distance and transport costs are limiting factors on growth. In 2001, Australia imported just less than \$3 million of goods from French Polynesia (almost exclusively black pearls).
- Samoa: Samoa has a positive balance of trade with Australia with Australian merchandise exports to Samoa were valued at \$58.1 million in 2000–01, almost half of which was refined petroleum. Imports from Samoa in 2001 totalled \$76.2 million. These were nearly all electrical parts for motor vehicles produced at the Yazaki plant in Apia.
- Vanuatu: Vanuatu's economy has weakened in recent years with per capita GDP declining from \$3,000 in 1996 to \$2,500 in 2000. Australia is Vanuatu's largest trading partner with Australian merchandise exports of \$51 million in 2001 against imports of \$3.3 million. Principal exports are food and beverages, raw materials, refined petroleum, machinery and equipment. Australia holds 43 per cent of market share in Vanuatu.
- Kiribati: The Kiribati economy is small and has few resources besides fisheries, which lie in its significant exclusive economic zone. Australia is the major

supplier of food, beverages, pharmaceuticals and services to Kiribati. Australian merchandise exports to Kiribati in 2001 totalled \$33.8 million, with market share at more than 40 per cent. Australian imports from Kiribati over the same period were negligible.

- Nauru: Australia is the key trade partner for Nauru. As a result of the economic downturn in Nauru, Australian exports to Nauru, including building materials, petroleum, food and beverages, have fallen to \$25 million in 2001 (from \$31 million in 1995). Nauru's exports to Australia, mostly phosphate, were valued at \$4.3 million for the same period. Nauru is a significant property investor in Australia, particularly in Victoria.
- Tonga: Australia's merchandise exports to Tonga were worth \$15.9 million in 2001. In addition, approximately \$9 million of petroleum products were exported via Fiji. Australia's main exports, in addition to petroleum products, were food and telecommunications equipment. Imports from Tonga in 2001 were valued at \$720,000, comprising mainly vegetables, fruits, nuts and spices. Australia's market share is approximately 12 per cent.
- Palau: With a per capita GDP of \$10 000 Palau enjoys one of the highest standards of living in Pacific island countries. Its main industry is tourism. Australian exports in 2001 were valued at slightly more than \$1 million and consisted of aircraft parts, food and beverages and refined petroleum. Imports were negligible.
- Federated States of Micronesia (FSM): Australia is the second largest source of imports to the FSM, after the United States. Exports from Australia were valued at \$18.5 million and consisted mainly of foodstuffs and petroleum. Imports were negligible.
- Marshall Islands: Australia's exports to the Marshall Islands in 2001 were valued at nearly \$8 million in 2001. Identified elements were largely plastic items, crude minerals, food stuffs and construction materials.

### ***Regional economic and trade agreements***

3.17 Australia is a party to a number of multilateral and bilateral trade agreements in the region. These are outlined below.

#### **South Pacific Regional Trade and Economic Cooperation Agreement**

3.18 DFAT advised the Committee that under the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), Australia grants duty free access to goods from developing country members of the Forum which meet SPARTECA rules of origin.<sup>14</sup> SPARTECA was signed by most Forum members at the

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14 The rules of origin are set out in SPARTECA and determine whether or not the products are the origin of a Forum Island Country for the purpose of SPARTECA concessions. Copies of the SPARTECA Handbook can be downloaded from the Forum Secretariat website:  
<http://www.forumsec.org.fj/docs/SPARTECA/SPARTECA.htm>

Forum’s Eleventh Meeting in Kiribati on 14 July, 1980. It entered into force generally on 1 January 1981, and for Australia on 30 June 1982.<sup>15</sup>

3.19 The Agreement includes:

- provisions for general economic, commercial and technical cooperation;
- safeguard provisions relating to dumped and subsidised goods and suspension of obligations; and
- provisions for general exceptions and revenue duties.

3.20 The Agreement also provides for special treatment and assistance to be extended to the smaller island countries.<sup>16</sup>

### **SPARTECA (TCF Provisions) Scheme**

3.21 In addition to SPARTECA, Australia provides further concessional market access to imports of textiles, clothing and footwear (TCF) (other than any good that contains woollen fibre) through the SPARTECA (TCF Provisions) Scheme. DFAT advised the Committee that under the Scheme, a TCF export that has over 70 per cent Forum content earns points which can be used to “top up” the Forum content of a TCF export to Australia that has at least 35 per cent Forum content so that it meets the 50 per cent Forum content requirement for duty-free entry. The Scheme was introduced in March 2001, and is aimed primarily at benefiting Fiji, the only Forum Island country with a substantial TCF industry. The Scheme will terminate on 31 December 2004, coinciding with the scheduled lifting of Australia’s TCF tariff pause on 1 January 2005. The Scheme is administered by the Department of Industry, Tourism and Resources.<sup>17</sup>

3.22 The Committee received a substantial submission in relation to the textile, clothing and footwear industries in Fiji from the Fiji Australia Business Council (‘the Business Council’). The Business Council was particularly concerned about the decline in Fiji’s share of the Australian TCF market. The Business Council presented a range of proposals to continue preferential treatment of the Fiji TCF industry. These included:

- extending the SPARTECA TCF Scheme beyond 2005; or
- supporting a collective approach to marketing by Australian and Fijian TCF industries within the global marketplace;
- introducing a Partnership Development Scheme which would provide for Australian exporters of intermediate products to receive a duty rebate entitlement on the basis of their exports to Fiji;

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15 *Submission 33*, p. 22 (Department of Foreign Affairs and Trade)

16 *Submission 33*, p. 22 (Department of Foreign Affairs and Trade). See also, Forum Secretariat, ‘What is SPARTECA?’ (<http://www.forumsec.org.fj/docs/SPARTECA/Sec1.htm>)

17 *Submission 33*, p. 23 (Department of Foreign Affairs and Trade)

- an extension of the Australian Strategic Investment Program to Fiji activities.

3.23 The Committee notes the Business Councils' argument turning on the WTO provisions for a transition period for the elimination of export subsidies for developing economies. However, the Committee understands that the existing arrangements are themselves an exercise in accommodating such a transition. Any further preferential agreement favouring the Fijian TCF industry could only be considered within the context of Australia's overall commitment to free trade and tariff reductions. It seems unlikely that such a consideration would deliver the results that the Business Council is seeking.

### **Papua New Guinea-Australia Trade and Commercial Relations Agreement**

3.24 Australia and PNG's bilateral trade and investment framework is provided for by the Papua New Guinea–Australia Trade and Commercial Relations Agreement (PATCRA). The Committee was advised that the Agreement was reviewed in 1990 and resulted in the signing of PATCRA II. PATCRA/PATCRA II ensures that all PNG exports enter Australia free of all duties and charges, with the exception of goods subject to excise in Australia. Papua New Guinea grants no preference to Australian goods.<sup>18</sup>

3.25 One submission to the inquiry argued that Pacific island countries and PNG have generally not been able to take advantage of SPARTECA and PATCRA due to reductions in Australian tariffs and preferential margins leaving the agreements largely ineffective.<sup>19</sup>

### **Pacific Island Countries Trade Agreement**

3.26 The Pacific Island Countries Trade Agreement (PICTA) was opened for signature at the Forum Meeting in August 2001 in Nauru. The PICTA is open to the 14 Forum Member Countries and came into force on 13 April 2003 following ratification from the sixth country, Nauru. Other countries that have ratified the agreement include the Cook Islands, Fiji, Niue, Samoa and Tonga. The agreement is intended to create a larger regional market of seven million people, and encourage greater trade, investment and economic development among the Pacific Island countries. It will be phased in over the next ten years.<sup>20</sup>

3.27 The Acting Secretary–General of the Pacific Islands Forum Secretariat, Mr Iosefa Maiava stated that the PICTA will “encourage greater efficiency in Forum Island Country economies, increase the trade between them and promote more

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18 *Submission 33*, p. 23 (DFAT)

19 *Submission 11*, p. 8 (Mr John Piper)

20 See Forum Secretariat, ‘PICTA into force 13 April’, Press Statement 43/03, 11 April 2003 (<http://www.forumsec.org.fj/news/2003/April%2008>)



investment” and that this “should lead to more jobs and lower import prices in the long term.”<sup>21</sup>

### **Pacific Agreement on Closer Economic Relations**

3.28 The Pacific Agreement on Closer Economic Relations (PACER) was negotiated in the Pacific Islands Forum during 2000–2001 in parallel with the PICTA. DFAT advised the Committee that the objective of the PACER was to establish a framework for the gradual trade and economic integration of the Forum members in a way that fully supports their sustainable development and contributes to their gradual and progressive integration into the international economy.<sup>22</sup>

3.29 The agreement also provides for the establishment of other elements of a single regional market (for example services and investment), but does not specify the timing of these negotiations which, according to DFAT, will arise only as and when the Parties are ready and it obliges Australia to maintain all existing arrangements with any Forum island country relating to market access, including those under SPARTECA.<sup>23</sup>

3.30 In addition, DFAT advised the Committee that the Agreement stipulates that Australia (and New Zealand) will provide financial and technical assistance for a program of work to be agreed between the Parties in the future, in areas such as trade facilitation and promotion, capacity building, and structural adjustment.<sup>24</sup>

3.31 The PACER also provides Australia with the opportunity to pursue greater gains from trade if and when a free trade agreement is negotiated between Forum Island Countries and another developed country or a country with a per capita GDP higher than the lowest of a developed Forum member.<sup>25</sup> In announcing Australia’s ratification of the PACER at the Forum Economic Ministers’ Meeting in July 2002, the Minister for Trade, the Hon Mark Vaile MP and the Treasurer, the Hon Peter Costello MP made the following comments:

The PACER will advance the region significantly towards the goal of regional free trade. It will increase economic opportunities and competitiveness through more effective regional trade arrangements.

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21 Forum Secretariat, ‘PICTA into force 13 April’, Press Statement 43/03, 11 April 2003 (<http://www.forumsec.org.fj/news/2003/April%2008>) See also, *Submission 37*, p. 8 (Australian Council for Overseas Aid (ACFOA))

22 *Submission 33*, p. 22 (Department of Foreign Affairs and Trade). See *Submission 37*, p. 8 (ACFOA). Through PACER, Australia and New Zealand, while not being included as members of the PICTA, will be treated on at least the same negotiating basis as the European Union.

23 *Submission 33*, p. 22 (DFAT)

24 *Submission 33*, p. 22 (DFAT). See also, *Submission 14*, p. 4 (Australia Council for the Arts). The Council explains its role in international market development and promotion.

25 *Submission 33*, p. 22 (DFAT)

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The strength of the agreement is that it recognises the particular circumstances of individual island states and the need for an interim adjustment period as appropriate, and gives the region enhanced credibility in trade matters, notably in Forum island countries' impending trade negotiations with the EU.<sup>26</sup>

3.32 The Business Councils stated that the conclusion of the PICTA and PACER agreements will create both challenges and opportunities for Australian business in the region but suggested that the full implications and possibilities under those treaties were not yet fully understood.<sup>27</sup>

3.33 The Business Councils also cautioned that, with the conclusion of these treaties, it is possible that the valuable role of SPARTECA might be overlooked:

SPARTECA has been largely seen as simply providing special access to the Australian (and New Zealand) markets for manufactures from the Pacific Island countries. The value of this concessional access has been substantially diluted by Australian tariff reductions in recent years, and when the tariff reductions resume in 2005 will be of even less value. But SPARTECA provides for more than just tariff concessions, and can remain an important element of Australia's support for private sector development in the Pacific Island countries.<sup>28</sup>

3.34 The Committee notes the comments in relation to the PICTA and PACER Agreements. The Committee refrains from making comment regarding the operation of these agreements given that they have only very recently been concluded and come into operation. However, the Committee will watch with interest the developments under these agreements and looks forward to regular update reports from the Government.

### **Australia-Fiji Trade and Economic Relations Agreement**

3.35 Australia and Fiji's bilateral trade and investment framework is provided for by the Australia Fiji Trade and Economic Relations Agreement (AFTERA) which was signed on 11 March 1999. The Committee was advised that the AFTERA aims to

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26 Minister for Trade, the Hon Mark Vaile MP and Treasurer, the Hon Peter Costello MP, 'Australia Ratifies the Pacific Agreement on Closer Economic Relations (PACER)', Joint Media Release, 3 July 2002.

27 *Submission* 15, p. 9 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

28 *Submission* 15, p. 9 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

strengthen and diversify the trade, investment and economic relationships between Australia and Fiji and supplements other regional trade agreements.<sup>29</sup>

### **Australia-New Caledonia Trade and Economic Relations Arrangement**

3.36 More recently, a Trade and Economic Relations Arrangement was signed between Australia and New Caledonia in March 2002. The Arrangement provides a framework for discussion of trade issues, including market access.<sup>30</sup>

### **Cotonou Agreement**

3.37 Also relevant to the region, the Cotonou Agreement is an agreement concluded between the European Union and its Member States and the Member States of the African, Caribbean and Pacific Group (ACP) which followed the expiration of the Lomé Convention<sup>31</sup> in February 2000. Australia is not party to the Agreement. The Agreement was signed in June 2000 in order to “promote and expedite the economic, cultural and social development of the ACP States, with a view to contributing to peace and security and to promoting a stable and democratic political environment”.<sup>32</sup>

3.38 The objective of the Agreement is to reduce and eventually eradicate poverty consistent with the objectives of sustainable development, taking account of the political, economic, social, cultural and environmental aspects of development. The development framework includes sustained economic growth, developing the private sector, increasing employment and improving access to productive resources together with the consideration for the situation of women and gender in political, economic and social arenas and the principles of sustainable management of natural resources and the environment.

3.39 In relation to economic and trade cooperation, the objectives of the Agreement are to promote smooth and gradual integration of ACP economies into the world economy; enhance production, supply and trading capacities; create new trade dynamics and foster investment and ensure full conformity with WTO provisions. The Agreement extends trade preferences to 2008 but defines the negotiating framework to enable ACP countries and the EU to conclude new trade agreements compatible with WTO rules by 31 December 2007.

### **Australia's role in capacity building on trade issues**

3.40 The Committee considers there to be a significant role for Australia to play in capacity building support for PNG and Pacific island countries in relation to trade

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29 *Submission 33*, p. 23 (Department of Foreign Affairs and Trade). See also, Minister for Foreign Affairs, the Hon Alexander Downer, ‘New Trade and Economic Relations Agreement with Fiji’, Media Release, 11 March 1999.

30 *Submission 33*, p. 23 (DFAT)

31 Relations between the European Union and the ACP were governed since 1975 by the Lomé Convention which provided a preferential trade regime to ACP countries.

32 For the text of the Cotonou Agreement, see <http://www.acpsec.org/gb/cotonou/accord1.htm>.

negotiations and particularly in relation to the World Trade Organisation (WTO). The Committee notes that apart from Australia and New Zealand, only PNG and the Solomon Islands are members of the WTO. Samoa, Tonga and Vanuatu have applied to join.

3.41 The Committee notes DFAT's report on the Doha round of negotiations which stated that "Australia will continue to actively engage with developing country members" and that Australia is "committed to addressing concerns about difficulties in the implementation of WTO agreements that emerged from the Uruguay Round". The Committee also notes that both DFAT and AusAID have programs of technical assistance and policy dialogue with developing countries aimed at strengthening their capacity to fully participate in the new trade negotiations.<sup>33</sup>

3.42 However, it is evident to the Committee from discussions with Pacific island governments during its visit to the region that improvements in such assistance are required. This is particularly the case for those countries that have applied for membership to the WTO to understand what the system means and how best they can work within the system to achieve the most beneficial outcomes.<sup>34</sup> It may be that the Commonwealth Parliament could provide some financial assistance to current or former parliamentarians with strong trade policy credentials to enable them to conduct seminars for parliamentarians and officials of Pacific countries on WTO mechanisms and broader trade policy issues.

3.43 In this regard, the Committee broadly supports the submission from the Australian Council for Overseas Aid (ACFOA).<sup>35</sup> ACFOA suggested that Australian trade assistance programs should meet the capacity needs of the least developed countries as identified at Doha. These include:

- market access (of little avail if there is little to competitively export);
- supply side solutions (to develop infrastructure, goods and services for exporting) in particular technology transfer, and
- human resource development (education and training initiatives, support for implementation of WTO rules and support for equal representation and participation in WTO negotiations).

3.44 In addition, meeting these needs should be guided by the following criteria on quality:

- be driven by developing country demand;
- include the flow of technology to developing countries, LDCs in particular;

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33 See also, AusAID, *Australian Aid: Investing in growth, stability and prosperity*, September 2002, p. 48.

34 See also, *Submission 50*, pp. 5–7 (World Vision Australia)

35 *Submission 37*, pp. 9–10 (ACFOA). See also, *Committee Hansard*, 18 October 2002, p. 73 (ACFOA)

- support the representation and participation of developing countries in Geneva and in key WTO negotiation forums;
- be based on long-term needs of the poorer communities of developing countries; and
- promote increased market access while ensuring special and differential treatment in support of food security and basic human rights of the poor.

### ***Non-tariff barriers to trade***

3.45 The Business Councils raised an issue in relation to perceived difficulties and restrictions in obtaining export permits for the export of processed fish from Australia to the Pacific:

Stock has to be isolated at point of manufacture, separately bonded, then inspected by AQIS inspectors before a permit is granted to export.<sup>36</sup>

3.46 The Business Councils stated that these processes are costly and difficult for business, and limits both Australian export potential to the Pacific Island countries and the development of further fish processing and export industries in those countries. However, AQIS advised the Committee that all fish products processed in Australia for export are required to be processed in an AQIS export registered establishment under an AQIS approved documented system which addresses the food safety risks to consumers associated with the products being processed. More recently AQIS has implemented an electronic documentation system called EXDOC, which permits the generation of the export permit and, where required, health certification at the company's premises. AQIS also advised the Committee that its primary forum for discussion of strategic issues of concern to the export industry is through the Seafood Exports Consultative Committee (SECC). The Committee is comprised of key industry personnel drawn from all major export sectors and are chosen by the industry.

3.47 The Committee also received evidence requesting Australia to re-examine some of its quarantine procedures to ensure that they are really necessary to protect it from disease. For example, the Committee was advised that other Pacific countries are allowed to export their taro crop to Australia but this is not the case for PNG.<sup>37</sup>

3.48 However, the Committee considers these issues to be somewhat different to the issue raised above in relation to export permits. The Committee agrees with the view that it would be preferable for the standard of facilities for processing or crop

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36 *Submission 15*, pp. 12–13 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

37 *Submission 75*, p. 11 (Business Council of Papua New Guinea and the Institute for National Affairs)

production in PNG and Pacific island countries to be raised rather than Australian quarantine standards lowered.<sup>38</sup>

3.49 The Committee notes the range of biosecurity measures undertaken by the Department of Agriculture, Fisheries and Forestry Australia (AFFA) and AQIS.<sup>39</sup> However, the Committee notes that these are largely in relation to PNG (and Indonesia). Australia could assist in this area by extending support to Pacific island nations to address the above concerns. In addition, where assistance is not already provided, assist in the identification of means to meet Australian standards.

3.50 The Committee was also advised that there are problems with the export of some Australian food products to certain Pacific Island countries for quarantine reasons such as the restriction on the import into Fiji of Australian chicken products because of claimed Newcastle disease.<sup>40</sup> The Committee is persuaded that some of these non-tariff barriers to trade in both directions could be overcome through the development of closer relations between AQIS and Pacific island countries quarantine and health authorities.

#### **Recommendation 4**

The Committee recommends that the Australian Quarantine and Inspection Service host a bi-annual meeting of quarantine and health authorities in the Pacific region to address issues of mutual concern and develop strategies for their resolution.

#### **Recommendation 5**

The Committee recommends that the Australian Government, through the Department of Agriculture, Fisheries and Forestry and other relevant State and federal agencies, consult with the governments of PNG and the Pacific island countries on the requirements needed to raise the standard of processing facilities and crop production in those countries in order to bring them up to Australian standards.

The Committee recommends that the findings of that study be forwarded to AusAID for consideration and implementation through Australia's development assistance programs.

### ***Private sector development***

3.51 The Committee agrees strongly with the view that the private sector has a major role to play as a driver of economic growth and poverty reduction in the Pacific island countries. A number of submissions argued that the best means of economic

38 See *Submission 15*, p. 13 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

39 See *Submission 51*, pp. 3–6 (Department of Agriculture, Fisheries and Forestry)

40 See *Submission 15*, p. 13 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

growth and self sufficiency in these countries is for the development of a strong private sector and that therefore support to private sector investment through the development assistance program should be increased.<sup>41</sup>

We acknowledge the good work undertaken by AusAID in delivering programs aimed at health, education and governance which seems to be the main focus of their work. But it is of limited value to have a healthy and well educated community if parallel private sector development has not taken place.<sup>42</sup>

3.52 The Committee notes the Pacific Islands Trade and Investment Commission which enhances the development of the private sector in increasing trade, facilitating export diversification and attracting Australian investors and the South Pacific Project Facility which encourages entrepreneurial activities in the Pacific for small to medium private sector enterprises.<sup>43</sup>

3.53 However, AusAID also advised the Committee of the challenges facing private sector development in the Pacific:

...in the Pacific the private sector has enormous challenges to overcome because of the very characteristics of the countries, not least the distance from the market, the limited resources and the cultural aspects, which perhaps do not contribute to private sector development to the degree you might find in other parts of the world.

They are very significant constraints, but one of the areas that we are working significantly in is in ensuring that the countries have the right economic framework to encourage whatever private sector development might be able to take place in those countries. As we have stated before, this is all quite a long and difficult process. Some countries respond better than others, and some countries have better circumstances and resources than others in being able to take advantage of this. Nevertheless, we see it as a fundamental aspect of the work we are doing in the Pacific and in PNG and as a way to encourage economic growth.<sup>44</sup>

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41 *Submission 15*, p. 9 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council). See also, *Submission 23* (Dr Geoffrey Stocker and Dr Colin Hunt); *Committee Hansard*, 18 October 2002, pp. 28–29 (Piper); *Submission 77*, p. 6. (Mr Bob McKillop); and *Submission 19*, p. 13 (OXFAM Community Aid Abroad). OXFAM stated that in 1990, the private sector accounted for 25 per cent of investment into the developing world while 75 per cent of investment was foreign aid. By 1996 the numbers had reversed with 75 per cent of investment being private sector investment. The level of private sector investment within the Pacific by Australian companies has also increased dramatically.

42 *Submission 15*, p. 9 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

43 See *Committee Hansard*, 28 March 2003, p. 414 (AusAID)

44 *Committee Hansard*, 28 March 2003, p. 413 (AusAID)

3.54 The Committee is mindful that pursuit of private sector investment and development should be with full consideration for the rights of, and in consultation with, indigenous communities, and should assist in the social development of those communities.

3.55 The Australian Treasury advised the Committee that the effects of inflation and interest rates from fiscal ill-discipline engender a climate that is not conducive to private sector development. In addition, investment is discouraged if land tenure is not secure, property rights are not respected, and if countries do not have robust systems of contract enforcement, dispute resolution, bankruptcy procedures or accounting standards.<sup>45</sup> These issues are discussed further below in relation to constraints to development.

### ***Export Finance and Insurance Corporation (EFIC)***

3.56 The Export Finance and Insurance Corporation (EFIC) is an Australian statutory corporation that provides finance and insurance services to encourage and facilitate Australian exports. As Australia's export credit agency, EFIC's role is to increase Australia's exports.<sup>46</sup>

3.57 The Committee received some evidence that criticised the role of EFIC in its financing of a number of projects, particularly in PNG, and its lack of concern for environmental and social accountability:

EFIC has no development mandate and only recently introduced minimal environmental guidelines. These guidelines have been fiercely criticised by a wide coalition of groups, from church groups, unions and non-government organisations within Australia and internationally. The environmental guidelines in their current form have failed to screen potentially environmentally destructive projects and demonstrate a lack of commitment from EFIC to the principles of environmentally sustainable development.<sup>47</sup>

3.58 Whilst acknowledging that the majority of projects funded by export credit agencies remain uncontroversial,<sup>48</sup> AID/WATCH argued that EFIC-supported projects that damaged the environment and impacted on communities in Pacific island countries were inconsistent with Australia's policy of environmentally sustainable and culturally appropriate development.<sup>49</sup>

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45 *Submission* 86, p. 9 (The Treasury)

46 See [www.efic.gov.au](http://www.efic.gov.au) EFIC provides its clients with internationally competitive insurance and finance services, particularly for those countries, companies and contracts which the commercial market may not have the capacity to cover.

47 *Committee Hansard*, 28 March 2003, p. 419 (AID/WATCH). See also, *Submission* 19, pp. 14–15 (OXFAM Community Aid Abroad); *Submission* 31, p. 7 (PNG Solidarity Action); and *Submission* 57, pp. 26–27 (Australian Conservation Foundation)

48 *Submission* 26, pp. 6–7 (AID/WATCH)

49 *Committee Hansard*, 28 March 2003, p. 419 (AID/WATCH)



3.59 AID/WATCH also argued that through loans to non-productive exports, EFIC assists in generating public sector debt:

Research conducted by AID/WATCH has found that 94.5 per cent of the money owed to Australia by developing countries has been generated by EFIC. This is not so relevant in relation to PNG but is very important to other Pacific countries such as Tonga, the Solomon Islands and the Cook Islands, where 100 per cent of their official debt to Australia is EFIC related.<sup>50</sup>

3.60 The Committee's view is that, on balance, EFIC is making a valuable contribution to development in the region. However, it is important that EFIC remain alert to issues of environmental and cultural concern in its deliberations about project funding.

### **Australia's promotion of economic self-sufficiency**

3.61 DFAT advised the Committee that economic and fiscal reform is a key objective for Australia and the region. To that end, the Forum Economic Ministers' Meeting (FEMM) and Forum Trade Ministers' Meeting (FTMM) seek to promote "an economic and governance environment which attracts investment, supports trade and is conducive to sustainable growth".<sup>51</sup> The inaugural FEMM Action Plan in 1997 committed Pacific Islands Forum members to enhanced public accountability, private sector development and more open investment policies.

3.62 The Committee was advised that the reform programs agreed by FEMM are designed to promote public accountability and institutional strengthening, improvements in macroeconomic and budgetary management, trade and investment liberalisation, and private sector development. With its emphasis on national ownership of reform, the FEMM process also provides an environment of peer pressure and experience sharing to facilitate the implementation of reform.<sup>52</sup>

3.63 Whilst it was clear to the Committee through evidence and its visit to the Pacific that all countries have accepted the need for economic reform and improved governance, it is was also clear that the development and implementation of appropriate policies remains a significant challenge. Countries such as Samoa and the Cook Islands have had relative success in pursuing economic reforms such as fiscal responsibility and trade liberalisation but economic reform poses particular challenges for communities with poorly resourced governments and small private sectors.<sup>53</sup>

3.64 DFAT identified electoral pressure on governments, especially with unstable governing coalitions and the lack of local capacity to implement the necessary

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50 *Committee Hansard*, 28 March 2003, p. 419 (AID/WATCH)

51 *Submission 33*, p. 18 (DFAT)

52 *Submission 86*, p. 10 (The Treasury)

53 See *Submission 33*, p. 18 (Department of Foreign Affairs and Trade)

measures as some of the obstacles to reform.<sup>54</sup> These are discussed in more detail below.

3.65 However, the Business Councils also recognised that the process of promoting and guiding economic reform and private sector development at the political level only addresses one part of the problem. For example, in all the Pacific Island economies there is limited, or in some cases no, understanding of the regional and global economic environment in which these countries must survive, and of private sector development and the role of wealth creation in building an economy.<sup>55</sup>

3.66 The Business Councils suggested that, in order to sustain the reforms being promoted amongst political leaders, it will be necessary to provide support in educating the wider community that these reforms are essential to their countries futures.

3.67 The Committee sees merit in this suggestion, particularly as some governments discussed the issue of educating their citizens about the need for economic reform during the Committee's visit to the region.

#### **Recommendation 6**

The Committee recommends that the Australian Government, through the Forum Economic Ministers' Meeting, assist the member states to develop comprehensive public education strategies explaining policies directed towards the achievement of economic self sufficiency.

### ***The impact of economic liberalisation agendas on the Pacific***

3.68 The Committee was advised that a country's engagement with the international financial institutions to undertake economic adjustment programs provides access to substantial financial resources, either directly or indirectly, through triggering additional associated bilateral support which has positive effects on business confidence and private sector capital flows. These programs also make available to the recipient country a body of experience and expertise in the implementation of economic adjustment programs.<sup>56</sup> Australia's loan to PNG for economic reform was provided in the context of PNG's engagement with the International Monetary Fund (IMF), supported by the World Bank, in undertaking structural adjustment programs.<sup>57</sup>

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54 *Submission 33*, p. 18 (Department of Foreign Affairs and Trade)

55 *Submission 15*, p. 11 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

56 *Submission 86*, p. 4 (The Treasury)

57 Structural adjustment programs involving the temporary provision of financial assistance to members facing balance of payments difficulties. The World Bank however, generally focuses on providing support for countries to undertake longer term structural reform to promote development and reduce poverty. The Asian Development Bank (ADB) focuses on poverty

3.69 The Committee received some evidence criticising the effectiveness of the economic liberalisation programs of the World Bank, IMF and Asian Development Bank (ADB) in the region.<sup>58</sup> In particular, the financial reporting of the international financial institutions was considered to lack engagement with the Pacific islands’ underlying economic difficulties, “being largely concerned with short term macroeconomic developments and an inevitable interest with the countries’ abilities to repay their loans”.<sup>59</sup>

3.70 For example, the Committee was advised that lending had tended to focus on social projects through budget support rather than infrastructure and production projects:

The lack of development of such infrastructure as road and sea transport, water, energy and telecommunications outside the main towns, the abysmal state of education and health, particularly in Melanesia, casts doubt on the effectiveness of more than 25 years of development banks’ lending to the Pacific.<sup>60</sup>

3.71 The Committee was advised that the World Bank has loaned US\$1.3 billion and the ADB has loaned US\$800 million to PNG. The ADB has concentrated its funding on:

- Higher Education (US\$16.5 million);
- Health Sector Investment (US\$9.127million);
- Smallholder Support Service Pilot (US\$7.6 million);
- Fisheries Development (US\$6.5 million);
- Financial Management (US\$25.8 million);
- Employment Oriented Skills (US\$18.796);
- Microfinance (US\$9.477 million);
- Road Maintenance and Upgrading (US\$63 million); and

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reduction. The Australian Treasury informed the Committee that the premise of the ADB’s operations continues to be that the Pacific Island countries require development strategies adapted to their special circumstances and vulnerabilities. The ADB considers the keys to generating sustainable growth in the Pacific are improvements in the policies and implementation capacities of Pacific governments, identifying and addressing the core factors contributing to economic growth, and for the donor community to improve the effectiveness of aid programs. At the same time, the ADB recognises that national ownership of reform programs is essential. See *Submission* 86, p. 8 (The Treasury)

58 See for example, *Submission* 61, pp. 19–20 (Professor Helen Hughes); *Submission* 31, p. 5 (Papua New Guinea Solidarity Action); Satish Chand, *Impact of rich country policies on the Pacific Island Countries*, June 2003, pp. 20–21; and *Committee Hansard*, 28 March 2003, p. 445 (Professor Helen Hughes)

59 *Submission* 61, pp. 19–20 (Professor Helen Hughes)

60 *Submission* 61, p. 19 (Professor Helen Hughes)

- Rehabilitation of Marine Navigation Aids (US\$19.8 million).

3.72 Of the 25 projects evaluated since PNG joined the ADB in 1975, only seven were successful and twelve were deemed partly successful by the Bank's own evaluation.<sup>61</sup>

3.73 In 2002, the Meltzer Commission of the US Congress concluded "that neither the World Bank nor the regional banks are pursuing the set of activities that could best help the world move rapidly toward (a world without poverty) or even the lesser, but more fully achievable goal of raising living standards and the quality of life, particularly for people in the poorest nations in the world".<sup>62</sup>

3.74 ACFOA also drew attention to a number of examples of the effects of structural adjustment programs in Fiji, Tonga, Samoa and PNG and discussed the concerns of civil society in relation to these programs. For example, Father Kevin Barr of the Ecumenical Centre for Research, Education and Advocacy in Fiji highlighted how the formal and informal economies in many of the countries in the region challenge the World Bank template:

The communal ownership of land is still strongly adhered to, the subsistence economy continues to complement the cash economy and provides livelihoods for many, and communitarian values of caring and sharing still motivate most people. Moreover, many who are unemployed in the formal sector of the economy create livelihoods for themselves (self-employment) in the non-formal sector. Thus in the Pacific alternatives to an export-oriented, market-driven globalised cash economy continue to exist and sustain small participatory communities...The modern formal cash economy devalues the traditional economy because, being money-based and reliant on production for cash, buying and selling and earning wages, it cannot comprehend or measure production for consumption, reciprocity, sharing and communal work without wages.<sup>63</sup>

3.75 In contrast, Mr Tim Curtin suggested that the Australian Government should insist that any new structural adjustment loans, including those of international agencies, should be structured along the same lines as AusAID programs. That is, all new loans should be on a project basis because loans provided in the form essentially of blank cheques to PNG's treasury have not been used for the purposes intended.<sup>64</sup>

3.76 Given the economic and social indicators outlined in Chapter Two, such comments and evaluations cannot be dismissed lightly. The Committee acknowledges the active role Australia plays in encouraging an integrated approach by the international agencies to the region's development needs. However, whilst financial assistance is provided in the form of a loan which is theoretically repayable, the

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61 *Submission 61*, p. 20 (Professor Helen Hughes)

62 See *Submission 61*, p. 20 (Professor Helen Hughes)

63 See *Submission 37*, p. 11 (ACFOA)

64 *Submission 43*, pp. 1–2 (Mr Tim Curtin). See also, attachment 1 to this submission.

Committee also perceives something of an anomaly in that the provision of budgetary support by international financial institutions contrasts with Australia's recent shift away from budgetary support in PNG.

### **Constraints to development**

3.77 A number of submissions to the inquiry discussed in detail the constraints to development, faced to different degrees by PNG and the Pacific island states. In addition to the effect of geography (the cost of transportation and susceptibility to natural disasters) and the rate of population growth exceeding the rate of economic growth,<sup>65</sup> the major constraints to development can be considered as arising from the following issues:

- A dependence on raw commodities for export earnings;
- Structural issues relating to infrastructure, land tenure and inadequate institutions;
- Political instability; and
- Law and order.

3.78 The Committee also notes that other potential constraints include unsustainable public sectors, the increasing incidence of HIV/AIDS and these issues are discussed in Chapter Four in relation to Australia's development assistance. The Committee considers it important to note at the outset that not all of the constraints to development affect all countries in the region equally.

### ***A dependence on raw commodities for export earnings***

3.79 As discussed above, Pacific island countries are characterised as dependent on raw materials for export. The Committee particularly notes the comments from OXFAM Community Aid Abroad that higher poverty rates are linked to this dependence. Referring to the recently released United Nations Convention on Trade and Development (UNCTAD) report, *Least Developed Countries Report 2002—Escaping the Poverty Trap*,<sup>66</sup> OXFAM explained that the incidence of extreme poverty is highest in countries dependent on primary commodity exports for their economic survival and development.<sup>67</sup> The UNCTAD report argued that, poverty is related to the form of trade integration, and in particular to the type of export specialisation. Where income levels are low, savings and investment are correspondingly low which leads to low productivity and the cycle is repeated. For example, the percentage of people living on less than \$1 a day in PNG has soared from 61 per cent in 1981–1983 to 82 per cent in 1997–1999.

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65 See Satish Chand, *Impact of rich country policies on the Pacific Island Countries*, June 2003, p. 5.

66 This report referred specifically to Least Developed Countries (LDCs) of which there are five in the Pacific: Kiribati, Samoa, Solomon Islands, Tuvalu, Vanuatu.

67 *Submission* 19, p.11 (OXFAM). See also, *Submission* 50, pp. 3–4 (World Vision Australia)

3.80 OXFAM argued that while access to foreign investment, markets and technology could help the countries of the South Pacific break out of the poverty trap, the trap is actually being reinforced, and not broken, by international trade and finance relationships. Therefore, the ability of international trade to act as an engine of growth and poverty reduction is being short-circuited by falling world commodity prices.<sup>68</sup>

3.81 The slow export growth and commodity price instability has also led to a build-up of unsustainable external debt in commodity exporting countries. OXFAM argued that new measures were needed in the Pacific to eliminate excessive price instability and provide compensatory financing schemes to deal with price shocks. There is a need to break the link between commodity price behaviour and persistent indebtedness, for example, by making debt repayment schedules contingent on world commodity prices.<sup>69</sup>

3.82 A number of Pacific Governments raised the issue of falling commodity prices as a concern for economic development with the Committee during its visit. The Committee notes the comments of OXFAM in relation to the possibility of making debt repayment schedules contingent on world commodity prices. The Committee sees merit in Australian participation in Pacific international forums as an advocate in ongoing discussions about ways to alleviate problems associated with the effect of falling commodity prices on debt repayments for developing countries.

### ***Structural issues relating to infrastructure, land tenure and inadequate institutions***

#### **Infrastructure**

3.83 The Committee received a lot of evidence relating to the state of infrastructure in many countries in the region, particularly in relation to roads which have an enormous impact on the ability to get goods to markets. Inadequate roads not only impact on economic development but make the delivery of services and access to health and education more difficult. Poor infrastructure is largely the result of poor original construction but more importantly, lack of maintenance. For example, the Committee was advised that funding for maintenance of the national road network in PNG is only around 10 per cent of that required.<sup>70</sup> This issue was raised by virtually all groups that met with the Committee in the region.

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68 *Submission 19*, p.12 (OXFAM)

69 *Submission 19*, p.12 (OXFAM). See also, *Committee Hansard*, 18 October 2002, p. 73 (OXFAM). ACFOA suggested that Australia could play a role in calling for the cancellation of international debt.

70 *Submission 17*, p. 5 (AusAID)

3.84 Drs Stocker and Hunt provided an example of the state of roads in PNG and the impact the poor infrastructure has on the coffee industry.<sup>71</sup> This issue is considered further in Chapter Four in relation to Australia’s development assistance programs.

### Land tenure

3.85 The issue of communal land tenure and its impact on economic development, particularly in Melanesian culture, is hotly debated and contested.

3.86 Communal land tenure is a distinctive feature of many Pacific island countries with the basis being to ensure that all indigenous people have the right of access to land to live and grow food—a minimum subsistence existence:

Features of this distinctiveness include the primacy of the community, a strong affinity of the people to the land, indigenous belief systems, the principle of reciprocity, and the uniting force of Christianity. The majority of land in the Pacific is held in customary tenure. The culture of all Pacific island societies is inextricably linked to their land and it is this link that forms the basis for people’s economic, social, cultural and spiritual well-being. Customary land tenure systems are however, considered by business, government interests and international financial institutions, to be a major stumbling block to economic development in the region. Changes to the customary system of land “ownership” pose a major threat to the independence and lifestyle of Pacific people, impacting on local cultures, social cohesion and ability of people to be self-sufficient.<sup>72</sup>

3.87 The Committee received a number of submissions that criticised communal land ownership as an impediment to development as it did not allow for security of investment. In addition, communal land ownership was argued to lead to inefficient resource use and conflict over who should reap the benefits.<sup>73</sup>

3.88 In evidence to the Committee, Mr Tim Curtin argued that no country has effectively developed without some form of land tenure:

To my mind, there is no country in the world where you have had development without some form of land tenure approximating what we have in Australia. It need not be freehold—Canberra, ACT, exists quite well with leasehold—but Papua New Guinea will never get anywhere without reforming its land tenure system. Its land tenure system may be a thing of

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71 See *Submission 23*, pp. 14–17 (Dr Geoffrey Stocker and Dr Colin Hunt). See also discussion in *Submission 75*, p. 6 (Business Council of Papua New Guinea and Institute of National Affairs). See *Submission 77*, p. 5 (Mr Bob McKillop). Mr McKillop suggest that there is a lack of empirical evidence to support the thesis that the difficulties associated with getting produce to market are the main deterrent to increased production.

72 *Submission 19*, p. 4 (OXFAM). See also, *Submission 60*, p. 5 (Dr Tim Anderson); and *Submission 63*, p. 20. (PNG Department of Prime Minister and National Executive Council)

73 *Submission 23*, p. 2 (Dr Geoffrey Stocker and Dr Colin Hunt). See also, *Committee Hansard*, 18 October 2002, p. 14 (Mr Tim Curtin)

joy to anthropologists but it is inefficient and incapable of underpinning bank lending for agriculture, housing or anything else. The more fundamental reform that has yet to be confronted by Papua New Guinea's friends goes to showing them how to go about land reform and providing the resources to help them do it in a way which is not threatening and does not steal any Papua New Guinean's land but simply enables them to make the most of their most important resource.<sup>74</sup>

3.89 Similarly, the PNG Government recognises this impediment and stated that there was a need to create a specialised agency for compensations claims procedure, land mediation, arbitration and basic surveys to provide services for the agriculture and mining industries.<sup>75</sup>

3.90 However, the Committee was advised that if any reform program for land tenure to be acceptable in PNG, it must be based on informed consent.<sup>76</sup>

3.91 The Committee was advised of options such as land registration and lease/lease-back arrangements which would give some security to investors. For example, the vehicle of lease/lease-back has enabled over 50,000 hectares to be brought under oil palm in PNG.<sup>77</sup> However, Mr Michael Morgan suggested that land registration would be highly provocative, particularly in Vanuatu:

I suggest that for Vanuatu—and I dare say it is going to be similar in the Solomon Islands and Papua New Guinea—land registration is a clear provocative act. Local people will see that as an attack on them by the government. Land is more than just land. It has cosmological significance; genealogies are written on the landscape.

It also is a major point of independence. There is a political and moral economy attached to this, but also a real economy. This is where people grow their subsistence crops. This is what allows them independence from more powerful, richer people. They have land and they hope that they will always have land. For many people in Vanuatu, registering it seems too close to delimiting it and taking it away. If any government does undertake that in Vanuatu, it will be political suicide. I do not think there will be much support for that in the near future, especially for the fact that, overall, democracy—this secular state, the separation of powers—is a fairly tenuous and ambiguous project for most local people.<sup>78</sup>

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74 *Committee Hansard*, 18 October 2002, p. 14 (Mr Tim Curtin). See also, Satish Chand, *Impact of rich country policies on the Pacific Island Countries*, June 2003, pp. 14–15.

75 *Submission 63*, p. 20. (PNG Department of Prime Minister and National Executive Council)

76 *Committee Hansard*, 19 February 2003, p. 228 (Australian Conservation Foundation)

77 *Submission 23*, p. 3 (Dr Geoffrey Stocker and Dr Colin Hunt)

78 *Committee Hansard*, 18 October 2002, p. 34 (Morgan). See also, *Submission 2*, p. 3 (Australia West Papua Association—Melbourne Inc and Global Justice Inc). The Australia West Papua Association—Melbourne Inc. (AWPA) and Global Justice Inc suggested to the Committee that



3.92 The Committee does not wish to advocate for or against communal land ownership in the region. However, bearing in mind the fundamental question of how to assist these economies to become sustainable, the Committee agrees with the view that there may be a need for financial institutions and donors to be more imaginative about ways in which development can be financed at the local level without individual land registration so that communities can remain in control of their land.<sup>79</sup>

### **Inadequate institutions**

3.93 The Committee received evidence that there are many state institutions and departments that have almost no capacity to implement policies, particularly at provincial levels.<sup>80</sup> This is largely the result of a poorly managed transition from colonial administration:

The poverty of the colonial inheritance has been felt in political or constitutional terms. All the Melanesian states have had to grapple with poorly laid out power-sharing arrangements between the centre and the provinces, as feelings of dispossession and of being denied a share of government resources have emerged in rural areas and outer islands.<sup>81</sup>

3.94 Mr Nicholas Maclellan, for example, noted that colonialism typically included a paternalistic and distant form of government, with a strong emphasis on centralisation and the state as a provider of services. Typically, local participation was generally restricted to a small number of educated elites, active in tightly proscribed roles within the civil service. This often meant that the legacy of the colonial period includes radically new approaches to politics and social organisation, while also leaving local communities with limited experience and skills in managing and directing those systems.<sup>82</sup>

3.95 Similarly, the PNG Government advised the Committee that in some cases, PNG has inherited institutions and structures from Australia and other jurisdictions that are not entirely appropriate in PNG. The interaction between the traditional village based dispute settlement traditions with western-based legal systems has been one of the sources of problems, especially at the village and local level.<sup>83</sup>

3.96 The Committee was advised that many of the institutions of colonial origin have lost momentum, efficiency, and in some cases relevance. Few institutions, more appropriate to Melanesian societies and more able to express and fulfil Melanesian

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Australia downplays the importance of this form of land tenure for Pacific countries, in favour of supporting individual ownership.

79 *Committee Hansard*, 18 October 2002, p. 36 (Douglas)

80 See *Committee Hansard*, 18 October 2002, p. 26 (Nelson)

81 The Hon Alexander Downer MP, *Australia's Strong Pacific Commitment*, 2 November 2000. ([www.dfat.gov.au/media/speeches/foreign/2000/001102\\_fa\\_riap.html](http://www.dfat.gov.au/media/speeches/foreign/2000/001102_fa_riap.html))

82 *Submission 30*, pp. 9–10 (Mr Nicholas Maclellan)

83 *Submission 63*, p. 7. (PNG Department of Prime Minister and National Executive Council)

expectations, have arisen to take their place. There has also been a tendency for outsiders to advise on policy when the agencies expected to implement policy have very limited capacity to do so.<sup>84</sup>

3.97 One example provided to the Committee relates to the often high level of uncertainty regarding the enforcement of contracts, transactions and the repayment of loans, particularly in PNG. Drs Stocker and Hunt argued that this uncertainty results from the failure of the legal system to prosecute the perpetrators of fraud and theft. The effect on business and economic development is that enforcement failures place a high degree of pressure on banks, resulting in the virtual ceasing of lending to the rural sector, forcing banks instead to concentrate on recouping outstanding debts.<sup>85</sup>

3.98 The high risk to lenders and monetary policy in many countries in the region results in expensive credit. Small business faces very high interest rates on bank or hire purchase loans. Drs Stocker and Hunt provided an example of what this means for small-scale forestry:

Because security in the form of real estate or land is usually absent, the most common source of credit for plant and equipment is hire purchase, requiring flat monthly repayments for three years. (Other commercial banks do not lend against equipment for small-scale timber production because of high rates of repayment default.) The generation of sufficient business margins to repay the loan in every month for three years is a tall order, given the production and marketing uncertainties associated with such small-scale timber enterprises.<sup>86</sup>

### ***Political instability***

3.99 The Committee acknowledges that chronic political instability and internal conflict present serious threats to development, particularly in Melanesia. The Committee also agrees that in much of the region there has existed a susceptibility for governments to support inappropriate commercial ventures that have the potential to bankrupt governments and destabilise financial systems. The effects of civil unrest in the Solomon Islands have been devastating to economic and social stability, as was the case in Bougainville. The Fiji coups were also particularly damaging to economic development.

3.100 Australia's Foreign Policy Statement, *Advancing the National Interest*, acknowledges that transplanted national institutions can find it difficult to deal with traditional practices, especially in relation to authority structures, land ownership and land use which have been demonstrated by the Fiji coups, the Bougainville crisis and

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84 See *Submission 36*, pp. 1–2 (Mr Hank Nelson and Mr David Hegarty). See also, *Submission 30*, pp. 9–10 (Mr Nicholas Maclellan)

85 *Submission 23*, p. 3 (Dr Geoffrey Stocker and Dr Colin Hunt). See also, *Submission 77*, pp. 2–3 (Mr Bob McKillop)

86 *Submission 23*, p. 4 (Dr Geoffrey Stocker and Dr Colin Hunt)

disorder in the Solomon Islands. In such situations, local loyalties often take priority over national interests and challenge principles of good governance.<sup>87</sup>

3.101 This view was supported by a number of submissions to the inquiry which suggested that the obligations of individuals to the clan and tribe rather than to the individual or nation are manifest in the favouritism extended by indigenous managers to clan members in employment and in the diversion of assets to clan members.<sup>88</sup>

3.102 For example, Dr Sinclair Dinnen stated that the character of Melanesian politics as it has evolved in the period since independence has become a major part of the problem and underlies many of the symptoms of economic dysfunction.<sup>89</sup> Dr Dinnen discussed the elections in PNG where an enormous number of candidates and parties were competing in a first-past-the-post election. The pattern of elections in PNG tends to see over 50 per cent of sitting candidates not being returned. New members are often elected with less than 10 per cent of the vote:

A coalition government is an inevitable outcome and in the absence of strong party loyalties and notions of public interest can only be held together by bribery. Self-interest and localism motivate most politicians. This is a recipe for corruption.<sup>90</sup>

## Corruption

3.103 The Committee is particularly concerned about the abundant allegations of corruption brought before it formally and informally and considers this issue to be a major inhibiting factor to economic development. The Committee particularly notes the comment by the former Prime Minister of PNG, Sir Mekere Morauta that corruption is both systemic and systematic.<sup>91</sup>

3.104 Corruption has a major negative impact on good governance and the distribution of essential social and infrastructure services to the mainly rural population being a significant drain on the public purse. The Committee is not in a position to test the veracity of these claims about corrupt practices, but is nevertheless satisfied that corrupt practices are sufficiently widespread to constitute a major impediment to the country's economic wellbeing and the rule of law.

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87 Department of Foreign Affairs and Trade, *Advancing the National Interest*, Foreign and Trade Policy White Paper, chapter 7.

88 See for example, *Submission 23*, p. 2 (Dr Geoffrey Stocker and Dr Colin Hunt); *Submission 39*, p. 2 (Dr Sinclair Dinnen); *Submission 40*, p. 2 (Dr Bronwen Douglas); *Submission 77*, pp. 2–3 (Mr Bob McKillop)

89 *Submission 39*, p. 2 (Dr Sinclair Dinnen)

90 *Submission 39*, p. 2 (Dr Sinclair Dinnen)

91 See Centre for Independent Studies, *Papua New Guinea on the Brink*, 12 March 2003, p. 4.

## ***Law and order***

3.105 It is clear to the Committee that poor or declining law and order is a major impediment to growth in many Melanesian countries as it significantly impacts on levels of investment. The Solomon Islands is a particularly relevant example, where the collapse of the rule of law has led to the withdrawal of investment and the virtual collapse of the economy. The Committee also acknowledges that law and order issues are inextricably linked to frustrations with lack of opportunities and poverty.

3.106 In relation to PNG, in a recent article, Dr Dinnen stated that “as well as the devastating impact on individual victims, concerns about lawlessness have undermined commercial and investor confidence”.<sup>92</sup> Dr Dinnen stated that they have become major constraints to the achievement of national and local development objectives and employers in PNG recently ranked theft and crime, followed by corruption and then poor infrastructure, as the most significant obstacles to doing business.<sup>93</sup>

3.107 Austrade also advised the Committee that the cost of doing business in PNG was quite high for Australian companies. That is, many companies build into their pricing a 10 per cent law and order premium to cover the additional security costs and risks.<sup>94</sup>

3.108 Several submissions supported, the presence, with the agreement of the receiving state, of Australian police officers on the ground, working alongside national police officers rather than simply ‘advising’ the government on law and order issues.<sup>95</sup> This proposal is considered in more detail in Chapter Four in relation to Australia’s development assistance in the law and justice sectors.

## ***The development of the tourism industry***

3.109 Tourism in the Pacific is advocated as being of social and environmental benefit, as well as being an earner of foreign exchange and therefore an industry, if well managed, that has the potential to offset development assistance.<sup>96</sup> One

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92 *Submission 39*, attachment 1, p. 3 (Dr Sinclair Dinnen). See also, *Submission 71*, pp. 3–4 (The Foundation of the Peoples of the South Pacific International)

93 *Submission 39*, attachment 1, p. 3 (Dr Sinclair Dinnen). This was also identified as an issue for the tourism industry in Fiji. See *Submission 87*, pp. 30–31. (Fiji Australia Business Council)

94 *Committee Hansard*, 25 October 2002, p. 117 (Austrade)

95 See for example, *Submission 15*, p. 15 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council); and *Submission 80* (Mr David Guinn OBE)

96 *Submission 4*, p. 1 (Ian Kennedy & Associates). See also, Satish Chand, *Impact of rich country policies on the Pacific Island Countries*, June 2003, p. 17; and *Committee Hansard*, 20 February 2003, p. 325 (Business Councils)

submission to the Committee argued that the sensitive development of viable tourism industries in PNG and the Pacific would deliver the following benefits:<sup>97</sup>

- an increase in foreign exchange earnings;
- incremental improvement in employment and relative gains in wealth at community level; and
- a sense of pride among communities which will lead them to the protection of their own environments.

3.110 However, there is no cohesive, cooperative and coordinated approach to tourism. The disjointedness of the approach tends to act as a deterrent to attracting tourists to the region. Poor marketing because of limited facilities and promotional funds tends to make tourism a “hit and miss” industry particularly when many of the destinations are not part of the routes of the world’s major airlines.

3.111 Given the potential, it was suggested to the Committee that resources should be directed to the industry through the governments and public sectors of the Pacific Island nations rather than regarding the industry as an exclusively private sector function.<sup>98</sup> However, discussion of the development of the tourism industry in the region must consider both the demand for the region as a destination and the capacities of island countries to accommodate tourists (‘supply’).

3.112 Figures provided by the Department of Industry, Tourism and Resources (DITR) show a steady two way flow of visitors travelling between Australia and PNG, New Caledonia, Fiji between 1998–2000 (with the exception of Australians travelling to Fiji in 2000 following the coup).<sup>99</sup> DITR also noted that, although numbers are small from French Polynesia, it is a market with potential for growth given its high standard of living compared with other South Pacific Island states. However, there is a strong market sensitivity to the economic and political situation in the South Pacific region which impacts on tourism flows between Australia and these countries.<sup>100</sup>

3.113 The Committee was advised that demand for the Pacific as a destination for tourists is essentially regional for travellers from long haul, northern hemisphere markets. That is, the vision is of the Pacific region rather than individual countries whereas travellers from Australia and New Zealand, given their familiarity with the Pacific, view the region on a country-by-country basis.

3.114 The Committee notes the comments of tourism consultant Mr Ian Kennedy, in relation to ‘supply’ that the island countries are at vastly different stages of

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97 *Submission 4*, p. 4 (Ian Kennedy & Associates)

98 *Submission 4*, p. 2 (Ian Kennedy & Associates). See also, *Submission 5*, Mr Basil Atkinson; *Submission 66*, p. 14 (Dr Jo Herlihy); and *Committee Hansard*, 19 February 2003, p. 257 (Kennedy)

99 *Submission 18*, pp. 11–12 (Department of Industry, Tourism and Resources (DITR))

100 *Submission 18*, p. 12 (DITR). See also, *Submission 33*, pp. 24–25 (DFAT)

development and they see themselves as competing for tourists, investment dollars, airline services and skilled labour.<sup>101</sup> It was also particularly evident to the Committee from discussions with PNG and Pacific governments that tourism was considered to have potential for economic growth but infrastructure to support the industry has not been fully developed. For example, given the devastating attacks in Bali, it was widely considered that the Pacific (particularly countries such as Fiji) would become the new destination of choice for many Australians. Tourist numbers to Fiji do not reflect this. Acknowledging the slight downturn in the numbers of people travelling generally, the Committee also considers this to be the result of both inadequate marketing and promotion and the relative high cost of travel in the Pacific.

3.115 Mr Kennedy suggested that the Australian Government should commission a study of the tourism supply needs (in terms of infrastructure and training) of the Pacific island countries in conjunction with the Pacific Asia Travel Association and the South Pacific Project Facility. The study would be to determine what assistance would be necessary to develop the industry.<sup>102</sup> The Committee sees merit in this suggestion.

3.116 Mr Kennedy also explained that the next step for the industry would be to develop a short-medium and long term strategic tourism plan:

‘Towards 2020’, which is the New South Wales tourism master plan. It is the sort of thing that every island out there should have, although they do not need it as sophisticated as that.<sup>103</sup>

3.117 This was reiterated by Qantas Airways:

Such a plan is most certainly lacking, and I believe it would take a great deal of political will across a wide spectrum of countries to get such a thing up and running. The concept of some sort of regional cooperation, and perhaps even regional equity in a single carrier, is something that has been widely discussed in the South Pacific for many years. It has never come to fruition, but in theory it is an excellent idea.<sup>104</sup>

3.118 However, the Committee was also advised that political fragmentation and possibly even regional jealousies exist that prevents cooperation and coordination at the regional level.<sup>105</sup> The Committee considers this issue to be of serious concern and something that needs to be addressed if the industry is to become viable.

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101 *Submission 4*, p. 3 (Ian Kennedy & Associates). In relation to constraints to an effective tourism industry, see also, *Submission 87*, p. 30 (Fiji Australia Business Council)

102 *Submission 4*, pp. 3–4 (Ian Kennedy & Associates)

103 *Committee Hansard*, 19 February 2003, p. 264 (Kennedy)

104 *Committee Hansard*, 27 March 2003, p. 341 (Qantas Airways)

105 See for example, *Committee Hansard*, 27 March 2003, p. 342 (Qantas Airways)

### **Bilateral and regional cooperation and coordination**

3.119 Australia and PNG are both members of the APEC Tourism Working Group and maintain an ongoing bilateral/multilateral relationship through the work of that forum. However, DITR stated that, in acknowledging the mutual regional interests, PNG was also granted observer status at the Australian Tourism Ministers Council and its senior officials committee, the Australian Standing Committee on Tourism but that a PNG representative had not attended those meetings for a number of years.<sup>106</sup>

3.120 The Department advised the Committee that the Australian Tourist Commission does not run any specific campaigns or have a presence in PNG and conversely, the Department understands that the PNG Tourism Promotion Authority's three overseas offices are in Germany, the USA and Japan.<sup>107</sup> However, Mr Kennedy argued that, from the point of view of Australian tourism, PNG could add an "exotic extension to our image" through a coordinated approach.

3.121 The Committee also notes the EU financed South Pacific Tourism Organisation (SPTO) which was established in the mid-1980's for joint promotion of the region as a tourist destination. SPTO's objectives include:<sup>108</sup>

- strengthening regional cooperation in tourism development;
- optimising the contribution of tourism to the sustainable development of the region;
- stimulating international awareness of the region and promoting tourism to the region;
- enhancing the human, economic, natural and other resources of the region; and
- increasing creative capacities and promoting cultural identities within the region.

3.122 Supplementary to past programs which focused on promotional aspects of marketing, under a new policy directive, SPTO plays a role in both the social and economic development of the Pacific region, through its support of the tourism industry. The SPTO states that this provides a crucial vehicle for the achievement of many national development and donor priority concerns including poverty alleviation, environmental conservation, rural development, gender issues including women in development, governance issues and small/medium enterprise development.<sup>109</sup> Australia is not a member of this organisation.

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106 *Submission 18*, p. 12 (DITR)

107 *Submission 18*, p. 12 (DITR)

108 Secretariat of the Pacific Community, *Regional Organisations of the Pacific*, (2002), p. 16. The Committee also notes the recent signing of an MOU between the SPTO and the Pacific Asia Travel Association (PATA) which is designed to streamline communications between the two organisations to ensure that they work together as much as possible to deliver the maximum benefits to their respective members.

109 Secretariat of the Pacific Community, *Regional Organisations of the Pacific*, (2002), p. 16.

3.123 Given the discussion above on the limited resource base for many island countries and the effect of falling raw commodity prices, commodities which Pacific island countries rely heavily on, the Committee sees merit in support for the sustainable development of the tourism industry in the region that will supplement foreign exchange earnings and increase employment. However, the Committee also considers that development of the industry should also keep cultural heritage in mind.

3.124 The Committee notes the recently released Tourism Green Paper as a means of improving the marketability of the region. The Committee supports the view that promotion of the Pacific as a destination in long haul markets should be focussed on the regional image, including Australia. The example provided was “Australia and its Island Neighbours” (similar to the recent initiative in the United States featuring Australia, New Zealand and Fiji, sponsored by the Australian Tourist Commission).<sup>110</sup> In order for such a marketing and promotion strategy to be effective and in the interests of Australian tourism, support for the ‘supply’ of the tourism industry in PNG and the Pacific would be required.

3.125 The Committee does not expect the Australian Government to single-handedly initiate and manage the development of the tourism industry in the region, particularly given the lack of regional cooperation to date. Rather, the Committee sees a role for Australia both through the Pacific Islands Forum, and its bilateral relationships to work with the governments in the region that have the potential for a viable, culturally appropriate tourism industry to sensitively provide guidance on how they can best engage with each other and the private sector and direct resources to the development of the industry. The Committee believes that an Australian initiative of regional marketing and promotion would also go a long way towards fostering trust in a cooperative and coordinated approach.

#### **Recommendation 7**

The Committee recommends that, within the Tourism Green Paper process, the Australian Government explore options for regional marketing and promotion with Papua New Guinea and Pacific island countries as part of the promotion of Australia as a destination.

#### **Recommendation 8**

The Committee recommends that AusAID, in association with the Pacific Asia Travel Association and the South Pacific Project Facility and with the agreement of the relevant Pacific governments, commission a study in order to determine the levels of infrastructure and facilities required for countries to develop a viable tourist industry.



**Recommendation 9**

The Committee further recommends that, upon completion of the study, Tourism Australia coordinate a group of experts through the Pacific Islands Forum to develop a medium to long term strategic plan for tourism in the region.

**Aviation and access to the region**

3.126 Whilst the Committee supports the development of the tourism industry and the creation of markets in PNG and the Pacific, the Committee considers that one of the most inhibiting factors to the fruition of the industry to be the lack of regular, safe and easy access to the region. The Committee experienced this dilemma first-hand when planning to visit the region.

Regional air travel remains expensive in local terms, with schedules infrequent, and often unreliable. This is due in part to thin passenger and cargo traffic volumes which restrict demand for air travel in any one State, with the exception of PNG, and in part to inadequate tourist infrastructure and trained personnel. North American and European tourists, and the burgeoning group markets from Japan, demand high standards, reliability and frequency if they are to circulate around the South Pacific region rather than spend their time and money at a convenient gateway point. These market characteristics demand a far higher degree of cooperation between the national airlines than has so far been apparent. Since virtually all have government shareholdings, any change of direction must involve political will to be properly effective.<sup>111</sup>

3.127 Markets such as Tonga and Samoa tend to be driven by visiting friends and relatives returning home. This usually occurs in the peak times of travel thereby limiting the number of seats for tourists during those times. It appears to the Committee that it is almost a double-edged sword: passenger numbers are not there other than peak times, mainly due to the cost and schedules but without an increase in passenger numbers, it is hard for airlines to reduce the cost of travel in the region.

3.128 More than the travel of passengers, limited access to the region through aviation also has trade implications as cargo is often carried on commercial flights. This issue was raised with the Committee during its visit to Samoa. The Samoa Chamber of Commerce and Industry advised the Committee that fish is currently flown from Samoa to its export markets on commercial flights. Therefore, costs are high and there tends to be seasonal fluctuations in supply as this coincides with seasonal peaks and troughs in terms of tourism. The Chamber identified a need to develop freight lines and tourist lines between Samoa and Australia in order to facilitate its trade in fish.

3.129 The Committee received evidence that suggested that the existing individual airline ownership regime is simply not viable and the best way for all interests to be

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111 *Submission 46*, p. 5 (Qantas Airways)

achieved would be through the operation of an efficient, cost effective, safe and secure regional airline service.<sup>112</sup> However, the Committee also understands that the proposal for an airline of many flags has been discussed previously with little agreement or success. There are obviously sensitivities surrounding this issue and clearly regional cooperation is fundamental, particularly in relation to the open skies approach adopted by the Forum governments.<sup>113</sup> The Committee considers that it should be an issue given attention by the governments in the region through the study of the supply needs for the industry recommended above.

3.130 The Committee notes the emergence of Virgin Blue into the region with permission being received to begin flying between Australia and Fiji, Vanuatu and New Zealand. Provided passenger numbers can be increased, Virgin Blue may have the effect of decreasing prices for air travel to the larger markets. The Committee will watch these developments with interest.

3.131 Supplementary to issues with access to the region, the Committee was also advised that there are significant issues in relation to the maintenance of infrastructure and training:

Regrettably, in many parts of the region, weakness and instability, not inconsistent with the fragile economies and unstable regional political regimes all too often experienced in the South Pacific, plague the aviation industry. Problems exist not just with various regional airlines, but also in the provision and maintenance of infrastructure, training and safety oversight necessary to support the industry.<sup>114</sup>

3.132 For example, the Committee was advised that the Civil Aviation and Safety Authority had advised PNG that it would close Australian airspace to all New Guinea registered aircraft unless there are very swift remediations undertaken in terms of safety oversight in PNG.<sup>115</sup> The Committee considers these issues to be serious both for current safety standards and for the future development of a sustainable tourism industry. The Committee suggests that through concentration on the development of the tourism industry, of which the aviation industry is an integral part, the Australian Government should consider a 'whole-of-industry' approach to development assistance and consider the extent to which assistance can be provided to the maintenance, infrastructure and technical aspects of the industry.

3.133 The Committee notes the assistance Qantas Airways provides to the region's airlines in terms of commercial alliances and code-share arrangements and the maintenance of fleets.

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112 *Submission 15*, p. 13 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

113 See *Committee Hansard*, 27 March 2003, p. 345 (Qantas Airways)

114 *Submission 46*, p. 1 (Qantas Airways)

115 *Committee Hansard*, 27 March 2003, p. 339 (Qantas Airways)

## **Are labour mobility, 'Dollarisation' and a 'Pacific Economic Community' the future for the region?**

3.134 In a submission to the Committee, Mr Graeme Dobell suggested that Australia should accept its unique role in the Pacific and coordinate development assistance, security and economic policies through the development of a 'Pacific Economic Community' which would include regional labour mobility and the possible adoption of a single currency, the most obvious being the Australian dollar ('dollarisation'). According to Dobell, an economic community, together with 'dollarisation' would be a means of attacking the "corruption and despair eating at Melanesia and threatening other parts of the Pacific".<sup>116</sup>

### ***Labour mobility***

3.135 Much of the evidence received by the Committee both formally<sup>117</sup> in Australia and informally during the Committee's visit discussed the issue of special migration access to Australia by Pacific islanders with the objective of giving Pacific Islanders the opportunity to learn new skills and earn money that could be remitted back to the home country to support family networks and contribute to their economies. The Australian Government has had a long-standing 'non-discriminatory' migration policy and does not support any special migration arrangements. Australia's migration policy is outlined below.

### **Australia's migration policy**

3.136 The Department of Immigration and Multicultural and Indigenous Affairs (DIMIA) informed the Committee that more recently, Australian immigration policy has focused strongly on attracting skilled migrants who can contribute to enhancing Australia's economy and international competitiveness, improving Australia's living standards by an estimated \$6.7 billion by 2007–08.<sup>118</sup>

3.137 DIMIA advised the Committee that the application of the non-discriminatory immigration policy requires applicants for skilled migration to satisfy a points test, have particular work skills, be nominated by particular employers or have other links to Australia, or have successful business skills and/or significant capital to bring to Australia to establish a business of benefit to the country. In addition, all applicants

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116 *Submission 62*, p. 17 (Mr Graeme Dobell)

117 See for example, *Submission 11*, p. 2 (Mr John Piper); *Submission 15*, pp. 14–15 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council); *Submission 62*, pp. 13–15 (Mr Graeme Dobell); *Submission 75*, pp. 11–12 (Business Council of Papua New Guinea and Institute of National Affairs); *Submission 66*, pp. 19–20 (Dr Jo Herlihy); *Committee Hansard*, 18 October 2002, p. 28 (Piper); *Committee Hansard*, 18 February 2003, pp. 154, 163 (Dorney); *Committee Hansard*, 20 February 2003, pp. 317–318, 323 (Business Councils)

118 *Submission 44*, p. 20 (Department of Immigration and Multicultural and Indigenous Affairs DIMIA). See also, *Committee Hansard*, 27 March 2003, pp. 368–369 (DIMIA)

for permanent entry to Australia must be assessed against Australia's health and character requirements, which are designed to exclude any person whose presence in Australia would not be in the interest of the Australian community.<sup>119</sup>

3.138 Australia currently allows for a number of short and long term business, student and general visitor visas for PNG and the Pacific.<sup>120</sup>

### **Proposed labour mobility schemes**

3.139 Labour mobility schemes have been widely discussed and considered as early as 1984 by the Committee to Review the Australian Aid Programme, (the Jackson Report) which said that Australia had to adapt its assistance to the special circumstances of the South Pacific and recommended a special immigration program to deal with the unique problems of the smaller islands.<sup>121</sup> Similarly, the 1989 report of the Joint Committee on Foreign Affairs, Defence and Trade recommended that the Australian Government establish, in conjunction with private enterprise, a work experience program for the South Pacific region.<sup>122</sup>

3.140 More recently, the 1997 Report of the Committee of Review of Australia's aid policy, *Once Clear Objective: Poverty Reduction through Sustainable Development* (the 'Simons Review') discussed the issue of migration for islanders from the smaller Pacific atoll states. The Simons Review stated that special rights for Pacific Islanders to live and work in Australia "may prove to be more cost-effective than continuing high levels of aid in perpetuity. Limited access to Australia, either on a temporary or permanent basis, has been argued for as an effective way to assist the very small states whose only export is labour services".<sup>123</sup>

3.141 Evidence to the Committee supported these findings and recommendations. The Australia Fiji, Australia Pacific Islands and the Australia PNG Business Councils suggested that this issue should be revisited with some imagination.<sup>124</sup> Many opinions relating to the needs for such a scheme (explored by earlier inquiries) were stated throughout the inquiry. For example:

- Remittances from overseas workers in Pacific Island countries and dependencies such as Kiribati, Tuvalu, Niue and Tokelau form an important part of the economy of these and some other smaller states of the Pacific Islands;

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119 *Submission 44*, p. 20 (DIMIA)

120 See *Submission 44*, pp. 20–30 (DIMIA)

121 See *Submission 62*, p. 13 (Mr Graeme Dobell)

122 Joint Committee on Foreign Affairs, Defence and Trade, *Australia's Relations with the South Pacific*, March 1989, p. 137.

123 Report of the Committee of Review April 1997, *One Clear Objective: Poverty Reduction through Sustainable Development*, p. 116.

124 *Submission 15*, pp. 14–15 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council). See also, *Submission 37*, pp. 34–35 (AFOA)

- Many of these countries have virtually no natural resources, are suffering population and environmental pressures, and have little prospect of developing viable economies.
- Countries such as Samoa and Tonga have benefited from significant remittances from overseas citizens. Nauru has not so far got into the business of labour export, but given its worsening economic state could develop an interest in the practice.<sup>125</sup>
- Papua New Guineans and Pacific islanders would benefit from a transfer of skills and knowledge, particularly in the area of agriculture that will assist them upon return to their home country.

3.142 Dobell suggests that the island governments should take much of the responsibility for running the scheme by initially nominating the people and then taking responsibility for the return of those people through bonds or conditions.<sup>126</sup> In addition, Dobell considers traditional issues would also play a factor in ensuring Pacific islanders return to their home country. For example, many Melanesians would be reluctant to spend too long away from home for fear of losing their traditional land right claims. A further incentive for Pacific island governments to manage the return of those in the scheme would be to control the problems of 'brain drain' and loss of expertise (see Chapter Four).<sup>127</sup>

3.143 The Committee received several submissions from enterprises in Australia and PNG requesting the Committee seriously consider such a scheme and providing models from which to develop such a scheme.<sup>128</sup> For example, the Queensland Fruit and Vegetable Growers (QFVG) advised the Committee that horticulture, a labour intensive industry, is Queensland's second largest primary industry, worth more than \$1.3 billion. The industry has a sense of frustration over the difficulty seeking sufficient numbers of workers at harvest time and labour shortages throughout the industry lead to losses of produce across various commodities.<sup>129</sup> The QFVG stated that through the development of employment links, there is potential to both improve the reliability of labour availability for horticulture producers, as well as provide

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125 In evidence to the Committee, Professor McCall argued that overwhelmingly, the experience of Samoans is that their actual economic benefits, the economic changes in Samoa, have been directed not through aid, not through economic development as normally defined, but through what Professor McCall would call the private sector—remittances and migration. See, *Committee Hansard*, 18 October 2002, p. 29 (McCall)

126 See *Submission 62*, p. 14 (Mr Graeme Dobell). See also, *Submission 66*, p. 20 (Dr Jo Herlihy)

127 *Submission 62*, p. 14 (Mr Graeme Dobell)

128 See for example, *Submission 70* (Mr Ian Nielsen); *Submission 74* (Keeper Corp Limited); *Submission 83* (Queensland Fruit & Vegetable Growers); and *Committee Hansard*, 18 October 2002, pp. 28–29 (Piper)

129 *Submission 83*, pp. 1–2 (Queensland Fruit & Vegetable Growers)

training (and knowledge transfer) together with a direct injection of income, on a commercial rather than aid basis to the economies of PNG and the Pacific.<sup>130</sup>

3.144 The QFVG supports measures such as the National Harvest Labour and Information Service<sup>131</sup> which provides travellers seeking employment in the industry with links to seasonal work but growers from across a number of commodities have indicated their interest in organised recruitment of workers from PNG and the Pacific, which they view as likely to be more reliable than depending solely on itinerant workers and backpackers. However, the QFVG also stated that, for the proposal to be effective, there would also need to be a consistent training program to encourage workers to stay long enough to obtain formal skills that can be utilised when they return to their country of origin but this could be achieved through vocational and on-site training either in Australia or in the workers' country of origin.<sup>132</sup>

3.145 This proposition was supported by Mr Ian Nielsen, owner and operator of a piggery and asparagus export business in Queensland. Mr Nielsen highlighted the effect of labour shortages for the Australian economy, stating that in the spring of 2002, as a consequence of not being able to find sufficient labour, he was unable to harvest approximately 30 per cent of his asparagus crop. Harvesting that crop could have yielded 150 tonnes of product worth approximately \$1,000,000 of which 75 per cent would have been exported.<sup>133</sup>

3.146 Similarly, Keeper Corp Limited outlined the benefits to both the Australian and PNG economies. Keeper Corp Limited, a Papua New Guinean company, also suggested that it could manage the recruitment of Papua New Guineans through a selection process, develop employment contracts with the Australian employers and as an incentive for the employee to return home, after the employees expenses were deducted for their stay in Australia, a lump sum would be paid to the employee in full upon return.<sup>134</sup>

3.147 Given the potential benefit to countries in the region of such a scheme, discussions of a possible model are continuous. In a supplementary submission, Mr Ian Nielsen stated that his group had had further discussions with the Government of PNG. Mr Nielsen stated that these discussions proposed that all potential workers would first be screened by the District Vocational Centres around PNG and that each worker would receive some initial training after the screening process. Workers would

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130 *Submission 83*, p. 1 (Queensland Fruit & Vegetable Growers). See also, *Submission 75*, p. 12 (Business Council of Papua New Guinea and Institute of National Affairs)

131 This service is part of the Department of Employment and Workplace Relations' Harvest Trail.

132 *Submission 83*, p. 2 (Queensland Fruit & Vegetable Growers)

133 *Submission 70*, p. 1 (Mr Ian Nielsen)

134 *Submission 74*, p. 3 (Keeper Corp Limited)

be selected from all over the country but primarily from the rural regions which most need economic development.<sup>135</sup>

3.148 Mr Nielsen explained that after the worker has completed their 6 months period of employment and returned to PNG, the Vocational Centres would then assist them to establish their own enterprise and help the rural regions become more self sufficient. In order to ensure that real benefits flow to the country from which the labour comes, Mr Nielsen also stated that he planned to provide advice to the PNG Government on how to develop new export markets for their agricultural commodities that are not currently being exported.<sup>136</sup>

3.149 The Committee also received evidence from the Australian Council of Trade Unions (ACTU) who are both supportive of such a proposal and have sought to develop a proposal in conjunction with the Fiji–Australia Foundation:

The ACTU is currently in preliminary and very initial discussions with the Fiji–Australia Foundation involving a pilot project bringing into Australia on short-term contracts, workers from Fiji to assist in harvesting fruit and vegetable crops. The proposal is with the appropriate employer organisations prior to discussion with the Australian Government.<sup>137</sup>

3.150 Pacific island governments also raised this issue with the Committee whilst travelling in the region and the government of Tonga has formally raised the issue with the Australian Government. However, as the type of work usually envisaged under such a scheme is seasonal work in labouring and agricultural sectors, DIMIA advised the Committee that it responds to these calls by affirming that Australia does not have such a scheme and does not support any type of guest worker scheme.<sup>138</sup> This is because these sectors have the highest domestic unemployment rate of any occupation group at over 10 per cent, well above the overall national rate. Therefore, given the relatively high rate of unemployment amongst low skill people in Australia, successive Australian Governments have resisted the introduction of low-skill guest worker schemes.<sup>139</sup> Whilst this may be the case, this is in contrast to the industry groups above which outline the difficulties in obtaining labour.

3.151 DIMIA referred to the experience of other countries which suggests that low-skill guest worker schemes fail to provide long-term benefits for either sending or receiving countries:

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135 *Submission 70A*, p. 1 (Mr Ian Nielsen)

136 *Submission 70A*, p. 1 (Mr Ian Nielsen)

137 *Submission 22A*, p. 6 (Australian Council of Trade Unions (ACTU))

138 *Submission 44*, p. 21 (DIMIA). See also, *Submission 66*, pp. 19–20 (Dr Jo Herlihy). Dr Herlihy suggests one model may be similar to Australia's working holiday scheme or alternatively, a separate Pacific 'work experience' scheme as part of the aid program.

139 *Submission 44*, p. 21 (DIMIA). See also, *Committee Hansard*, 27 March 2003, pp. 368–369 (DIMIA)

While the temporary entry of unskilled guest workers may be seen to provide a short-term economic benefit by meeting labour needs during exceptional peaks in demand, long-term use may have undesirable consequences for receiving countries. Some of those issues include a structural dependence on foreign labour; removing incentives for rationalisation and technological change; and postponing improvements in education and training. Semi and unskilled guest workers are also open to exploitation and abuse.<sup>140</sup>

3.152 DIMIA also referred to the potential expense of regulation with overstay and non-return rates:

Very strong regulation and enforcement would be needed. Our suspicion is that that would be quite expensive. Overstay issues associated with low-skilled guest worker schemes also cannot be underestimated, given the experience in other places. It is certainly true that overstay rates, non-return rates and the rates of protection visa applications from visitors from the South Pacific are quite high. They would be amongst the factors that we would need to take into account in considering any guest worker scheme proposals.<sup>141</sup>

3.153 Emeritus Professor Helen Hughes also acknowledged that emigration to Australia would increase remittances to the Pacific and create savings and skills that would start business as some migrants return. However, Professor Hughes supports DIMIA's view that access to Australian labour markets should be under the same conditions as other immigrants to avoid the creation of "welfare dependent ghettos of Pacific immigrants in Australian cities".<sup>142</sup> Professor Hughes argues that present trends show that Pacific islanders are no less able to migrate than people from other countries and it is highly paternal to argue that they require special immigration conditions.<sup>143</sup>

3.154 The Committee notes that there are also reciprocal considerations that arise. For example, the Committee became aware that it can sometimes be difficult for Australians to conduct business effectively in the region. A visa for business purposes is generally only granted for 14 days in Fiji. At times, this length of stay is not long enough for business interests. However, if travelling to Fiji as a tourist, a visa can be granted for up to 3 months. The Committee believes consideration should also be given to reconciling these distinctions with the desire for better commercial engagement.

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140 *Submission 44*, p. 21 (DIMIA). See also, Professor Helen Hughes, "Helping the Islands to help themselves", *Quadrant*, vol. 47 (7-8), pp. 47-49.

141 *Committee Hansard*, 27 March 2003, p. 369 (DIMIA)

142 *Submission 61*, p. 3 (Hughes). See also *Committee Hansard*, 28 March 2003, pp. 445-446 (Hughes)

143 Professor Helen Hughes, "Helping the Islands to help themselves", *Quadrant*, vol. 47 (7-8), pp. 47-49.



3.155 One submission noted that such a scheme may benefit Polynesian countries but would be unlikely to offer significant benefits to Melanesians who have much stronger ties to their land and are less interested in migration. Formal exchanges for work experience were suggested to be more beneficial for Australia and Pacific countries.<sup>144</sup>

3.156 Dr Jo Herlihy advised the Committee that in addition to the economic benefits, such a scheme would have symbolic and practical flow-on effects. For example, such a scheme would be a highly visible sign that Australia's relationship with the Pacific was changing; a greatly improved flow of information and intelligence relevant to Australia's interests in the region; and a reduction in many of the current constraints on greater Australian involvement in the Pacific.<sup>145</sup>

3.157 Similarly, the Business Councils stated that benefits to Australia would include the generation of enormous goodwill in the countries concerned and in support of industry groups above, such labour might even fill a gap in the Australian labour market.<sup>146</sup>

## Conclusion

3.158 The Committee is persuaded by the arguments for the development and trial of such a scheme and supports the findings of earlier inquiries. The Committee supports the Government's non-discriminatory immigration policy. However, the Committee also believes that such a scheme has the potential to provide meaningful and significant income and assistance to PNG and Pacific island countries at the same time as being of benefit to the Australian economy. The Committee considers that such a scheme supports Australia's national interest in so far as it would contribute to the sustainable economic and social development of the region, contributing to stability.

3.159 The Committee is not suggesting that Australia should immediately open up its labour market to the Pacific. Rather, the Committee is suggesting that a pilot model be developed in conjunction with Australian business and the ACTU that takes into consideration the intention of the scheme. That is, a model be developed that addresses the concerns of industry groups outlined above which makes available labour for seasonal work, the provision of training and knowledge to the labour employed through the scheme to ensure a transfer of skills, and arrangements for remuneration be thoroughly considered to ensure that these workers are not the subject

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144 See *Submission 77*, pp. 8–9 (Mr Bob McKillop)

145 *Submission 66*, p. 20 (Dr Jo Herlihy)

146 *Submission 15*, p. 15 (Australia Fiji Business Council, Australia Pacific Islands Business Council and Australia Papua New Guinea Business Council)

of systematic exploitation. It may also be possible for such a scheme to be developed in conjunction with the Government's current 'Harvest Trail' scheme.<sup>147</sup>

3.160 The Committee notes the Government's concerns in relation to overstayers. However, the Committee also believes that the number of overstayers is less likely to be a concern if the program does not limit the ability of workers to return to Australia on a yearly basis provided they are selected through the selection process. The Committee also sees merit in the management, organisation and responsibility of the scheme being performed in large part by the country from which the labour is being sourced. This would also reduce the cost to Australia of any additional regulation.

3.161 The Committee suggests that once a sufficient model is developed, a pilot be conducted initially for the smaller island countries that stand to benefit most from the income. The successful trial of the pilot could see the scheme expanded to include labour from other countries.

#### **Recommendation 10**

The Committee recommends the Australia Government support Australian industry groups, State governments, unions, Non-Government Organisations and regional governments to develop a pilot program to allow for labour to be sourced from the region for seasonal work in Australia.

#### **Recommendation 11**

The Committee also recommends that the model developed provide for management and organisational arrangements to be the responsibility of the source country and adequate mechanisms to be in place for training and the transfer of skills.

### ***'Dollarisation' and a 'Pacific Economic and Political Community'***

3.162 Given the vulnerability of many of the Pacific island countries to supply shocks such as bad weather and crop failure, foreign demand shocks and political instability, many of these countries are then also susceptible to pressure on foreign exchange reserves and currency values. These factors have given rise to the argument that many of the countries in the region would benefit from adopting another country's currency as their own—'dollarisation'.<sup>148</sup>

3.163 Gordon de Brouwer explains 'dollarisation' to mean that a country officially uses the currency of another country as its own. De Brouwer states that under

147 The Harvest Trail scheme puts job seekers in touch with primarily fruit-growers that require seasonal labour. The scheme is operating through Job Search.

148 Gordon de Brouwer, "Should Pacific island nations adopt the Australian dollar?", *Pacific Economic Bulletin*, vol. 15(2), 2000, p. 161. See also, Ron Duncan, "Dollarising the Solomon Islands Economy", *Pacific Economic Bulletin*, vol. 17(2), 2002, pp. 145–146; and Ron Duncan and Xinpeng Xu, "Should Papua New Guinea Adopt a Stronger Exchange Rate Regime?" *Pacific Economic Bulletin*, 15(2), 2000, pp. 36–45.

'dollarisation', the country's exchange rate is permanently fixed to that of the other country and it is seen as the most credible of fixed exchange rate systems.<sup>149</sup> In the case of the Pacific island countries, given the economic importance of Australia to these countries and the size of the Australian dollar market, the Australian dollar is considered the most suitable.<sup>150</sup>

3.164 The key conditions required for countries to use the same currency are that their economies need to be similar in structure in relation to trade, industry and financial development, as well as policy structures including the need for some form of fiscal transfer to redistribute or compensate for differences in unemployment between countries in a common currency bloc.<sup>151</sup>

3.165 De Brouwer also notes that the more mobile labour is within a region, and the less mobile it is between regions, the more appropriate it is to fix the exchange rate and adopt a common currency within the region.<sup>152</sup> Arguably, labour is not currently sufficiently mobile within the region and when considering the above criteria together with price flexibility,<sup>153</sup> de Brouwer notes that the argument that Pacific island nations should use the Australian dollar looks mixed:

The Australian economy is much more diverse than Pacific island economies, there are no formal fiscal transfer arrangements between these nations and Australia—and no likelihood of them—and none of these countries has free labour mobility with Australia. Moreover, real effective exchange rates of these countries diverge substantially from each other at times. Real exchange rates are endogenous prices and the outcome of the structure of the economy and the set of domestic and foreign shocks that affect it, and so one would expect that the real exchange rates of countries that have similar structures and experience similar shocks would have common trends. But they do not.<sup>154</sup>

3.166 However, de Brouwer explains that the differences are over-stated and while the Australian economy is more diverse, it is the economy of most importance to the Pacific island nations with strong trade flows, substantial aid flows from Australia and as the Australian dollar has historically tended to depreciate when agricultural and

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149 Gordon de Brouwer, 'Currency and Monetary Arrangements for East Timor', in *Worlds Newest Nation*, Institute of Southeast Asian Studies, Mal Hill & João M. Saldanha eds., (2001), p. 43.

150 Gordon de Brouwer, "Should Pacific island nations adopt the Australian dollar?", *Pacific Economic Bulletin*, vol. 15, No. 2, 2000, p. 161.

151 Gordon de Brouwer, "Should Pacific island nations adopt the Australian dollar?", *Pacific Economic Bulletin*, vol. 15(2), 2000, p. 162.

152 Gordon de Brouwer, "Should Pacific island nations adopt the Australian dollar?", *Pacific Economic Bulletin*, vol. 15(2), 2000, p. 162.

153 Without price flexibility, dollarisation could worsen a recessionary impact of a large adverse macroeconomic shock.

154 Gordon de Brouwer, "Should Pacific island nations adopt the Australian dollar?", *Pacific Economic Bulletin*, vol. 15(2), 2000, p. 163.

resource commodity prices fall (thereby stabilising the economy), to the extent that the prices of individual commodities move with commodity prices in aggregate, fixing to the Australian dollar would provide similar insulating properties.<sup>155</sup>

3.167 In the case of the Solomon Islands, Professor Ron Duncan argues that the benefits to adopting the Australian dollar include a reduction in the currency risks facing investors, reduction in inflation and interest rate risks and the saving of costs of running a Central Bank as the government would no longer have an independent monetary policy (removing one area of policy indiscipline from the government's hands).<sup>156</sup> Professor Duncan acknowledges that fiscal indiscipline could still lead to capital flight and interest rate rises but the government would not be able to print money to fund the deficit, it would need to issue bonds for this purpose which would still provide some discipline over its fiscal performance. Given the current state of the Solomon Islands economy and the very weak Solomon Islands dollar, this may be an option worthy of consideration for the Government, similar to arrangements made in East Timor during the recovery phase. However, 'dollarisation' will not prevent investors leaving a country from political crises.

3.168 However, similar to de Brouwer's conditions, Professor Duncan notes that critical in the adoption of a common currency is that the countries sharing the currency should share the same external shocks and nominal wages should be flexible, especially downwards, in order for the economy to adjust to shocks that the common currency does not adjust to otherwise, all the adjustment has to be through unemployment.<sup>157</sup>

3.169 Potential disadvantages to 'dollarisation' include:

- Authorities cannot bail out banks unless there is the necessary excess of foreign exchange reserves;
- Authorities lose seignorage which is the revenue earned by making currency which could be a significant loss to the budget (although this may not be a problem if a transfer of seignorage is negotiated); and
- It may be interpreted as a loss of sovereignty.<sup>158</sup>

3.170 In any consideration of a move toward 'dollarisation', it is also important to note that once adopted, it is difficult to reverse. Any reversal would be expensive and potentially create financial chaos.

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155 Gordon de Brouwer, "Should Pacific island nations adopt the Australian dollar?", *Pacific Economic Bulletin*, vol. 15(2), 2000, pp. 163–164.

156 Ron Duncan, "Dollarising the Solomon Islands Economy", *Pacific Economic Bulletin*, vol. 17(2), 2002, pp. 145–146.

157 Ron Duncan, "Dollarising the Solomon Islands Economy", *Pacific Economic Bulletin*, vol. 17(2), 2002, p. 146.

158 Gordon de Brouwer, 'Currency and Monetary Arrangements for East Timor', in *Worlds Newest Nation*, Institute of Southeast Asian Studies, Mal Hill & João M. Saldanha eds., (2001), pp. 44–45.

3.171 The suggestion of the development of a 'Pacific Economic and Political Community' is along similar lines to the arrangement for the European Union. Whilst the Committee did not receive specific evidence on the advantages or disadvantages of the development of such a community in the Pacific region, the Committee suspects that many of the same conditions necessary for 'dollarisation' would apply to the establishment of an economic community. That is, economies would need to be similar in structure in relation to trade, industry and financial development, together with capital and labour mobility. The Committee has outlined a proposal for further consideration of a Pacific Economic and Political Community in Chapter One.

### **Implications for Australia**

3.172 The Committee acknowledges that in and of themselves, neither 'dollarisation' nor a 'Pacific Economic Community' will create economic development. However, there are potential benefits for the region and therefore, should be a consideration in the medium–long term future of the region.

3.173 Whilst the Committee has made recommendations in relation to labour mobility for the purpose of seasonal work in the agriculture sector, the Committee does not seek to impose the possibility of 'dollarisation' or the development of a 'Pacific Economic and Political Community' on the region. However, if PNG and Pacific island countries see benefit to their economies and their overall economic development by adopting the Australian dollar or using the potential for an integrated region as an incentive to reform and address the necessary structural and other issues, the Committee believes the Australian Government should not discourage this. In this regard, the Committee notes the comments of Mr Mike Moore, former New Zealand Prime Minister and former Director-General of the WTO:

Studies show that countries preparing for entry to the E.U. and the WTO do better than those without such objectives. The economic discipline brings with it growth, social progress and better governance.<sup>159</sup>

3.174 The Committee considers its proposal for a 'Pacific Economic and Political Community' as outlined in Chapter One as having the potential to underpin Pacific stability over the longer term.

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159 See Elizabeth Feizkhah, "Hands Across the Water", *Time*, 7 July 2003, p. 31.

