

FORUM ISLAND COUNTRIES AND THE SINGLE EUROPEAN MARKET 1992

A Study for the

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PART 1

EXECUTIVE SUMMARY

1. This study explores the effects on the Forum Island Countries (FIC)s, in particular on Fiji, Western Samoa, Papua New Guinea (PNG), the Solomon Islands and Vanuatu, of the introduction of the Single European Market (SEM). The SEM was launched in 1985 as a way of re-establishing the original goals of the founders of the European Economic Community (EC) set out in the Treaty of Rome, signed in 1957. The SEM is aimed at the removal of remaining barriers to trade among the 12 member countries of the European Community (EC).
2. SEM was conceived and launched because of a recognition by the European Commission that something had to be done to, renew the impetus towards European integration, the goal of the Treaty of Rome; to jolt European economies from their lethargy; and to make them more competitive in the face of the economic challenges from Japan and South east Asia. The SEM is but one of many changes in the relations between Europe and the countries of the Pacific. Political Independence, largely achieved by the 1970s was the first step towards developing modern nations in the Pacific. However, most of the FICs now find themselves as much, if not more dependent on concessional access to European markets and the distributions of European aid and grant monies.
3. Analysis of the major export products from the FICs indicates that the actual SEM process will make little immediate impact, although it will create opportunities in the future. Most of the exports from the FICs to Europe are governed by the Treaty between Europe and the African, Caribbean and Pacific (ACP) states, called the Lome Convention. The SEM is a significant step, but it is only one of many changes that are occurring in Europe in a very brief space of time. Other changes include the political and economic absorption of the countries of Eastern Europe, changes to the Common Agricultural Policy (CAP) and the move to integrate the European Community (EC) and the European Free Trade Area (EFTA). Together they will significantly alter the structure of European Economies. Reforms in the European Agricultural support policies, in particular, will erode the margin of preference gained by Pacific ACP states but also create opportunities by expanding world trade in agricultural products.
4. Taking advantage of these opportunities will demand substantial modification of the post independence practices adopted in FICs. It will require the FIC economies to adopt as a primary goal of economic policy making their economies internationally competitive, so that they may be integrated into the economic activity of their region and compete more strongly on European niche markets. This will require dramatic cost reductions as they affect they key industries of the region, particularly agriculture. Policy must aim to enhance the potential for normal profitable multilateral trading relations to provide improvements in average living standards. As the major benefit of the SEM in the Pacific could come from the increased wealth and competitiveness of the European Market, a more competitive Pacific could lead to an increase in the demand, and better prices for certain commodity exports, for easier access to Europe for value added consumer products and for greater use of services like tourism.
5. European tourism is a growing source of tourists to the South Pacific, although still dwarfed by Australia and New Zealand as markets. In the areas of financial and other

professional services, the exploitation of tax free status and time zone differences have enormous potential that has only just begun to be appreciated. While offering a greater potential for trade with Europe these policies are likely to reinforce the shift that has taken place away from Europe and even Australia and New Zealand. Increasingly the focus of economic activity will move towards the faster growing economies of Japan, China and South East Asia as outlets for trade, tourism and services and as sources of consumer goods, technology and even aid.

6. Most of the FICs are seeing a diversification from agriculture and fishing into services, such as tourism, and small scale manufacturing. While the developments in the more recent activities offer great promise they should not overshadow the importance of the fundamental realities of these societies. It is in adding value to the commodities that are the basic strengths of their economies that viable future commercial relations with Europe will develop. A growing problem is the cumulative effect of the declining standards of husbandry in primary industries. Agriculture is their most important source of employment and economic activity and will remain so. There will need to be changes in policies to permit it to achieve its full potential. It will only happen if FIC products can regain international competitiveness by overcoming both the traditional handicaps and man made handicaps of more recent origin.
7. Traditional handicaps include the problems of isolation, distance, communications and small populations. The more recent problems include high cost structures, inadequate maintenance of physical capital, inappropriate institutional structures, a lack of sophistication in marketing, product development and inadequate investment in human capital. Just as agriculture's problems are of recent origin so are some of the solutions. Reforms to the management of shipping services and modern communications are rapidly overcoming handicaps of distance and communications, and access to education. A more entrepreneurial culture will help overcome the problems of small populations and small total output.
8. There will need to be improvements in the infrastructure of several economies to take full advantage of modern methods, both in price reductions and improved technology. These will demand and assist a greater focus on the development of the human capital of the region and the maintenance of physical capital. There will need to be an improvement in the standards and the professionalism in the manufacture, presentation and marking of goods that can only come about if accompanied by a liberalisation of imports to assist the creation of a more discerning local consumer market. There will need to be a review of institutional structures, including a search for models more appropriate than those copied from Australia and New Zealand, the least dynamic Pacific economies. They are now in the process of discarding many of the structures that were copied by the FICs in the '70s and '80s and the appropriateness of these models needs urgent questioning.
9. At present the FIC economies are very much in the "eye of the cyclone"¹ of economic development taking place on the Pacific rim, surrounded by developments of gigantic proportions, but little affected by them. Most of their trade has been with the slow growth economies of Australia and New Zealand. Except for the extent to which they are funded from outside, the capacity of FICs to earn income currently delivers their people low standards of living. Fiji has begun to make the break towards becoming a self-sustaining developing economy. It is doing that by integrating itself into the developments around the Pacific Rim, including but not exclusively greater integration

¹ HE Henri Jacolin, French Ambassador to Fiji, 13th August, 1992

with Australia and New Zealand. The next few years will show whether this policy will succeed or whether the economy will slip backwards.

10. All available advice is encouraging the other island economies to follow a similar pattern of development. In this context the SEM will be a phase that will bring short term costs and long term gains. In the context of achieving self-sustaining development for the FICs, the successful conclusion of the GATT round, the reform of the CAP and the successful integration of the French Pacific Territories into the Pacific Economy will have greater long term significance. The potential that these developments offer will be realised only if policy decisions are made that will allow opportunities to be exploited.

PART 2

FOCUS ON EUROPE

11. It is appropriate that leaders of the Pacific Forum (PF)² should focus their attention on the events in Europe, in particular the formation of the SEM. This study attempts to achieve that goal and explores at some length the policy options necessary to place the FICs in a position to take advantage of developments in Europe.
12. All of the FICs are politically independent, and are in the middle of the region with the world's most dynamic burst of economic growth. While by 1997 the European Community will still be expanding, and gaining new members, the fastest growing economies will still be those of Japan and ASEAN/Taiwan.³ Despite this strategic location FIC economies are largely unaffected by the growth that is taking place around them. Economic policies that have been followed since independence were largely those copied from former colonial administrations and adapted from those in place in Australia and New Zealand. This curious mixture of economic statism and governmental tinkering has made their economic focus peculiarly inward looking and undesirably protectionist in their instincts. It has also meant that the FICs are now as if not more dependent upon aid and concessional access for their exports to Europe, than they were at independence.
13. This fact can be seen in the very high proportions of the Gross Domestic Product (GDP) which is accounted for by Overseas Development Aid (ODA).⁴ These figures show that the Solomon Islands increased their dependence on ODA from 25% in 1979 to 33% in 1988. Vanuatu and Samoa's dependence on aid remained about the same. In Kiribati, which is not the focus of this study the dependence increased from 21.4% to 48.9% between 1979 and 1988. Even these figures understate the case, because Fiji, which has been the smallest recipient of ODA, has nevertheless enjoyed a market price for its sugar exports, three times that it would receive from the World Market, thanks to the transitional arrangements negotiated when Britain joined the EC.
14. While this situation may have attractions for some, as a long term strategy it is risky. The SEM can be interpreted as another stage in the integration of the economies of the members of the EC with each other. Other moves underway at the same time, including the reforms to the CAP, the integration of the EFTA nations with the EC and the Uruguay Round, will all have the effect of a better integration of Europe into the World Economy. As that takes place the value of the concessional trade access that Europe offers is likely to reduce and the support for current levels of ODA within Europe is likely to at best remain the same as it is now.

WHAT IS THE SINGLE EUROPEAN MARKET?

15. During the 1970's the process of European integration was widely perceived to have stalled. This coincided with a growing awareness of the trading challenge presented by

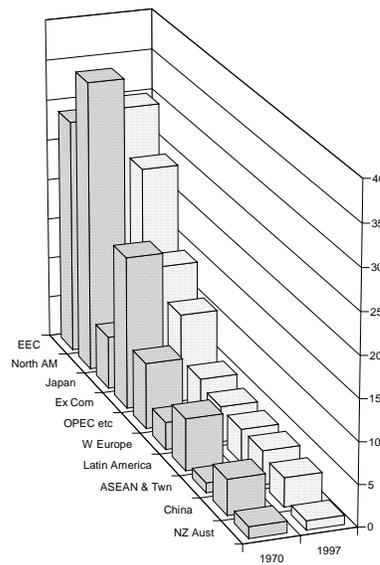
² For a complete list of the membership of the regional organisations see Appendix 1

³ See Chart 1

⁴ See Chart 2

CHART 1

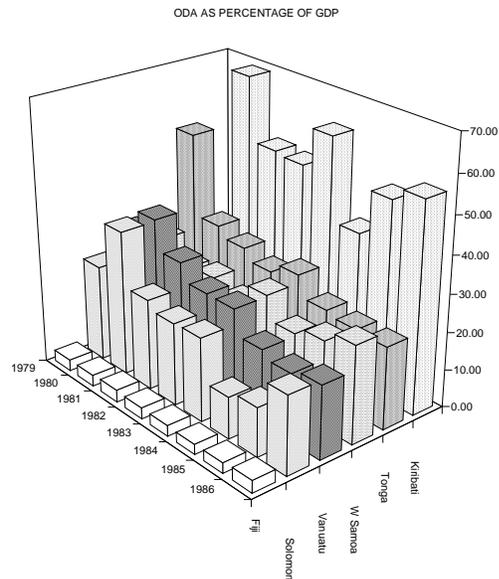
SHARES IN GLOBAL GDP 1970-1997



Source: WEFA, Quoted Caragatta, Dr P, Australian Tax Research Foundation
Conference Sydney Australia, 10th June 1992

CHART 2

FIC DEPENDENCE ON ODA AS % GDP



Source: Toward Higher Growth in Pacific Island Economies: Lessons from the 1980's, The World Bank, Report No, 9059-ASIA, P 76

the resurgent economy of Japan and the rapidly growing "Dragon" economies of South East Asia. Europe's economies were, by contrast, characterised by sluggish growth, high unemployment and a declining heavy industrial sector. In key areas such as electronics Europe was lagging behind the achievements of America and Japan.

EC SINGLE MARKET MEASURES⁵

TABLE 1

SECTOR				
IMPACT	MERCHANDISE TRADE	SERVICES	LABOUR	CAPITAL
	Abolition of frontier measures	Mutual recognition, harmonisation in financial services	Remove Frontier Checks	Abolition of Exchange Controls
	Abolition of frontier controls	Weakening of bilateral restrictions on transport	Remove residence requirements	Migration of firms
	Harmonisation of standards	Harmonisation of standards		Admission of securities
	Harmonisation of indirect taxes			
MARKET EFFICIENCY	Open up public sector procurement	Open up public sector procurement	Harmonisation of training provisions	Elimination of Double taxation
	Harmonisation on intellectual property rights	Harmonisation of pro-competition policy	Mutual Recognition of professional qualifications	Compatible company statutes and bankruptcy provisions
	Evening out industrial support		Double taxation agreements	Competition policy

16. "Globalisation" of enterprise, which to most countries was assuming a truly global dimension, in Europe had proceeded little further than the concept of joint ventures between European firms in competition with the Americans and the Japanese. Despite the earlier plans for the removal of customs duties and quotas, barriers to free movement remained. Business from one European Country to another still involved barriers such as passport controls and frontier checks, technical impediments, such as differences in electrical appliances' specifications, different technical standards, and financial barriers, like differing rates for Value Added Taxes and impediments to the free movement of capital.

SINGLE EUROPEAN ACT

17. In March 1985, the President of the European Commission, put to the European Parliament the idea of the single market programme, to remove many of these barriers to trade and competition and to promote the economic revival of Europe. Accordingly, an action programme, incorporated in the "Single European Act" (SEA) was presented to the European Parliament in February 1987. It sought to create a common economic and social area, creating the conditions for stronger economic growth, concerted action on

⁵ "Implications of the Single European Act for Non-Member Countries", UN DESD, Journal of Development Planning, No 21.1992, P. 51

foreign affairs and adapting the CAP and placing the finances of the community on a stronger, sounder footing, The Single Act came into force on 1st July 1987.

18. The SEA sought to remove barriers to economic activity in three areas: Physical (Merchandise trade and labour), Technical (particularly in respect of services) and Fiscal (largely on the movement of capital and taxation). The elimination of physical barriers involved getting rid of real obstacles such as passport control, immigration declarations and customs checks at political frontiers. These controls often stem from outdated national regulations and in many cases serve no useful purpose. In future system checks will only be performed at the Community's frontiers with third countries. In other words for third countries the big advantage of the SEM is the potential it offers for transparency, once a technical requirement is satisfied in one jurisdiction it must be accepted by all of the other European jurisdictions.
19. Technical requirements will no longer be able to be used as effective barriers to trade between European states and requirements satisfied by third countries in one European state will be accepted in the others⁶. Technical barriers to trade included a wide variety of different standards ranging from those for electrical appliances, to the varying national requirements for automobile safety. Reform of technical and bureaucratic procedures has included the removal of restrictions on the supply of services across EC frontiers. Previously it was difficult for transport companies to pick up and deliver loads in countries other than their own. Similarly, FIC exporters might successfully overcome health and quarantine certification in one country only to be faced with a different but no less onerous or costly set of requirements in a neighbouring country. Any restrictions on carriage have now been removed. Each country has undertaken to recognise the health and quarantine certification requirements of the others. This is the most important single change as far as FICs are concerned.
20. With the same objective, companies in one EC country can bid for government contracts in any other on an equal footing with that country's firms. This alone opens up a market equivalent to 15% of Community GDP to greater competition. In anticipation of the greater competition this will permit, there have been numerous mergers and strategic alliances formed across European borders and with companies from third countries. Greater competition will result in stronger incentives to improve efficiency and reduce prices.
21. The removal of fiscal barriers required a rethinking of the system of indirect taxes like value Added Taxes and Excise Duties. It was not possible to obtain full agreement on harmonisation of the VAT system. Different rates still apply in different countries and the extent of exemptions and zero ratings differ. However, agreements have been reached which are designed to gradually eliminate the differences by bringing divergent rates closer together. A significant achievement has been the abolition of frontier checks on VAT. In total the seven years since the strategy was launched more than 300 different obstacles to trade have been removed.

EFFECTS OF SEM

22. The Single European Act is due, with minor exceptions, to be fully effective on 31st December 1992. From the original time of passage of the Single European Act, Europe's trading partners have been following developments with a mixture of concern and relief

⁶ However, third countries shipping to several European Markets will still have to satisfy the authorities at EACH port of entry, the single market provisions will be of assistance only where a single port is used.

TABLE 2

ESTIMATES OF THE IMPACT OF THE SEM 1992
(based on 1987 Data, converted to \$US)

	EC imports from Idcs, US\$million	Ldc share of EC Imports %	EC imports as % of ldc exports	21. Changes in US\$ million	% Change
MERCHANDISE TRADE					
Creation of primary goods	79123	26.7	31.9	4190	5.30
Creation of manufactured goods	59595	7.8	21.5	5764	9.67
Sub Total					
LESS: Diversions of manufactured goods				-6046	
Plus Terms of trade impacts				953	
Sub Total	138718			4861	3.6
HORTICULTURAL AND FISHERY PRODUCTS:					
Member state quotas abolished	1747	na	na	455	26.0
TEXTILES					
Member state quotas abolished	13742	50.4	19.0	571	4.2
EXCISE TAXES					
Elimination of 5% VAT					
Coffee	6040	99.1	42.6	329	5.5
Cocoa	839	98.1	50.7	68	8.1
Tea	1894	100	68.6	-82	-4.3
OTHER TAXES					
Harmonisation					
Tobacco	2560	54.2	44.9	142	7.21
Bananas	2032	100	35.6	1595	78.5
SERVICES					
Trade Expansion Effects	29517	4.1	9.8	826	2.8
Price of EC services					
TOTALS	171566			8815	5.1

Source: Davenport & Page, P 6. Note the many limitation of this analysis which are mentioned and the cautions regarding data used. However, the value of the table stems from its illustration of the diverse, if overall favourable impact of 1992

depending on the specific decisions that have been made and how they affect the numerous groups of trading partners. At an early stage of the process the Europeans themselves sought to quantify the effects of the changes they were making. To allay some of these fears the European Commission published a quantitative assessment of the effects of Integration in the Cecchini Report of 1988. This was followed by a more comprehensive report entitled "Economies of 1992". These reports have in turn been

dissected by numerous commentators, including that of Davenport and Page⁷ that has been drawn upon extensively in the preparation of this report.

23. Most trading partners and regional trading organisations commenced work on the implications of 1992 SEM soon after the concept was mooted. For some regions the anticipated impact is so serious that comprehensive reports have been prepared by aid agencies.⁸ By contrast the Pacific Forum Countries have commissioned work on this subject relatively late in the SEM process and this reflects what will probably be a relatively speaking, much smaller impact upon their economies. Indeed it is considered by more recent commentators that many of the changes that will be brought about by the SEM are already in place and the principal task that lies ahead is the enactment and enforcement of laws already agreed to.⁹
24. The Cecchini Report was dismissive of the consequences of SEM 1992 for other countries. It described the impact of the SEM as "a much-needed shot in the arm for other markets and economies in less buoyant shape".¹⁰ The essence of the argument put forward is that because the SEM will create economic efficiencies within Europe and will increase competition this will increase average incomes in the 12 member countries and their demands for imports will increase. In other words as Europe becomes more prosperous it will demand more imports of goods and services, but this is not a uniform increase for all goods and all services. The responses are potentially complex and uneven.
25. Table 2 gives an early and rough set of estimates of the impact of 1992 on the trade between the EC and the so called Less Developed Countries (LDCs). It can be seen at once that the overall impact of 1992 is not large, a 5.14% increase in trade. Within this global figure there are large variations, from the 78.5% increase in the demand for bananas, to the -4.32% fall in the demand for tea. This is counteracted by 5.45% and 8.06% increases in the demand for coffee and cocoa respectively. This may be explained by substitution effects which will be examined more fully later. However, overall, the estimate reveals that the manufactured exports of the LDCs will benefit from an increase of 3.66%, textile exports would increase by 4.15% and horticultural and fishery products exports will increase by 26.04%. It must be stressed that these are not predictions of actual increases, nor are they applicable across each trading partner with the EC. They simply give, from the European perspective an indication of the impacts that could be expected. In practice it is likely that quite unrelated events would dramatically alter the picture both overall and as they apply to a particular trading partner.
26. It is in the opening up of government contracts that there will be important immediate impacts in the FICs. European goods, other than consumer goods have repeatedly lost markets in the FICs to cheaper goods of a similar or better quality from Japan and the Newly Industrialised Countries of Asia (NIC)s. With greater competition lower prices can be expected. These will make it easier for European producers to compete on their home market and will benefit consumers in the community. In third markets it will increase the competitiveness of the Community's exports and may reverse the loss of business to the NICs and Japan. For those FICs that currently receive aid that is tied to the purchase of goods in the European donor country, such as that through the French

⁷ "Europe: 1992 and the Developing World", Overseas Development Institute, 1991

⁸ Eg, "The European Communities' Single Market - The challenge for Sub-Saharan Africa", Alfred Toviás, The World Bank 1990.

⁹ "After 1992", The Economist, 26th September 1992, P.73

¹⁰ Cecchini Report, P XIX, quoted Davenport, P 2.

Caisse Central, it is implicit in the Treaty that goods from throughout Europe will now be eligible for purchase under tied aid, because discrimination will not be permitted between Treaty parties.

27. The reasons for caution are persuasive. Firstly, the internal gains and the external impacts of the Single Market depend on how the economies in Europe adapt to greater competition. Secondly, while agreements have been made by all the European countries, in many cases Parliaments have yet to adopt them into domestic law. Thirdly, the way the SEM is implemented depends to some extent on whether the enforcement mechanisms that have been provided for in the Maastricht, are actually agreed to by the Member States and whether they will be lost if that Treaty is not ratified. Fourthly, the success of the SEM, from the point of view of the Forum Island Countries and their competitors in the Third World, depends on their ability to take advantage of the liberalising provisions of the SEM in boosting their exports to Europe. Fifthly, despite the opening up of the European market it will still be necessary to MARKET products in each market. Each country will still have its own tastes and consumer preferences.
28. Last , but not leas, for the FICs, the Lome Convention, which is not part of the SEM process, is the Treaty that governs their ability to export to Europe. Other developments underway in Europe and through the Uruguay Round, will have far more influence on the future of the Lome Convention than the SEM as such.

WHAT ELSE IS HAPPENING IN EUROPE?

29. The imminent fully operational single market in Europe has opened up new prospects for the community including the possibility of greater economic and monetary union, seen by many as a natural complement to the implementation of the Single European Act. It is argued by the proponents of greater integration that the full economic and social benefits of integration will be enjoyed only when business, industry and citizens can use a common currency. In addition to act effectively in the political sphere, so that political influence matches economic power, it is believed that new institutional structures are required to complement greater integration in economic matters.
30. In 1988 the European Council instructed a committee to study and propose concrete steps that would lead towards a greater union. The Delors Report, presented one year later recommended a three stage plan for monetary union, and for greater powers for the central institutions of the Community to enforce the community's decisions in economic policy: Stage 1, would achieve greater convergence in economic performance through: increased coordination of economic and monetary policy and increased cooperation between central banks. Stage 2, Would be a transitional and learning phase with the establishment of a European Central Banking system, but the final responsibility for economic and monetary policy would still lie with the member states.
31. Stage 3, would see three changes: permanent fixed exchange rates, monetary and economic powers would be handed to the Community and national currencies would be replaced with a Single European Currency. On the basis of this report, The European Council decided one year later to launch the first stage of economic and monetary union on 1st July 1990 and to prepare the necessary Treaty amendments for the second and third stages. This work came together on the 7th of February 1992 when the Foreign and Finance Ministers of the Member Countries signed a Treaty embodying the principles suggested by the Delors report, in the Dutch town of Maastricht.

32. However, several countries have resolved that such fundamental changes in their economies and the powers of their national governments cannot occur without a referendum being held among their people. The Danes were the first country to hold such a referendum, which saw a narrow majority voting against the Treaty's provisions and following that the Irish and French, (albeit very narrowly) voted in favour. Concern about the possibly of a stalled process of capital market integration was one of the factors leading to the crisis in the European Monetary system in September 1992. With the process of greater economic coordination, sometimes called a "deeper union", facing new hurdles, the attention of many Europeans has turned to the widening of the community's membership, the so called "wider union".
33. Some Europeans who believe the visions of a Federal Europe to be impractical welcome new members as a way of demonstrating that impracticality, and making even less likely to come to fruition. Even convinced pro-Europeans believe that a focus on freer trade, in a single market, among wider membership will bring the best results sooner, rather than putting all of Europe's efforts into the more difficult path of Federalism.¹¹ Despite all the work that has been undertaken so far, much remains to be done to complete the work involved in the SEM.

COMPLETION OF THE SEM

34. The crucial test for the SEM will not be the passage of resolutions at the international level nor will it be the passage of legislation through the national parliaments, it will be the implementation.¹² About 175 measures need to be passed through national Parliaments in order to give effect to the SEM. By September 1992, from 150, (in Denmark), to 104, (in Belgium) measures had been passed by national parliaments. As the target date for the remainder to be completed is December 1992, this represents commendable progress, although some members may be late in a relatively small number of areas.
35. However, the key test for the efficient functioning of the Community is the determination of the respective national governments to live up to the laws on their statute books and to observe the directives issued by the Commission. It has already become involved in numerous disputes with national governments that respond to domestic political pressures by paying subsidies to ailing industries in violation of the directives on competition. The scope to cheating is very great, and many of the powers that were devised to give the European institutions the power to hold violators to account, were contained in the Maastricht Treaty and if that falls by the wayside only the European Court is available to obtain satisfaction. At the end of 1991 there remained 105 Court rulings that were not being applied by the governments against which they had been made. Italy was the worst offender and Denmark the least culpable.
36. There is also a fear that new environmental laws will be used to create barriers to competition. Not all Environmental concerns are spurious. The Solomon Islands have encountered some environmental concerns already in their timber trade with Europe and some of the issues addressed could be helpful. The key issue is to dovetail community directives designed to free up market, with national laws aimed at improving safety and the environment. One of the means by which the proponents of Maastricht have sought to sell the concept of deeper union is by stressing the "subsidiarity" concept: the primacy

¹¹ See "The European Community", *The Economist*, July 11th, 1992, opposite P. 52

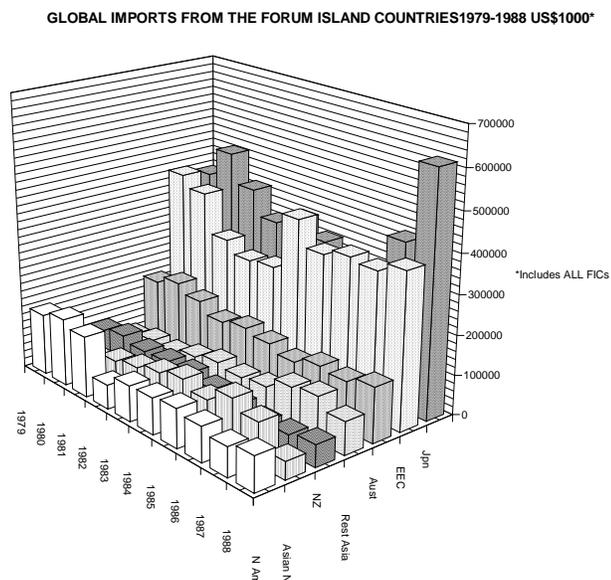
¹² See "After 1992", *The Economist*, September 26th, 1992, P. 73

of national laws in appropriate areas. This is a difficult concept to reconcile with a Community-Wide policy of guaranteeing fair competition.

CHART 3

IMPORTANCE OF EUROPE TO THE FICS

GLOBAL IMPORTS FROM FORUM ISLAND COUNTRIES 1979-1988 US\$ 1000



Source: ANU Canberra Australia, See Appendix 4

PART 3

EUROPE AND THE SOUTH PACIFIC

37. The decisions of the Danish and French voters, and the impact on the German currency of the costs of German Unification has further complicated the prospects for European Union. However, interviews revealed that despite the huge distances between the FICs and Europe, and the wide gulf in cultures and size, it is widely appreciated that Europe remains very important to the Pacific as an outlet for exports and as a source of Development Assistance and Tourists. It is also appreciated that there is a great deal of potential yet to be realised and some keenness to use the opportunities that are likely to be created in following the successful completion of the SEM process.

TABLE 3

COMPARATIVE STATISTICS EUROPE/USA/JAPAN AND THE PACIFIC

	EC12	US	JAPAN	PACIFIC ACP*
Countries	12	1	1	8
Area-000s sqkm	2254.7	9372.7	378	527
Population	324.3 mil	245.9	122.4	4.6
GDP	4769.2	4847.3	2843.7	
GDP/per capita	14,685.51	19,678.21	23,192.56	726
Exports US\$ Bn	430.8	321.6	264.9	
Imports US\$ Bn	458.5	459.6	187.4	
ODA Bn US\$ Bn	21.6	10.1	9.1	NA
Net ODA/GDP%	.45	.21	.32	NA
ODA to Pacific	135.4@	150.1@**	142.3@	Recipients

Source DOTS 1989, IEC Social Indicators, The World Bank, Tovias 1990

* 1986 Figures, COMTRADE, Geneva

@ 1984-1988 Totals, Fiji, Kiribati, Solomon Islands, Tonga, Vanuatu and Western Samoa, ie excluding Papua New Guinea etc

@** A residual figure of which the contribution of the United States is the most significant.

38. Before any further expansion Europe is already the largest and one of the wealthiest trading blocks in the world.¹³ Europe has an area of 2254.7 million square kilometres, compared with 9372.7 in the USA and 378 in Japan. Its population is 324,3 million compared with the United States' 245.9 million, and Japan's 122.4 million. Gross Domestic Product per capita (GDP per capita)¹⁴ is the EC is US\$ 14,685.5 and that in the United States and Japan US\$ 19,678.21 and \$23,192.56 respectively. Total exports for the community are US\$430.8 billion and Imports are US\$485.5 billion. Already the Communities' population is much larger than that of the US or Japan (approximately 32% and 165% larger).
39. Enlarged by Norway and Austria the Community's population will be almost three times largest than that of Japan. Since these figures were taken out, countries as diverse as Switzerland, Sweden, Czechoslovakia and Finland have indicated interest in joining the Community before the year 2000. That would make Europe even larger and its markets potentially richer with more opportunities for niche suppliers. What seems to be minuscule in Europe is already a feast in the Pacific. SEM and the enlargement of the community will add to that potential.

¹³ See Chart 1

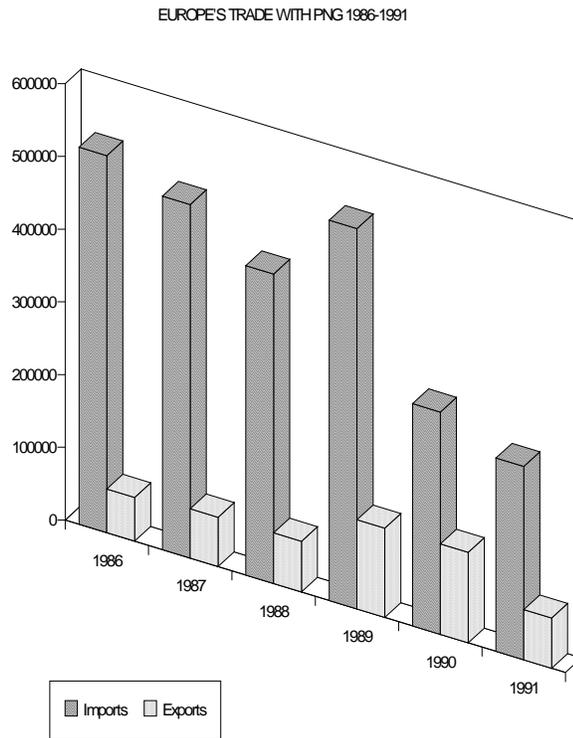
¹⁴ DOTS 1989; IEC Social Indicators, from Tovias

PACIFIC CONTRAST

40. By contrast to the vastness and wealth of Europe, the Islands of the Pacific Forum are some of the smallest communities in the world scattered over some of the largest distances and with some of the lowest capacities to earn incomes. There are 8 Pacific States covered by the ACP provisions of the Lome Convention. They have barely 5

million people, a land area of only 527 thousand square kilometres and are scattered through nearly twelve million square kilometres of ocean. They have shown little capacity for joint action on matters of common interest and many urgent changes to their infrastructure of institutions and business enterprises have been subject to extensive delays and obstructions that have their source in the desire of proud people to retain their independence of action and to enjoy the autonomy they won with their political independence.

Chart 4



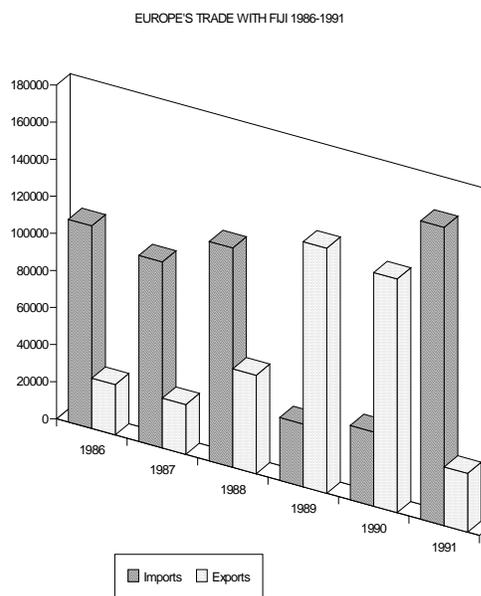
41. Europe remains important to the Pacific States as a source of aid, information and trade. The

significant development during the 1980s was the growth in the importance of Japan, and the other countries of Asia, as a destination for Exports from the Pacific. Between 1979 and 1988, (excluding the UK) Europe's share of exports from the Pacific fell from 33% to 21% between 1979 and 1982 but recovered to be 31% in 1988.¹⁵ More recent country data indicates this share is likely to continue to fall. The total value of exports to Europe has fallen at the same time, which suggest that increasingly the countries of the Pacific are finding markets in places other than Europe. Despite this declining trend some Pacific nations, particularly Fiji, are finding new markets in Europe for products as diverse as processed fish, clothing and feedstocks for pharmaceuticals.

Chart 5

¹⁵ "Forum Island Country Global Exports", Trade and Investment Division Forum Secretariat, 1991, Table 1, sourced ANU

42. Europe is also significant in the Pacific for the fact that its aid to the Third World is substantially larger than that from either the United States or Japan, notwithstanding the fact that living standards are on average higher in the latter two countries. The share of the EC in world ODA (average for 1986/87) was 35.8% compared to the United States' 20.1% and Japan's 13.3%. Even in the Pacific, notwithstanding the closer proximity of Japan and the USA, Europe is still a significant aid donor. For the years 1984-88 Europe's aid to the Pacific Countries that were members of the World Bank, was almost equivalent to that of Japan.¹⁶



TRADE WITH INDIVIDUAL COUNTRIES

43. The most outstanding characteristic of the trade between Europe and the Pacific during the last few years, is that it has consistently been in favour of the Pacific nations. Fiji (Chart 5) has consistently achieved a favourable balance, based on the Lome Convention access for its sugar crop. This favourable balance became negative in the immediate aftermath of the military coup, but with the introduction of the new market orientated economic policy it swung dramatically back into Fiji's favour. PNG trade's surplus with Europe (Chart 4) has been falling as the strength of the Kina has made its exports less competitive with those of competitor countries, however, its trade with Europe is still its fourth largest, behind Australia, Japan, and the Newly Industrialised Asian Countries (NIC)s. The Solomons are experiencing a rapid growth in exports to Europe based on the success of the Solomon Taiyo Limited Fishing venture and this will be augmented following the resumption of timber exports to Europe later this year.

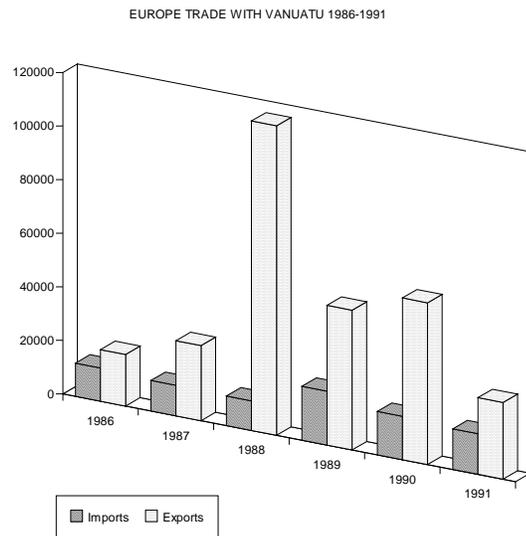
44. Vanuatu (Chart 6) has had a large trade deficit with Europe, with the demands of its Tourism Industry and its expatriate community for consumer goods far exceeding the capacity of the economy to export copra to Europe or to attract European tourists. Further development of a European Tourist trade is hampered by the lack of direct air routes and by the lack of market identification in the minds of the Europeans. To offset these problems, vigorous marketing in French Polynesia and New Caledonia is being tried with some success. Samoa, by contrast, is better endowed with Air Communications but by comparison, still has a rudimentary, but rapidly improving tourist industry. Despite that, when it has had a competitive exchange rate, it has usually managed a strong balance of payments surplus with Europe, until Cyclone Offa removed its capacity to generate exports and created a large demand for imports for reconstruction.

45. The Pacific then has an excellent base in Europe from which to build. Notwithstanding that much of the access to the European market has been traditional access from former

¹⁶ "Toward Higher Growth in Pacific Island Economies: Lessons from the 1980s", The World Bank, Report 9059-Asia, Volume 1 P. 77

Colonial Powers, and that it is facilitated by concessional access under Lome, it is a worthwhile beginning. For the FICs, the key question raised by the SEM is, has it changed the access to Europe that they have customarily enjoyed? Because of the importance of the Lome Convention to the FICs this will entail an analysis of the Convention and the advantages and disadvantages that it has conferred on the Pacific nations as well as the others of the ACP Group.

Chart 6



LOME CONVENTION

46. The Treaty of Rome had as its centrepiece the Common Agricultural Policy. For many Europeans, in particular French Farmers, it has often been alleged that the CAP, WAS the European Community, which perhaps accounts for its continuing popularity in that country. The CAP was designed to increase the production of food in Europe and to provide better living standards for European farmers by providing them with protection from competition. This was achieved by applying levies and quotas against food imports and by the administration of the

market in Europe to keep prices at levels that secured European farmers a good standard of living.

47. This administered price level was usually substantially above the World Price. Price support to European farmers cost the community's consumers and taxpayers about US\$98 billion in 1989.¹⁷ and this sum has increased rather than declined. It was recognised from the outset that this policy would have adverse cost impact on the exports of French Colonial Territories and other territories with long standing relationships with Europe. When Britain joined the community many of its former colonies came into this category too. A series of ad hoc arrangements had been entered into to limit the adverse impact on these former Colonial Territories. With the expansion of the Community the need to address the problem in a systematic fashion became urgent.

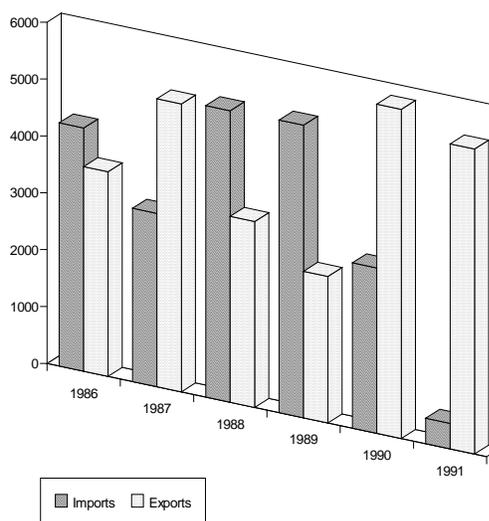
48. Accordingly, the Community sought to link the issues of aid and the costs imposed on developing countries by the high levels of protection afforded to European producers. An accommodation was negotiated and the *EEC-Africa, Caribbean and Pacific Convention*, was signed in the Togo Capital of Lome in 1974. This created a framework within which these exceptions to the provisions of the Common Agricultural Policy, for tropical and exotic products, could continue within a more consistent framework. It also created a structure within which the channelling of substantial sums of soft loans and aid to less developed societies could take place.

Chart 7

¹⁷ "Meeting the European Challenge", Holmes and Pearson, Institute of Policy Studies, P 78, quoting OECD, "Agricultural Policies etc, Outlook", 1990

49. The philosophy of the convention is summed up in Article 4. It commits the respective parties to the achievement of self-reliant and self-sustained development through the satisfaction of their basic needs. Under Article 168, products, which tend to be agricultural and tropical, originating in the ACP States,¹⁸ are allowed into Europe free of customs duties and charges having the effect of being duties. Under article 169 they are also allowed in without the application of quantitative restrictions against them. They must, however, meet health and quarantine requirements, although under Article 40 the Community may make available information and aid to ensure that these requirements are properly carried out.

EUROPE TRADE WITH WESTERN SAMOA 1986-1991



50. The fund distributed pursuant to the Lome Convention is also the largest single aid program in the world and is the European Community's single largest instrument of overseas development. It has a current value of ECU 12 billion, (US\$ 18 billion), which will be disbursed to all of the ACP states over a five year period beginning in 1989. Aid disbursements to the Pacific are very significant. Over the first three Lome Programs, aid under the auspices of Lome amounted to ECU 739.7, of which one third was STABEX funds.

51. STABEX funds have the aim of offsetting the instability of export earnings and helping the ACP States overcome "one of the main obstacles to the stability, profitability, and sustained growth of their economies". It has become a significant portion of the budgets of some Pacific states. It is grant money, not tied to the purchase of good and services in Europe. More recently emphasis has been placed on the use of STABEX funds to restructure industries that are subject to unstable export earnings with the objective of removing sources of instability, to the extent that these are amenable to the application of technology or to diversification into new products.

ACCESS TO EUROPE

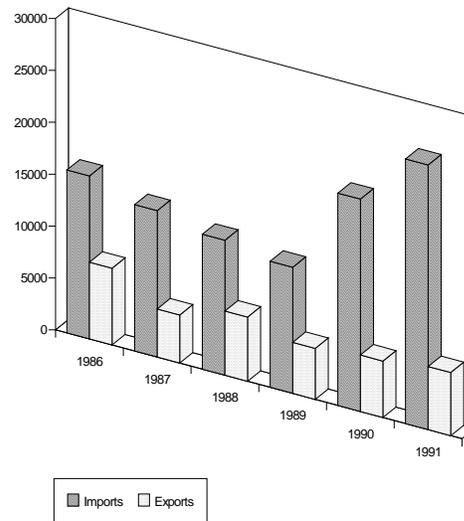
52. The Convention is significant in the Pacific Region for the fact that, most of the region's exports to Europe are achieved thanks to preferential access it grants. Sugar exports, for example, the largest single export from the second largest FIC, are governed by Protocol 3 to the Convention. Article 3 of this Protocol determines that every year Fiji, and other ACP exporters, will be entitled to export to Europe, (in practice to the United Kingdom), 163,600 tons of white sugar. This sugar is paid for at the prevailing European price rather than at the World Price. The European price, which is kept high to encourage the production of beet sugar by European farmers, is three times the World Price. Even a phased reduction in the prevailing sugar price would have drastic consequences for Fiji, with the need to eliminate the highest cost producers in the industry, to remove other

¹⁸ See Appendix 1 for South Pacific States included as ACP States.

sources of cost, including employment of labour, the prices paid for the leasing of land and the efficiency of processing, handling and the administration of the sector. Chart 8

53. From the perspective of the Europeans, their negotiators and their representatives the Lome Access looks secure. It must be remembered that the Convention is an international agreement that has been signed and agreed by the contracting parties. It runs for the duration of Lome IV, which means that it will not expire until the year 2000. As an international agreement its terms can be modified only with the agreement of both parties and mid term variation would be difficult to organise and even more difficult to negotiate, even if there were a will or a reason and nether seems to be present. At the expiry of the agreement, its successor agreement will be negotiated using the same process and with the same concepts

EUROPE'S TRADE WITH THE SOLOMON ISLANDS 1986-1991



of mutual benefit as its starting point. It can only be replaced by agreement between the parties and as such is unlikely to be modified to the substantial disadvantage of the ACP parties, without substantial political embarrassment or compensation. From the point of view of Europe the agreement appears to be as secure as anything can be.

LOME SEEN FROM THE PACIFIC

54. From the perspective of the Pacific Nations and nations of the ACP, things might look very different. The recipient nations are aware of the benefits that they have enjoyed export earnings that they have received from Lome. Lome has permitted Fiji and the other nations subject to Lome to enjoy, for 18 years a standard of living that otherwise they could never have experienced.¹⁹ While this is true as far as it goes it begs a much wider question. At no point of the negotiation, implementation and operation of the CAP and the Lome agreement was there any attempt to assess the wider issue of the relative costs and benefits to the ACP countries' development overall, of the protection regime faced by all exporters and the preferential access enjoyed by the ACP countries, on the one hand and the generous provision of aid on the other. STABEX is a recognition of the adverse effect on world markets of the instability and the low prices fostered by protectionism throughout the world. It also recognises the particularly adverse impact that creates on the export earnings of the developing world.

55. In one sense the Europeans have recognised that impact and tried to do something about it. Other nations, including Finland and Norway, both of which will be seeking admission to the EC, protect their agriculture more heavily, as does the United States, and have less generous provision for aid than does Europe. However, even that incurs costs in terms of the income redistribution that "aid-in-place-of-trade" fosters in the recipient countries. Instead of the resources flowing to entrepreneurs, by the means of flows of income from the market, aid money flows to the Government and the public

¹⁹ See "Sugar Under Threat", The Fiji Times, Saturday 15th August 1992.

sector as grants. Grants are particularly popular with governments as this increases the discretion with which the money may be spent. By contrast if the revenue has to be taxed from successful exporters, the degree of accountability insisted upon is likely to be greater. Although in recent years the EC has become more demanding in the way in which the money is used, it now insists that STABEX be used in the sector for which it is allocated, the very presence of aid money instead of export earnings creates incentives other than those likely to require improved standards of accountability and stewardship.

PART 4

PACIFIC EXPORTS

56. For the FICs of the Pacific the importance of the Lome Convention is very great. However, it is the other pressures on the process of European Union, including the financial and international pressures to Reform the CAP that have called its role into question. While it is unlikely that the EC will substantially reduce its aid to the ACP

countries, barring major economic upheaval, with pressure tending inexorably towards the liberalisation of world trade, any system that is built on a hierarchy of trade preferences, is likely to be affected. To illustrate this point, in the case of the Fiji sugar, Fiji currently enjoys a margin of preference over non-ACP suppliers of sugar to Europe. With absolutely no change to Lome, the phasing down, evening out, or the elimination of preferences will inevitably erode or abolish the margin of preference that is currently enjoyed. The next step is to look at the exports from each of the Pacific nations under study and examine how they will be affected by all of the developments in Europe

PACIFIC EXPORTS, COMMODITIES AND PRODUCTS

Bananas

57. Bananas are not currently a recorded export of any of the FICs under study. However, Tonga lists Bananas as an export and in the recent past Bananas were an export from the Cook Islands. In several of the FICs, Bananas are grown for local consumption. Export potential is limited by the high cost of production, the small size of the fruit and by quality standards inadequate for the sophisticated markets of Australia and New Zealand. Japan is not a realistic market for Forum Countries as the quantities available are insufficient and the shipping is inadequate for a perishable product that would face strong competition from the large, cheap bananas from the multinational commercial plantations of South America and Central America.
58. In Europe, high cost but tariff free ACP Bananas are supplied mostly to Britain, France and Spain by the ACP countries of the Caribbean and by French overseas territories. This trade is governed by Protocol 5 of the Lome Convention which in Article 1 states that "no ACP state shall be placed, as regards access to its traditional markets, in a less favourable situation than in the past or at present". In the rest of the EC so called "dollar zone" bananas are provided from Central America. As a result of the two sources and varying conditions of supply, bananas are sold for a wide variety of prices within the EEC. Prices vary from more than US\$ 1100 in Spain to US\$ 240 in Portugal. Two alternative plans have been put forward to overcome this difference. One option is a ten year plan essentially a continuation of ACP access through a mixture of tariffs and quotas. The other option is a simple 20% tariff.
59. The problem with the first plan is that in Germany, for example, the retail price of bananas would rise by 50%. The problem with the second is that the efficient producers of Latin America would quickly squeeze out the ACP suppliers, who in many cases have no alternative crops, other than narcotics. Another problem with the first plan is that it would be contrary to the GATT principle of "tariffication", that is evolving the protective effect of all remaining protection into tariffs that can then be negotiated up or down on a consistent basis.
60. The importance of this argument for the Pacific is not the fate of the European market for bananas, but the sort of issues that are likely to be raised concerning the handling of other ACP products as the pressures towards lower levels of protection and tariffication increase.

EXPORT COMMODITIES, FORUM ISLAND COUNTRIES 1991

Table 4

	Fiji %	Samoa % '90	PNG %	SI '88 %	Vatu %
Bananas					
Beef					360 33

C Cream			3538	32					
Cocoa			2282	20	36	3	7444	5	272 25
Coconut oil	2		803	7	12	1			
Coffee					96	8			
Copper					257	20			
Copra			628	6					526 48
Fish(prepare)	36	6			15	1	79886	51	
Fish	11	2							
Fruits									
Ginger	3	1							
Gold	47	8			560	45			
Kava									
Molasses	15	3							
Other Mineral					27	2			
Palm Oil					46	4	13004	8	
Rubber					2				
Sugar	217	39							
Taro			27						
Tea					8	1			
Timber	26	5	21		98	8	39790	26	
Other veg									
Other									
Manufacture			3919	35					
Clothing	131	24							
Other	67	12			85	7			
Total	555	100	11218	100	1253	100	15529	100	1098 100
							4		

Sources: Official Figures, Mostly from Reserve Banks Bulletins

Coconut Cream

61. Coconut cream is one of the first "Value Added" products to be exported from the Pacific Islands, that uses the very important coconut fruit. Coconuts are "originating products" within the meaning of Title 1 of Protocol 1 of the Lome Convention that classifies them as products eligible for duty free and quota free entry. In 1990, before the cyclone it represented nearly 31% of the merchandise exports of Samoa, with the principal markets being Australia and New Zealand. While coconut cream is a useful niche product for the European market it is hampered by the cost of transportation and the competition from better placed suppliers. As a tropical product it is not subject to Tariff or Quota restriction in the EC and will not be affected by the introduction of the SEM.

Cocoa

62. Cocoa is a recognised export for Samoa, Papua New Guinea, Solomon Islands and Vanuatu. It represents about 20% of the exports of Samoa, 3% for PNG, 5% for the Solomon Islands and 25% for Vanuatu. The statistics do not indicate whether any of these exports go to Europe but in any case they would represent a very small proportion of the world market. As a classic tropical product, cocoa would not encounter tariff or import restrictions into Europe, although as a tropical beverage it has attracted an excise tax in most countries of the EC. These taxes vary greatly and it was the desire to harmonise them as part of the SEM that led to the EC making an offer to eliminate them as part of its bid to the Tropical Products Negotiating Group of the GATT round. According to Davenport's analysis the elimination of these excise duties and their replacement with an assumed Value Added Tax (VAT) of 5%, could boost the demand for cocoa by about 8%.

63. Vanuatu and PNG would stand to benefit most from this increase in demand, which even if not reflected in an increase in demand for Vanuatu cocoa from Europe, would strengthen the world market for cocoa. The principal barriers to trade with Europe would be the distance involved and the ability to find a market niche able to cope with

the small quantities involved. However, as a result of the failure to agree on fiscal harmonisation in time for the 1992 deadline, and as a result of the stalled GATT negotiations, it could be several years yet before the benefits of these changes will be felt in the Pacific.

Coconut Oil

64. Is a very small scale export from Fiji, Samoa and PNG. In the case of Samoa in 1990, before the cyclone it reached only 7% of merchandise exports, and in the case of the other two exporters it failed to top 1% of the total. Coconut oil is not subject to any special protocol in the Lome Convention and it's unlikely to be affected even in the event of phasing down of agricultural protection. With the move out of Palm oils by Malaysia, which is ceasing to be competitive, there could be an opportunity for coconut oil, although the volumes available is likely to be the major constraint. Coconut oil is a tropical product, it does not incur tariff or quota restrictions in Europe and will be unaffected by the SEM.

Coffee

65. Coffee is an important export for PNG and it is produced, largely for domestic consumption in Samoa and other Islands. While the quality of PNG Coffee is generally very good it has been declining due to lack of fertilisers and declining standards of husbandry. The World Coffee Market is very volatile and it experiences long periods of low or falling prices, and short periods of high prices.

66. While Coffee is a useful additional export its price volatility, which is often as much as 12.2% monthly average absolute percentage deviation from the trend of coffee prices, causes problems where an economy is dependent upon the crop. One of the reasons for the volatility is the form of protection that is employed in Developed countries. In the EC there are substantial excise taxes on coffee that have a weighted average of 18.2%²⁰ and range as high as 50% on coffee and tea in Germany. As stated in the discussion of the future of cocoa, the elimination of these duties, even if they are replaced by a VAT of 5%, or, some larger figure, would result in worthwhile benefits in the Pacific. Although only a significant export for PNG, this could make the export of coffee more attractive for Samoa and other Islands, particularly of specialist niche markets can be discovered.

Copper

67. Copper represents more than 20% of the exports from PNG but is not exported from any of the other countries subject to study. Copper prices and markets are determined by the marketing arrangements of the particular firm responsible for the development of the resource. As a raw material ore product it is not subjected to duties or quotas in the EC. It is also eligible for support in the event of major price falls, or loss of capacity, under the Mining Products: Special Financing Facility (SYSMIN). This will be unaffected by the SEM.

Copra

68. Copra is traditionally an important export for FICs. It represents nearly 50% of the merchandise trade of Vanuatu and 6% of exports from Samoa. It is a feedstock for the pharmaceutical industry and while the statistics do not reveal it as such, the major market appears to be Western Germany. In Vanuatu, Copra sales are controlled by a Vanuatu Copra Marketing Board (VCMB). The board has two offices: Vila and Santo. Vila contains the Head Office as it is required as a statutory body to operate through out

²⁰ Davenport op cit. P. 61

the country it has 2 buying stations: Vila and Santo. Despite its name the board also buys Cocoa, and Kava as well as copra. Vanuatu is widely regarded as a good place to grow Kava, because of its high lactone content.

69. There are middlemen between the farmer and the Board and shippers operate as middlemen too. Cost control is not assisted by the standard pricing system that is operated. This problem is compounded by the zone allowances that are paid depending on the distance of the producer from the buying centre. The Board also offer advice to the farmers on how to improve quality of their product and will only accept a maximum of 7% moisture content. Modern testers have recently been introduced to accurately gauge the moisture content and this has made the grading easier and helped the farmers improve the quality.
70. Most of the Copra goes to Germany. In Germany the main buyer is the firm, Walter Rau. Their agent in London is LM Fischel. Vanuatu's Copra Board has been exporting there for 11 years. In the last few months there has been interest expressed in the setting up of an activated carbon factory. Clients want to buy copra from the VCMB and use the shell for carbon (which is employed in the gold industry to attract gold from a chemical bath) and to use the copra husk for filters. The clients are interested in 12,000 tonnes per year and offered the prospect of a better price to the farmers that they receive at present. This is the sort of value added product that the Pacific needs in order to get the best value from its Copra. There is a difference of opinion as to the reasons why this scheme has not proceeded thus far.
71. In 1990 the quality of the Copra crop was very low. At that time Vanuatu was regarded as having the lowest quality Copra in the world. The use of the moisture metre in selecting copra has greatly improved the quality. Another threat is the aging of its coconut plantations. A levy was imposed on exports to pay for the rehabilitation of the Coconut trees but the money was diverted to meet an urgent budget crisis in the nation's local government system. Copra suffers from the handicap of all primary commodities, namely it has a weak market, subject to wide swings in pricing and it is usually a buyers' market. It will have a bright future if value added products can be developed. However, at the present time, as a tropical product it is not subject to quota or duty in Europe and will be unaffected by the SEM.

Fish Products

72. Two basic factors govern the exports of fish from the FICs to Europe. The first is Title III to Lome Convention on the Development of fisheries. This creates a framework within which the Community seeks to assist the ACP countries to develop their fishing industries. The Second is the Annex LXVI to the Lome Convention that effectively restricts the application of the Treaty to fish caught by "taking account" of the 12 nautical mile territorial waters international limit when as applying the protocols of the Convention. This is of considerable significance when considered in the light of the Economic Zone of 11,730,000 square kilometres for only 527,000 square miles of territory within the 8 ACP Forum Island states. For the Solomon Islands, fish exports represent over 50% of exports, for Fiji it is almost 10% and for PNG it is growing area of investment. Effectively for many of the FICS studied, and even more so with respect to others outside its scope, fish is the only resource they have with long term development prospects.

FICS, DESTINATION OF EXPORTS, PERCENTAGES
Table 5

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	Fiji %	Samoa %	PNG %	Solomon %	Vanuatu %
Asia other	2	0	0	1	0
Asian Nics	2	0	12	15	3
Australia	16	11	37	1	17
Japan	6	0	22	25	23
UK	26	0	4	11	0
Other Europe	0	18	9	6	0
Total Europe	26	18	5	17	0
NZ	9	34	2	0	1
Pacific	12	31		18	1
USA	11	6	2	3	30
Others	16	0	12	0	24

Sources: Reserve Bank Reports and Trade Statistics

73. The SEM will bring changes to the regulations governing the trade in fish. This is as part of the agreement to harmonise technical standards. Under the new regime, the Commission will "for each third country, lay down conditions for the importation of fishery products" and that may include establishing a list of processing plants and factory vessels that are authorised to export to the Community. The frequency of inspections will depend upon the capacity of the country to offer guarantees with respect to checks carried out at the place of processing. While these checks will be similar to the checks performed by domestic producers, the ACP states will suffer the disadvantage of access to trained manpower and technology. They will also have to bear the cost of clearing their coastal waters of pollution or disease.
74. Already the requirements are strenuous and for many developing countries authorisation to export to Europe has been denied. Implementation of the directive is obviously crucial and it remains to see whether tougher requirements in Europe are followed by similar requirements elsewhere. The United States is contemplating similar regulations. The Solomon Islands have managed to secure a position in Europe through a joint venture with partners who have the capability to meet the exacting requirement of European customers. This may be a pattern that will be followed elsewhere.

Fruit

75. Fruits are not listed as an export for any of the countries, the subject of study. This is surprising in the light of the growing climate available for a wide range of tropical fruits. The conclusion must be that the fruit exports that do occur are caught in the "other" categories, because of their relatively insignificant amounts. Should crops be developed that can both meet the needs of customers in Europe and withstand the transportation difficulties in good condition, they will find Europe a difficult market to enter. France in particular has succeeded for many years in maintaining quantitative restrictions of the importation of horticultural products.
76. The origin of these restrictions dates back to exemptions granted at the time the Treaty of Rome was introduced although some rest upon the terms of Article 115 of the Treaty that permits a Member of EC to restrict the free circulation of goods where non member exporters are circumventing or threatening to circumvent quota restrictions by transshipping through other member states. The Commission has prepared proposals to eliminate these remaining quotas on horticultural goods and the 1992 SEM process has speeded up attention being paid to this subject. However, there is no guarantee that the proposals will be accepted, nor is there a guarantee that fresh restrictions will not be introduced as New Zealand has discovered with its Apple and Kiwifruit exports.

Ginger

77. Fiji has developed a good trade in Ginger with the West Coast of the United States. The only Ginger product that is exported to Europe is Crystallised and Industrial Syrup Ginger. The National Trading Corporation has discovered a good niche market in Germany and Holland for 600 tons per annum. This product as an ACP Tropical product does not encounter tariff or quota restrictions. It should be noted that Ginger has a long shelf life due to it being a fibrous root vegetable.

Gold

78. Both Fiji and PNG have gold resources that provide them with approximately 9% and 45% of their export earnings respectively. This is not a product that faces import quotas or tariffs.

Kava

79. Both Samoa and Vanuatu are developing a trade in Kava, although as yet it is not significant enough to be recorded. Kava is becoming highly prized in as a pharmaceutical feedstock. It has properties as a muscle relaxant, soporific, diuretic, an antibacterial application and as an anti-convulsive medicine. Capsules in liquid formulations are being developed as relaxants and sedatives. Six companies in Germany are interested and 3-4 in France. With the growth of herbal and homeopathic medicines the potential market is huge. The problem at present is that the Samoan Kava crop was destroyed by Cyclone Offa and that in Vanuatu is largely consumed in the local economy. SEM will make no difference to this crop.

Molasses

80. No information has been obtained concerning Molasses. However, as it is an extract of sugar it is likely that the comments made with respect to Sugar will apply.

Other Mineral Exports

81. PNG is the principal exporter of minerals other than Gold and Copper and will be unaffected by the SEM. To the extent that the current SYSMIN regime applies to Mineral exports it will continue to apply for the duration of the Lome IV.

Palm Oil

82. Palm Oil represents nearly 4% of PNG exports and 8% of the exports from the Solomon Islands. It has been characterised by low prices, which combined with the relatively high wages in PNG has led to reduced interest and production. In view of the fact that Malaysia, the largest producer of palm oil is rapidly becoming uncompetitive, due to rising wage rates, the longer term prospects for this product must be good. However, neither the Solomons nor PNG have any substantial trade with Europe at present and are unlikely to be competitive in the European market. As a tropical product Palm Oil is permitted tariff and quota free entry into Europe. Impediments to a European trade are primarily, distance, volumes and competitiveness.

Rubber

83. The Pacific is not a significant producer of rubber. It is unlikely to be able to compete with other producers such as Malaysia. As an industrial raw material, rubber would have tariff and duty free entry to Europe.

Sugar

84. Sugar is the largest single export from Fiji and is governed by Protocol 3 to the Convention. Article 3 of this Protocol determines that every year Fiji, and other ACP exporters, will be entitled to export to Europe, (in practice to the United Kingdom), 163,600 tons of white sugar. This sugar is paid for at the prevailing European price rather than at the World Price. The European price is three times the World Price. As a commodity subject to the Protocol of the Convention the access to Europe for Sugar is secure until 1994 and can only be modified by agreement. Under the Uruguay Round the Europeans are under pressure to liberalise trade in Agriculture and in sugar in particular. The effect of that is likely to be a cut in the European price, with great benefit to consumers, and costs to producers, followed by a rise in the world price as Europeans import more natural sugar and reduce their consumption of beet sugar. However, there is nothing in SEM that will affect the sugar market, although the climate of opinion it engenders could be instrumental in bringing a decision forward.

Taro And Tea

85. There are small exports of Taro and tea from FICs but none of this is reported to go to Europe

Timber

86. Timber represents 26% of the Exports of the Solomon Islands, 1 % of the exports from PNG and 5% of those from Fiji. The Solomon Islands, had been exporting into the UK and Germany for many years, until from February 1991, the Banks' Line refused to take timber with ventilation spacer sticks between logs because of the extra space taken up. This effectively forced the trade to Germany to be discontinued. With the installation of kiln drying facilities from November 1992 the trade to Germany will resume.

87. Europe is the best market for timber with the best prices. However, conservation moves in Europe, rather than trade barriers are the growing problem. The Solomon Timber trade believe it is necessary to have a policy on a sustainable resource yield to meet the legitimate needs of the conservationists and to ensure that the country's timber resource is not exhausted. They believe that there needs to be a rational policy for resource management, and meeting the needs of the market. Some estimates indicate that the Solomon's Timber resource could be exhausted in 7 years. The Australian Government are financing a Forestry Industry inventory and measures designed to create a sustainable resource eligible for Lome Convention Funding. None of these matters will be affected by the SEM.

Manufactured Goods

88. The two principal developments in the area of manufactured goods have been the rapid development of the Fiji clothing industry, following the change in economic policy following the 1987 Coup, and the development of the Car Wiring Harness factory in Samoa. Only the first of these is relevant to Europe. While the 23% devaluation of the Fiji Dollar and the development of Tax Free development zones were important in the development of the Clothing industry in Fiji, developments in markets were more significant. The first development was the access to New Zealand and Australia, gained under the Spartecca Agreement. This led to many clothing firms in New Zealand and Australia moving to Fiji to set up there as their home market access was assured. The second development was the obtaining a Derogation from Europe, under Article 31 of Protocol 1 of the Lome Convention, for access to Europe for garments manufactured in Fiji.

89. As a result of these events, Fijian garments are permitted quota free access to Europe for three years, up to a maximum of 500,000 units. Currently, Fiji can only fill about 20%

of the allowed level. The reason for this is that for most fashion garments, the production lead times are too long to permit the manufacture of garments in Fiji for the European market. By way of illustration it takes the Fabric 8 weeks to arrive in Fiji from Europe. Manufacture takes at least another 4 weeks. The finished garments then have to be returned to Europe and that takes another four weeks. This means that five months have elapsed from the origination of the project by which time the fashion has changed.

90. Europe is seen as a highly competitive market.²¹ The key requirement for a manufacturer in Fiji is to obtain a reliable importer. Excluded from the fashion market, they can produce for the Stock Service Market, that is, items such as underwear, "T" shirts and jeans, that do not change rapidly with movements in fashion. Most clothing exporters with interests in Europe receive 20-25% of their orders from there. Australia and New Zealand, however, remain the main markets for fashion items.
91. The United States is a possible future market but the volumes are too huge for the small industry in Fiji to cope with and importers tend to provide a good market for the first two seasons and then having obtained effective control of the manufacturers' output, try and screw down the manufacturer's prices thereafter. The Japanese market is regarded as potentially good, but Fiji manufacturers cannot cope with the Japanese insistence that the manufacturer take back the unsold stock and there is no market for Japanese size clothing elsewhere in Asia. Similarly there is no market in Japan for discounted clothing.
92. The Fiji Manufacturers believe that the SEM will help the cause of Fiji Exports to Europe. The biggest problem manufacturers perceive in Europe is that they do not have good sales representatives. Accordingly they have applied to the Commonwealth Development Institute for funds to train and recruit better representation for this very sophisticated fashion market. They are also applying to CDI for funding to support participation in fashion exhibitions in Europe.

LOME SEM AND FIC EXPORTS

93. This analysis demonstrates that few if any of the exports from the FICs will be affected by the development of the SEM. Indeed there remains considerable scope under the present Lome convention for the FICs to expand their exports. They have not been able to do so for a mixture of reasons, many of which have their origins in the Pacific rather than in Europe. Distance, perishability and small volumes are handicaps. Equally, overvalued currencies, excessive protection, and overcharging for government owned utility industry services are hurdles to expanded exports.
94. In the longer term the successful conclusion of the GATT round and the overall reduction in the protection afforded to agricultural products could see the margins of preference enjoyed under the Lome Convention eroded. Baring major developments in Europe, of a highly unfavourable character, it is unlikely that the Lome Structure with its emphasis on Trade, Aid and Development, and its duty and quota free access for Tropical products, will vanish overnight. In the event that changes in agricultural protection generally or a change in the philosophy of aid donors does occur, it is likely that STABEX and SYSMIN funding will be capped rather than reduced, and preferences phased out rather than abolished overnight.

²¹ Interviews with Mark Halabee, MARK ONE APPAREL, and Ramesh Salanki, UNITED APPAREL, 13th August 1992

95. Prudent Medium Term policy would look towards the possibility of eventual reduction in, or phasing out, of the existing concessional access and aid programs from Europe and other sources, and look towards full participation in the growth that is taking place, both in Europe and on the periphery of the Pacific.

PART 5

FOREIGN INVESTMENT

96. Despite the fact that all of the FICs have announced policies that favour of an inward flow in foreign capital there is little evidence of an inward flow of capital from Europe. This is unlikely to be affected by the SEM although the capital requirements of Eastern Europe's reconstruction are such that it will become even harder to attract foreign capital in the future. Many FICs have investment agencies with the specific task of promoting an inward flow of foreign investment. Several have experimented with Tax Free Zones (TFZS) and others have or are introducing generous investment allowances to encourage foreign investment. One of the main arguments for TFZs is that despite the display of official enthusiasm for investors, the potential investor is constricted by an array of licensing systems, regulations, and administrative procedures. These procedures are administered by Government agencies that have the task of controlling investment. Despite these efforts, the total inflow of private sector capital has been small and current

inflows remain smaller than in similarly placed island territories in the Caribbean and Indian Ocean.²²

NET DIRECT FOREIGN INVESTMENT SELECTED FICS COMPARED WITH MAURITIUS
Table 6

	FIJI	SOLOMON	TONGA	VANUATU	Mauritius
1980	34.20	2.40		na	1.20
1981	37.60	0.20		na	0.70
1982	35.90	1.00		6.90	1.80
1983	32.00	0.30		5.90	1.60
1984	23.00	1.90		7.40	4.90
1985	42.80	0.90	0.02	4.60	8.00
1986	30.00	2.10	0.11	2.00	7.40
1987	6.30	10.40	0.19	12.90	17.10
1988	44.70	1.70	0.06	10.80	23.60
1989	32.40	na	na	na	25.60
GROWTH RATES	3.40	-4.20	44.20	7.80	45.10

"Toward Higher Growth in Pacific Island Economies: Lessons from the 1980s", Volume 1, The World Bank, Report No 9059-ASIA, Ps. 46.

97. The adverse impact of this poor record has been a heavy cost placed on the FIC economies, in terms of lost opportunities. Governments have struggled to provide the alternative development initiatives, a task for which they are ill equipped and which stresses the ability of these countries to mobilise expertise and development capital. It also draws the governments deeper and deeper into detailed commercial matters where their level of expertise is low and their ability to devote the time required is limited. Fiji has had a record of foreign involvement in the sugar industry, but before the change of policy in 1987 most investment was concerned with expansion of the investments that were there already. It also had a large number of loss making government enterprises and poorly maintained infrastructure. PNG has succeeded in attracting investment into its mineral sector, but it would be surprising if that were not possible. Apart from that the manufacturing sector is very small and very little of the agriculture or manufacturing sector is export orientated.
98. The Solomon Islands have a few isolated examples of successful export orientated enterprises with a strong foreign component, such as Palm Oil Enterprise and the Solomon Taiyo Limited factory which exports canned Tuna to the United Kingdom. It also has an investment promotion organisation that has an impressive record of approving investment proposals. However, it has not means of telling whether these approvals turn into hard investments. Samoa can point to its successful Yazuki Electrical Harness Assembly Factory, but its economy needs many of these to employ its growing population of young people. Vanuatu is managing to attract significant investment through the use of its Tax Free Centre and by the use of Tax free privileges although it too has a small and domestic orientated manufacturing sector. Recent political instability and an apparent change of direction by the government has generally

²² "Toward Higher Growth in Pacific Island Economies: Lessons from the 1980s", Volume 1, The World Bank, Report No 9059-ASIA, Ps. 45-46.

not been well received by potential investors and there appears to be something of a pause in new investments by foreign investors.

99. It is significant that when officials were pressed to name new European private sector investments in each of the FICs, when the relevant enterprises mentioned above had been enumerated, only a further fish canning works in PNG, and an elusive European interest in the establishment of a honey industry in Fiji or the Solomon Islands was recalled. The practical examples of successful enterprises in the FICs, with foreign involvement, are all worthwhile and most promising. However, the truth is that as the basis of an industrial development strategy they are too few in number. This disappointing record led some observers to suggest that development planning with a stress of sustainable enterprises is misdirected. It has been suggested that the central problem for FICs is the preservation and enhancement of their status as rentier societies and that "an externally imposed 'capitalist road' will prove burdensome and expensive."²³ Undoubtedly there are people in the FICs who would be content to follow this analysis, however, since that conclusion was reached, policy changes in Fiji and elsewhere have shown that critics of market led development in the Pacific have been unnecessarily pessimistic, and the end of the "Cold War" have made some of the resource flows much less secure. These changes have enhanced the attractiveness of becoming involved in the economic activity around the Pacific Rim and make the sustainability of the rentier resource flows more problematic.

STRONG DISINCENTIVES

100. An analysis of the policy settings in most of the FICs quickly indicates that several policies which are common to most of the FICs are significant disincentives to foreign investment. Many are economic policies following those in place in New Zealand and Australia and since discarded by them. Most taxes in the FICs are collected on imports that increases the domestic cost structure making exports less competitive. Import controls and foreign exchange controls, designed to conserve foreign exchange and promote domestic employment opportunities, actually have the opposite effect, as they make doing international business expensive and difficult. Cost of living adjusted wage increases bear no relationship to the ability of enterprises to earn or to the value of the labour to the enterprise and remove significant areas of managerial leadership, discretion and undermine incentives. They also reduce the available paid employment which precludes involvement in the modern economy for those unable to obtain work. Wage increases in the heavily protected public sectors of FICs make private sector wage negotiations difficult and expectations unrealistic in countries where the state is already the largest employer. Because Europe is the most distant of the sources of investment this only compounds the difficulty of encouraging investments from that source.

101. While the focus on foreign investment must be welcomed, the way in which this is given effect can also be counterproductive. The recently organised Investment Promotion Authority (IPA) in PNG, is staffed by competent and enthusiastic young people, but it is required to charge hefty up-front fees to potential investors and has the ability to impose substantial additional charges on clients at the discretion of the manager of the Authority. If that is insufficient as a disincentive, a wide range of business are out of bounds to foreign investors. This prohibited list is undoubtedly designed to ensure that opportunities within the capabilities of local entrepreneurs are reserved for locals leaving more complex enterprises open to investors from overseas. However, the net impact of these restrictions seems to be to prevent local service providers from being tested in the market place against competition from outside, leaving them with little incentive to raise the standards of service they offer to

²³ Bertram, "World Development", Vol. 14, No 7, 1986, PP 809-822

international levels. This in turn prevents them from acquiring experience of providing first class service as a stepping stone to more complex enterprises in the future.

102. There can be little doubt that the effect of these contradictory policies has been to reduce the available employment, stifle competition, inhibit flexibility of resource use, and retard to adoption of productivity improving technologies. These handicaps in turn have had the effect of raising production costs and reducing international competitiveness of FIC products. This in turn makes the FICs are less desirable location for investments from outside their borders, which compounds the problems that the policies were designed to overcome. They are to a great extent responsible for the shortage of export commodities, and products for export which has in turn contributed to a failure to take advantage of the opportunities that exist under the Lome Convention. If the funds available from STABEX and SYSMIN are used to compensate FICs for inefficiencies in their economies then their impact could well be negative in terms of coming to grips with the problems that need to be addressed. If they are used to assist the necessary restructuring, then they can play a significant role in easing the burden of structural adjustment.

CAPITAL MARKET MODEL

103. Prompted by the World Bank and other agencies, many of the FICs are reviewing their attitudes to foreign investment. The formation of the IPA in PNG was a response to these urgings and succeeded an even less commercially orientated body. However, before satisfactory policies and institutions can be evolved, to promote foreign investment, analysis is required of the reasons for encouraging foreign investment and the fundamental conditions that have to be satisfied if there is to be a reasonable chance that foreign investment will be encouraged.
104. One of the reasons for this confusion of goals on foreign investment can perhaps be best found in the word "Control". In most FICs the aim of the policy is to control the flow of investment and direct it into politically determined locations, sectors or lines of business. This idea rests on the assumption that there is an abundant pool of investment capital available, that left to itself, will rapidly move into the development of finite natural resources, and depart leaving the host country little better off and minus its natural resource endowment. Such a scenario is close to the experience of one or more of the FICs and is not unreasonable in the circumstances. It is also an idea that was prevalent in Australia and New Zealand and the time that many FICs gained their independence.
105. Most countries, including Australia and New Zealand have observed the success of those economies with relatively relaxed control regimes. This suggests that a more realistic model is to look at foreign capital as a capital market. Capital managers seek out not only the profitable investments but also the least cost solutions to the problems confronting them. Confronted with market opportunities they will seek the lowest cost available option. It is the cost of the total package, the natural resource, the available labour, the tax regime, the political climate, efficiency of the infrastructure and many other factors combined determine that determines the location of the investment.
106. Once achieved, the advantages of foreign investment include access to foreign sources of capital, the mobilisation of domestic resources, the creation of additional wealth, the creation of a new taxation base and the introduction of new ideas, technologies and techniques. The concerns about foreign investment are that resources will be over exploited, that workers will be underpaid, that sovereignty will be lost over

significant parts of the economy and that foreign exchange that could have been used for development purposes will be syphoned off by the owners of foreign owned businesses.

CERTAINTY IN THE ECONOMIC CLIMATE

107. These concerns are real and mechanisms must be devised to ensure that while fundamental concerns are not lost sight of, worthwhile opportunities are not lost. Undoubtedly influenced by the procedures in place in Australia and New Zealand at the time of independence, most of the regulatory systems in FICs depend heavily on the decisions made by public servants acting under legislation that compels them to make decisions in the public interest, or in the national good. However, it is readily apparent now in both Australia and New Zealand that officials seldom have the information or the expertise available to make decisions of the quality required. If the information is collected it is expensive to acquire. If the expense is incurred, very often the information is out of date by the time it is collected.

108. In this context, the capital manager will prefer an administrative process that delivers a rapid "no", to one that offers a prolonged "maybe" followed after several years by a "no". It is the responsibility of the sovereign government to determine which resources and which areas of investment will be placed off limits. The drawing of that line may be debated. It is also the responsibility of the government to ensure that the total package, including the yes/no procedure, is such that will attract the sympathetic attention of investors in what is becoming an increasing competitive market for increasingly expensive and scarce capital.

MARKET LED

109. This desire for more rapid and certain investment climate, has led many countries, including Australia and New Zealand, to make better use of the information that is readily available at no cost. Information relating to what people are prepared to pay for something is readily available, through the market place, at no cost and is constantly updated. This implies greater use of market based methods of determining which business are desirable and which might be better turned down. For example, instead of a long list of prohibited enterprises, it might be better to set a dollar value below which any foreign investment is permitted, provided that the activity contemplated is legal. For enterprises of successively higher value, the increasing gradations of controls might be employed.

110. Despite more stringent controls, these again can be market based. If a construction job is to be undertaken, calling for worldwide tenders is a common phenomenon. However, if an air service is to be provided to a remote community it might be appropriate to call for negative tenders, that is bids to provide a service with contract going to the one offering the smallest subsidy requirement for a competitive operator to undertake to provide the service. If access to minerals in a prospective region is sought by an investor, the right to operate in the region could be tendered internationally. If new electricity capacity is required, the electrical capacity that is required can be tendered and proposals sought, rather than a country with limited resources having to pay itself for all of the options to be canvassed.

SOVEREIGNTY

111. One fundamental concern in many FICs is that if significant enterprises fall into foreign hands the sovereignty of the country might be undermined. This is a particular concern with respect to utility industries such as telephones, airlines and electricity undertakings. In FICs these services are performed by public or private monopolies, and there is intense opposition to privatisation, even where the enterprise as it stands offers

an inferior service at high cost. In terms of encouraging foreign investment the high cost of air travel, telephones, telex and fax facilities are increasingly important drawbacks to investment decisions by undermining the attractiveness of the total package, notwithstanding the service improvements that have occurred in recent years.

112. There are alternative approaches that have the multiple advantages of securing a rapid improvement in service, a reduction in the cost of the service, improvements in efficiency and, ultimately, in a deepening of the local capital market. One approach which, was tried by New Zealand, in the sale of its telecommunications company, was to sell the utility services, as is where is, with or without an exclusive franchise, deregulated to permit competition, or the threat of competition, and the main constraint on the new owner being requirement to sell a portion of the company's shares back onto the local capital market, again by public tender.
113. This approach is significant for placing international competitiveness of the economy and the system ahead of other objectives such as retaining existing levels of employment, achieving the best cash figure for the enterprise on its sale and retaining the power of the government to influence the prices charged for particular services. It also achieves a number of other objectives. It creates a better climate of investment by demonstrating the capacity of the host country to conduct a sale of this kind. It secures an injection of capital, management expertise and technology. It invariably leads to the exposure of the local community to better quality service that makes them more demanding of local suppliers, which in turn enhances their capacity to compete in export markets. It also fosters the development of a capital market where none exists by providing potential local savers and investors with high quality investments in enterprises in strategic alliances with some of the largest and strongest enterprises in the world.

POLICY OBJECTIVE

114. The key decision that has to be made is the decision as to the objective of the policy. If the policy objective is to secure a better standard of living for the peoples of the Pacific, comparable with the standards enjoyed by communities around the world in similar geographic locations with similar resource endowments, then the policy has to be determined by requirement to make all aspects of the economy and the infrastructure internationally competitive.
115. The SEM was promoted as a means of forcing Europe to face up to its lack of competitiveness in the world. Despite their size, many European economies are not large enough to support modern industries unless they are competitive in a global market. In the short term much of the available capital in Europe is being channelled into the former Eastern Block countries. Official aid sources are not up to the task of rehabilitating the Eastern Economies on their own. Despite the smaller scale of the problem in the FICs, the same factors operate. Smallness, isolation and low incomes are not reasons for rejecting privatisation and for excluding foreign investment from important industries. They are reasons why encouraging it is more important.

PART 6

SERVICES SECTOR

116. Freer trade in services is an area where the SEM will have the greatest impact in Europe. However, the immediate impact of reforms in services sectors, on Europe's relations with the South Pacific, will be small. Services represent a high proportion of economic activity in the FICs, ranging from 38.9% GDP in PNG to 78.8% GDP in the Cooks and 68.7% in Vanuatu²⁴. This study is primarily concerned with traded services and FICs are relatively large exporters of services, ranging, in the countries being studied, from a high of 79.9% of exports in Vanuatu to an unusual low of 6.8% in PNG. These services would include the remittances of residents living abroad and the cost of the Fiji Forces Employed in the UN Peace Keeping activities, but the two major services provided by the Pacific to Europe are Tourism and Financial Services.

CONTRIBUTION OF FIC SERVICE EXPORTS TO TOTAL FIC EXPORTS

TABLE 7

Source: Trade in Services Under Spartecca, Price Waterhouse Government Liaison Services, Canberra, Feb 1992

Total Exports of Goods and Services	Total Service Exports	Traded Services, Share of Total
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²⁴ See Appendix 6.

	Local Currency	\$US	Local Currency	\$US	Total Export %	GDP %
Fiji F\$	1296.5	868.4	566.2	379.9	43.7	31.1
Kiribati, 1988 A\$	11.4	9.1	4.7	3.7	41.2	11.5
PNG K	1268.5	1333.3	86.5	90.9	6.8	2.8
Solomon Is, 1990 SI\$	221.4	84.8	44.1	16.9	19.9	17.9
Tonga 1990 T\$	25.9	19.9	14.2	10.9	54.8	22.1
Vanuatu VT	846.8	72.4	6767	57.8	79.9	37.8
W Samoa T\$	87.8	37.6	67.3	28.9	76.6	63
Total US\$		2425.5		589	24.3	11.8

FINANCIAL SERVICES

117. As the Governments of the European Community seek to eliminate the scope for Tax avoidance within their borders, by the closure of tax havens, the scope for the Financial Planning Centres of Vanuatu and Western Samoa will increase. These services have shown a rapid increase in their popularity and currently service mainly Asian clients, however, Europe has been identified as an area of future expansion. Samoan based operators in the financial centre cannot act for Western Samoans, nor are local residents allowed to set up companies under the offshore company rules. Samoan based companies can give advice to Australian Residents of Western Samoa.
118. This facility is proving popular with more and more Europeans because the difficulties faced by tax planning enclaves in Europe from the spreading powers of the EEC. To do business with the EC it is becoming increasingly important to follow the rules laid down by the EC and even the traditional tax havens of Isle of Man, Channel Islands, Leichensitein and Switzerland. have had comply with European rules. They are now running the risk of being closed completely if they fail to permit their regulatory regimes to be brought into line with those elsewhere on the continent.
119. Even some of the offshore centres, such as the British Virgin Islands are being brought with the scope of EEC directives. Following the insolvency rules in the UK being brought within the ambit of international cooperation, the EC insolvency law now applies to the British and the French Dependencies, a group in which the British Virgin Islands are included, Certain countries and territories are designated including places such as the Cayman Islands and New Zealand. However, Western Samoa is completely independent, and does not have a Treaty binding it to following the UK rules, so this legislation does not apply.
120. The SEM is aimed at making Europe more affluent. The more affluent that Europe becomes, the greater will be the incentive for taxpayers and companies to locate offshore for taxation minimising arrangements. With the prevalence of the international laundering of drug money in traditional tax havens, all financial planning locations are being asked to join in the search for cash. Samoa perceives that it has an advantage over Vanuatu which was early in joining the anti-drug cooperation measures and there are reports in Samoa that the operation of the Vanuatu centre has lost some of the advantages it enjoyed because of the intrusion of regulatory agencies into the affairs of otherwise legitimate activities.
121. Samoa's other advantage is its placement on the Eastern side of the international date line. This permits the filing of documents on the previous working day in cases where this has commercial significance. The finance centre currently provides employment for

20-30 Samoans and is potentially worth US\$ 2.5 million a year to the economy in fees and charges alone. Currently this potential is not being realised and the latest estimate of its worth is about US\$ 800,000.

122. The other aspect to the Western Samoan financial centre is the Registry. This was set up for the use of persons and companies doing business outside Western Samoa. Companies can become domiciled in Samoa for taxation purposes. A US\$300 fee for incorporation is charged, plus an annual fee of US\$300. So far 450 companies have registered using this facility. They include 9 Banks, 5 International Insurance Companies, 60 Trusts, 3 Registered Trustee Companies. Administration of Trusts is restricted to Registered and Trustworthy Trustee Companies. Trustee Companies from other countries now have been setting up branches in Samoa. Company management Acts require the licensing of the trustees, this acts as a quality control measure.
123. The Banks registered there have to provide quarterly statements to the Registry and transactions for the larger banks must now go through the trustee companies. This regime is thought to be relatively restrictive but competitive with the other "havens". There is a strong possibility that the other havens may copy Samoa's regime. However, the main difference is the scale of operation. The British Virgin Islands, has 60,000 companies on its books and 24,000 new ones are registering per year.
124. Vanuatu has operated a Finance Centre, or "Tax Haven" for 20 years. At present most of its business is for Hong Kong or other Asian clients. Europe is thought of as a possible area of additional business. One advantage of Vanuatu is that its laws are written in English and French and this gives a competitive margin in Francophone countries. This can be an advantage to clients, although a source of confusion in Vanuatu where in the Parliament new laws are debated in a third language, Bislama, or Vanuatu Pidgin.

TAX HAVEN

125. The Vanuatu Legislation is in the process of change because recent developments have made current laws relatively obsolete. The Government has agreed to the passage of an International Companies Act, which will be passed soon and other new laws, permitting confidentiality for international clients, are currently under consideration by the government. Once this has been achieved Vanuatu intends to seek the support of its competitors in the Pacific for a joint promotion of the facilities offered in the Pacific, to their main market, in the Asia Pacific Region. Europe is still seen as relatively peripheral and the possibilities offered by the EC extending the scope of its regulation are not yet perceived to be great.
126. The Finance Centre is currently worth 15% of the GNP of Vanuatu. This makes it worth some Vatu 500 million. Pre independence Australia, New Zealand and Singapore were the main markets. Since independence Hong Kong has been the most rapidly developing market. Most of the operators in the financial centre perform their usual banking and accounting functions, and for them the work associated with the Finance Centre is a substantial add on. It currently provides employment for about 30 Vanuatu citizens who are among the highest paid workers in the country. Nevertheless, the increase in the Minimum monthly wage from V8,000 to V11,000 decreed by the previous government has created difficulties for the centre's operations. The current government when seeking election promised to increase the Minimum wage to V25,000 but so far have not done so. Were this to happen it could cause serious difficulties for the centre's continued operation

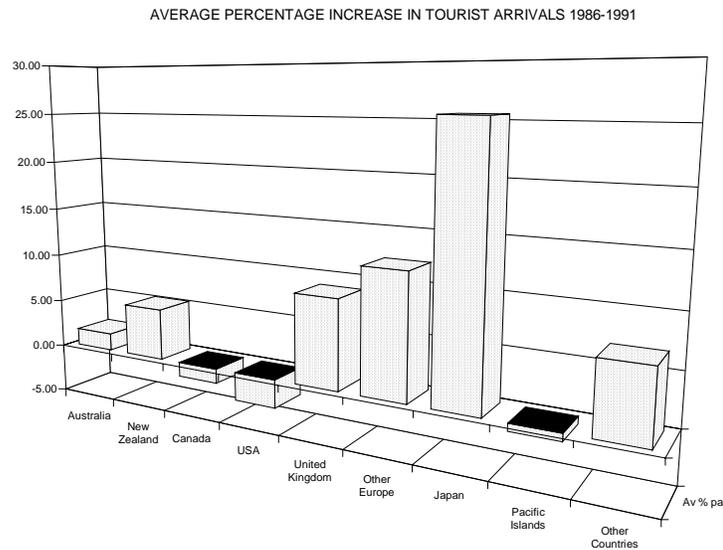
127. Financial services are the sector of any economy which has the quickest potential to create jobs in a pollution free, low finite resource consuming industry. With the rapid spread of modern technology in the travel and electronic communications, industries based on knowledge and information can be based anywhere, with very little additional cost. Recent improvements in the telecommunications services in most of the FICs means that there are no significant disadvantages to performing financial services transactions in the Pacific, except the relatively high cost of toll calls and faxes. The success of the Financial Centre in Vanuatu demonstrated this fact and led to matching service improvements in other FICs. Any suggestion that a FIC government is not going to carry through reforms in telecommunications will increasingly be a negative feature to the overall business climate and influence decisions on the location of future investments.

TOURISM

128. The other significant service industry is the Tourism Industry. Fiji is the dominant provider of tourism services, although many countries are realising its potential and rapidly developing their tourism sectors. Vanuatu and Samoa were relatively late entrants into the business but are working hard to catch up. Recent improvements in telephone services in Samoa will increase its acceptability to business tourists and several new developments are beginning to provide a range of tourism opportunities. PNG's tourism industry has enormous potential from young "backpacker" tourists seeking new experiences, but is hampered by the law and order situation in the major cities and the high value of the Kina.

129. The pattern of the tourism traffic varies a great deal from year to year, depending on whether the South Pacific developed countries of New Zealand and Australia, the North American countries or the Europeans are in boom or recession. However, over the last six years the three most interesting points have been: firstly the increase in Japanese tourist arrivals, increasing by an annual rate of 25%. Secondly, that starting from a larger base the European market is still growing, by 8% a year for the United Kingdom and by 12% a year for the rest of Europe. Thirdly, there has been the decline in the importance of North America that has seen Canadian and US arrivals fall by -1.5% and -2.8% a year respectively.

Chart 8



SOURCE TCSP Suva Fiji

130. With Europe being the south Pacific's second fastest growing market for tourism, the SEM represents no constraint. Tourism planners and operators are working on the assumption that they will continue to tap into the European Market, and are especially looking towards the totally unexploited Italian Market. The German Market is currently the biggest and with English widely spoken there is no problem with language, whereas in the French market there is perceived to be a language problem. This is being overcome to some extent by Vanuatu which has been exploiting the French market indirectly through New Caledonia. Europe is unlikely to become a mass tourism market. Europeans tend to be like the backpacker tourist, seeking a different experience, have an average stay of 2-3 weeks, via a visit the 2-3 days of tour parties.
131. While the European market will always be of interest as a source of relatively wealthy customers, the dominant tourist markets remain New Zealand and Australia. Not much more growth is possible from Australia and New Zealand. In addition, for a successful tourism industry the structure of airlines is very important. Air New Zealand (ANZ) alone has a regional approach, which treats Tourism as a subset of the Aviation industry. It has been playing the leading role in the South Pacific network and has entered a range of commercial relationships that are having the effect of rationalising flights and increasing the efficiency and reliability of service. It operates a three pronged strategy: (1) Concentrating on increasing inbound tourism, (2) Operating through strategically placed Hubs, (3) Recognising that tourism drives aviation.
132. This strategy will be necessary if the Forum Governments are unable to resolve the problems with their airlines recently analysed in the Sir Alexander Gibb Report.²⁵ This report pointed out the chronic state of over capacity, service duplication, high fares, low loadings and imminent insolvency faced by many of the airlines of the Region. Air New Zealand recognises these facts and that there are two groups of carriers operating in the FICs: The internationally capable carriers, with the capacity to operate outside the

²⁵ "Air Transport Study", Sir Alexander Gibb and Partners, Dec 1991

region. These include ANZ, QANTAS, Air Pacific and ANSETT. The other group are Polynesian, Solomon Airlines, Air Vanuatu etc, which are well placed to link the hubs with their own destinations. If the second group did not operate there would be strong pressure on Air New Zealand to take over their destinations, and with Air NZ's cost structure this could not be achieved. This is not to say that the current cost structures of the second tier operators could not be reduced.

WEAKNESS IN THE STRATEGY

133. The weakness of the present structure is the absence of East West routes for Air New Zealand. Also, there is no North, South route through the Solomon Islands, PNG or Noumea. Solomons' Airlines and Air Vanuatu have complementary strategies to Air New Zealand, they both hub on Auckland, or Brisbane and Honiara. The Solomon Islands tourism industry has the problem of not being well known in its source markets or tours there being included in Pacific wide tours. Endemic Malaria in that country is becoming a major issue for tourist that is an aspect of the safety issue that was mentioned before. PNG not only has the problem of being off the main NS routes but has a difficult law and order problem in its major cities which tarnishes what would other wise be a very attractive tourist destination.
134. For Vanuatu the big problem since independence has been name recognition, when the country changed its name. This is gradually being overcome in NZ and Australia and unfortunate events like the fire at the South Pacific Pavilion in Seville created more publicity than there would have been without the fire. Unless these issues can be addressed, load factors which are a major problem, could prove to be fatal. Access from Europe remains difficult and expensive. Vanuatu will feature in Air New Zealand "Hotpac" Hotel Pacific Booking system from January 1993. Because until now Vanuatu was an "add on" holiday this linkage will give it something to market.
135. Tourism operators in the Pacific report difficulties with the low the productivity and high rates of sickness and absenteeism, among their staff. This means a 50% additional staff loading is required. Minimum wages that are unrealistic in relation to the productivity of the workforce is a major handicap to the industry. This has been a significant problem in PNG and would become one in Vanuatu if the promised increase is made. For employers and potential employers the problem of inadequate public education is very real. Additional training to bring staff up to basic levels of literacy and reliability is reported as a problem, particularly in PNG and Vanuatu. A clear tourism policy would be a major advance, particularly in Vanuatu. In 3 years there have been seven Ministers of Tourism and this does not permit anyone to come to grips with the problems of the Industry.
136. From this analysis it is obvious that not only are the prospects of developing the sale of tourism services to Europe bright, but SEM will make little difference except possibly expanding the market very slightly. For there to be significant growth, the major changes must come from the Pacific end and these include reducing the cost of airline services, reducing the incidence of Malaria in the Solomon Islands and improving the education and law and order situation in PNG. While Australia and New Zealand will remain dominant markets and Europe can look forward to steady even faster growth, Japan and other Asian countries will become more and more significant as sources of tourist.
137. Air New Zealand, the only private sector airline currently operating in the South Pacific has correctly identified these features of the market and has a strategy to exploit them. It has also succeeded in implementing a strategy where governments and

government controlled airlines failed. This suggests very strongly that progress will be made if the necessary rationalisation of FIC air services is based on firm commercial principles and as far as possible left to the private sector. Although this report has not focused on shipping services, it is reported that bringing commercial principles and, where necessary, market led intervention, has brought about improvements in service and lower freight rates.

OTHER SERVICES

138. There are at least two other significant exports of services from within the FICs. The first is the provision of Military Services by Fiji to the United Nations Peacekeeping Forces in the Sinai and Lebanon. The other is the continuing provision of trained seamen to the German Merchant Marine is now very significant. In each of Tuvalu, Kiribati and Tonga, there is a training school for merchant seamen. These people are employed under the German Labour Law so are not exploited as they might have been had they been employed in lines or vessels that sail under a flag of convenience. For Kiribati: the estimated value of this service is A\$8 mil pa, and for Tuvalu A\$2 mil pa.²⁶ It is in the supply of trained people power that the greatest potential for future services industry exports lie. One of the difficulties that has afflicted the FICs is the sending of young people to other countries, particularly Australia and New Zealand for training only to find that they decided to remain there to make better use of their skills and to obtain higher rewards.
139. Modern technology offers a way out of this. In Jamaica there is a thriving computer industry based on satisfying the needs of customers in the United States. In the late 1970s a similar interchange took place with entrepreneurs in New Zealand, seeking to reduce costs by utilising Fiji's lower wage rates to cut their costs. With modern communications technology the scope for this kind of work has increased enormously. There is the potential for New Zealand and Australia, as well as the FICs to exploit time zone differences to undertake the labour intensive part of professional work for firms in the United Kingdom and other parts of Europe during the European night.
140. The conditions that need to be satisfied for this idea to work are: totally reliable communications, highly skilled workers and political and economic stability. Once these conditions are satisfied imagination and enterprise are the only two limiting factors in making this industry thrive. For example, in years to come there is scope to attract prolonged stays by creative people such as authors, playwrights, scriptwriters etc attracted to the Pacific by the generally better weather and lower costs of some essential living items (in some though not all of the FICs) while undertaking lengthy creative assignments. They would enjoy all the advantages of a relaxed holiday atmosphere, while still having all the advantages of modern communications and satellite TV from CNN and the BBC.
141. In years gone by there has been a tendency to dismiss service industries because they do not produce tangible outputs and most politicians have been drawn from classes of people who are practical in orientation. Internationally, service industries are the fastest growing sectors of most economies and much of the push for both the Uruguay Round and the SEM have come from the need to satisfy the requirements of financial service, intellectual property and certification standards agreements. It is widely appreciated that the FICs are in a good position to pick up on the growth in leisure industries. What is not so widely appreciated is their potential for development in the other service sectors as well. To succeed it is necessary for the FIC economies to be internationally

²⁶ Estimate of the NZ Ministry of Foreign Affairs.

competitive in services as much as in the more traditional commodity and manufactured goods exports.

PART 6

POTENTIAL NEW DEVELOPMENTS

142. This study has stressed in several places that to take advantage of the vigorous economic activity occurring in Europe and on the rim of the Pacific the FICs need to place increased competitiveness as high on their list of priorities. Potential for internationally competitive new developments between the FICs and the EC can be analysed under four headings:

- Attention to Fundamentals
- Micro Enterprise Development
- Adding Value to Traditional Products
- Development of Services Trade

ATTENTION TO FUNDAMENTALS

143. New Developments in the Pacific are unlikely to take place in an environment very different from those that operate elsewhere. The essential factor that will determine whether products and services from the FICs will sell in Europe and in the markets around the Pacific Rim, is, whether they are competitive with products and services that are available from elsewhere. In a study of ten nations, Michael Porter of Harvard University sought clues as to the factors that determine whether a nation and its products will be internationally competitive.²⁷ He concluded that companies gain and sustain competitive advantage in international competition through *improvement, innovation and upgrading*. These are dynamic process that demand a continuing commitment and investment both to perceive and act upon opportunities. However, there are four broad determinants of national competitive advantage that shape the industrial environment to the benefit or detriment of a nation's firms: *factor conditions, demand conditions, related and supporting industries* and *firm strategy, structure and rivalry*.
144. Factor conditions are the inputs necessary to compete in an industry, such as labour arable land, natural resources, capital and infrastructure. Basic factors are those which are inherited passively, or which can be acquired with moderate investment. Advanced factors are those which can be developed through sustained investment in both human and physical capital, such as advanced education and telephone networks. Generalised factors relate to factors that can be utilised by many industries and specific factors are those which relate to a few.
145. Demand conditions are effectively the nature of the demands of consumers in the home market. These appear to have a much larger than anticipated effect on how firms perceive and respond to buyers needs. It was this lack of appreciation by consumers of what should be possible in terms of quality that was instrumental in undermining the quality of goods from Eastern Europe. A similar phenomenon is the psychological barrier, among FIC consumers that anything imported is automatically superior to anything made locally.²⁸ Size of demand, its pattern of growth and how internationally orientated it is are the most important features.
146. The third determinant is the presence of related and supporting industries of a world-class. These are firms that share common technologies, inputs distribution channels, customers or complementary products. Supportive industries often have the role of delivering world-class inputs in a cost-effective and supportive way. It is not necessary for all to be present. They can however, be very small. For example, a locally operated range of cleaning and maintenance services can relieve managers of international trading firms of the responsibility for this minor function and for a very small fee create more pleasant, healthy working conditions for staff with world-wide responsibilities.
147. The final determinant is the strategies, structure and rivalry of firms. The nature of domestic competition and rivalry has a very important impact on the international competitiveness of a nation's firms. The presence of local rivals is an important stimulus to improved performance. Competition from foreign firms is another stimulant but not so important as domestic stimulus. However, the smaller the domestic economy the more likely that any competition will have to come from abroad. Chance events of course can play a role. The SEM is a chance event, quite outside the control of the FICs but, which properly handled can be turned to their advantage.

²⁷ "Upgrading NZ's Competitive Advantage", Crocombe, Enright and Porter, Oxford University Press, 1991, P. 28 and "The Competitive Advantage of Nations", Michael Porter, Free Press, 1990

²⁸ Interview Folongi Chan Tung, Trade and Commerce Department, Western Samoa 19th August 1992

148. Governments too can impede or improve the advantage of firms in its nations. It should be remembered, that throughout this study of competitive advantage that Porter constantly emphasises that it is firms that compete, not countries. If Governments want to improve the competitiveness of their firms they must remove impediments to their development, foster the creation and development of successful firms and require them to compete domestically and internationally as much as possible.

ERRORS IN THE PACIFIC STRATEGIES

149. If Porter is correct, the traditional pattern of development in the Pacific has not fostered the development of competitive advantages because it has not created an environment conducive to the development of competitive firms. Extensive bureaucracies, government owned and subsidised enterprises, high import taxes, import bans and quotas, controls on the use of foreign exchange, confused and uncertain land tenure and policies that have discouraged the investment of foreign capital have all undermined the development of the fundamental conditions for competitive advantage.

150. Other government interventions, copied from and now abandoned by New Zealand and Australia, such as labour market controls, high minimum wages and efforts to provide developments, alternative to the largely missing private initiatives, have all adversely impacted upon the ability of FIC economies to take advantage of the opportunities now opening in Europe and elsewhere. What is worse is that the culture of enterprise, improvement, innovation and upgrading, which is a culture new to the largely collective cultures of the Pacific, has not been fostered.

151. Despite the achievement of political independence the predominant culture remains the hangover from the colonial administration that the primary economic problem is one of "distribution".²⁹ This has permitted governments to come and go without coming to grips with the reality that prosperity does not "happen", nor can governments create it themselves. Governments must create the conditions in which prosperity and foster a culture within which their citizens grasp the opportunities that are offered.

152. However, there are signs that policies are changing and there is a growing realisation that a more outward looking, competitive economic strategy will foster a climate of improvement, innovation and upgrading, and will deliver more lasting advantages more quickly and more effectively than the state led aid financed strategies of the past. The Fiji clothing industry is the first in the region that has combined basic factors of competitive advantage, including abundant labour, educated workers and strategic location, with chance events, SPARTECA and LOME access to create an industry that now accounts for 24% of the country's GDP. Clothing is usually the first industry to develop on the ladder from subsistence agriculture to industrialisation. Fiji will have to seek out opportunities on the next rung of the ladder in areas such as electronics and plastics if it is to sustain the momentum as its labour force becomes more prosperous.

153. It is at that point that Fiji's neighbours will have an opportunity to use their advantages, such as proximity to Fiji with its established clothing trade and a significantly cheaper labour force, to tap into that opportunity as Fiji moves out of simple clothing into more complex parts of that industry and into the plastics and electronics industries. This scenario relates to one industry in one country, but the same or similar sets of opportunities are occurring all of the time, not only in relation to Fiji and Australia and New Zealand but in relation to the FICs and other parts of the world.

²⁹ "Wages Incomes and Productivity in Papua New Guinea", PA McGavin, Institute of National Affairs, PNG June 1991, P. 145

Opportunities will only be seized if firms are there available to identify and exploit them. It is also significant that once an industry like clothing does develop on the basis of competitive advantages, it begins to look towards the European market.

MICRO ENTERPRISES DEVELOPMENT

154. In the short term the bulk of opportunities are likely to occur in the domestic economies and in relation to very important but simple services, such as laundry and cleaning, repair and maintenance of appliances, small runs of simple basic consumer goods and speciality items for sale to visitors such as tourists. Many examples are to be found, in the FICs, of entrepreneurs in these areas: Manufacture of holiday clothing and hats for tourists, the manufacture of carved souvenirs, manufacture of coconut soap, coconut liqueur and packaging of cocoa, coffee and kava for the New Zealand market. Other enterprises being planned include the bottling purified water for home consumption, the bottling of aerated Pacific mineral waters for the international market, lambskin products using imported lambskins from Australia and New Zealand and bags for taro export. In addition vanilla production, currently viable in French Polynesia, should be even more profitable in other islands with the much lower labour costs.
155. Several of these ideas have latched onto the opportunity that exists with very cheap airfreights available on backloads to Europe. Another opportunity has been created with the dropping of many import quotas in French Polynesia. However, in many cases supply is the problem not the market. Polynesian and other Pacific women workers have well-established cultural traditions of dexterous work. Despite that, coconut, banana, pineapple and other trees and plants are not cared for, with inadequate pruning and propagation and therefore are not of export quality. The presence of government agencies responsible for marketing traditional crops has been a deadening influence of the supply of traditional produce, fostering the climate that the production, presentation and export of traditional crops are issues that can be left to the government. Incentives have to be reviewed so that farmers have the incentive to produce first grade products, as cheaply as possible, with quality and timeliness of supply being rewarded over volume.
156. A necessary condition for the development of competitive firms is that micro enterprises must flourish. For that to be achieved governments need to adopt clear policies with respect to the goods and services that they consume. The government service should be confined to the core role that must be performed by the government: the preparation of policy and the enforcement of regulations. All other functions can be successfully tendered out to private businesses, the majority of them to very small enterprises. Where services are currently being performed by the government's own employees they can be taught how to run their own businesses and offered the purchase of the businesses they currently run. If they are unable or unwilling to do so, or if the business is clearly beyond their capabilities, then the businesses should be offered for sale on the international market.
157. Where businesses are believed to be of strategic significance, the government can insist on reasonable conditions with respect to future service provision being attached to the sale. In some cases the government can insist on the resale of some or part of the business, to the private sector in their country in years to come. The conditions imposed must be realistic and a necessary condition for share sales to take place is the existence of a share market. Most FICs realise that the existence of such a market is a prerequisite to successful private commercial development, but only Fiji has such a market at the present time and it is short of good quality tradeable stocks. The prevalence of government enterprises is one of the reasons for such a shortage.

158. One opportunity that is clearly evident to visitors to the Pacific region is the area of property development. The South Pacific is full of government buildings that are either of historic, cultural or sentimental significance, but are in very poor repair. Many have been donated over the years by well intentioned aid programs leaving the host country with an insupportable bill for operation and upkeep. These are now expensive liabilities with governments having little capacity to renovate, modernise or maintain public buildings. As a consequence many government functions are housed in depressing and dilapidated surroundings.
159. The international sale and lease back of government buildings to the private sector, with a right to repurchase, say in 20 or 50 years, would enable to governments to mobilise capital for other essential purposes. It would also induce worthwhile foreign investment into their economies in the next few years, modernise and improve the quality of surroundings for the government's own employees and preserve the right of the government to repurchase buildings of historic significance at a time when the FIC economies will be richer than they are now. Such a policy will also provide a useful stimulus to the construction and building maintenance industry with desirable downstream effects.
160. Another opportunity that remains to be exploited in years to come is the significant infrastructure of science and technology that exists in French Polynesia and New Caledonia. While there are language difficulties, this is a substantial resource that with the gradual winding down of military establishments in the Pacific, will need to be redeployed for civilian and development purposes. French Polynesia and New Caledonia are the two parts of the Pacific that enjoy completely European wages and conditions and standards of living. This is based on the substantial resource put into these communities by the Colonial Power. While the Government of France has every intention of maintaining its commitment to these communities and will probably continue to do so, clearly the commitment is unlikely to increase and effectively may be capped over a number of years. This implies that these communities will have to undergo considerable restructuring to bring their cost structures to internationally competitive levels if they are to begin to earn a significant proportion of their incomes on their own merits. It also implies that they will have to find a Pacific market for many of the services they have to offer. This creates an opportunity in terms of the desire of other Pacific Communities to add value to their exports.

ADDING VALUE TO TRADITIONAL PRODUCTS

161. The FICs products are still largely commodities exported in the raw state. The prevalence of government marketing boards has tended to keep the trade, the technology and the product development on traditional lines. As increased agricultural productivity reduces international commodity prices, "tradition" means, a downward earnings curve. This guarantees that the prices received by the marketing board and ultimately the farmer in the village have remained at the bottom end of the market. To change that a position a mixture of product development and improved marketing will be required. The goal must be to create a range of consumer products from the traditional exports of the FICs. Such a switch of strategies will be facilitated by a higher degree of integration of markets in the Pacific.
162. An example of how this is happening can be found in Western Samoa after Cyclone Offa. Several small factories in Samoa have created small but growing domestic and international markets for branded products such as coconut cream, ground coffee, kava and cocoa. With the loss of almost all of one year's crop of coconuts, kava and coffee,

and 60% of the nations' trees being damaged,³⁰ these operators faced ruin without continuing supplies of raw material. While the former state owned copra factory closed, the private entrepreneurs managed to obtain small supplies by a mixture of imports from other islands and by offering farmers a higher price for their products.

163. It will not be financially viable or economically efficient to have coconut cream factories in every country, but freer trade among the Islands would encourage greater competition for the available commodity products, increasing the prices received by farmers. It would also allow several different marketing techniques and approaches to be tried with all the producers in all the FICs benefiting from the successes. It would also spread the costs of the failures more widely, with less drastic impact on any one country in a short period of time.

GOVERNMENT DEPARTMENTS INTO BUSINESSES

164. Experience in many countries has shown that while governments have an important role in the creation of value added industries, governments are not good at managing the process themselves. For Ministers and officials there are always more pressing and urgent demands on their time than coming to grips with the needs of a particular industry. Governments always have more urgent things to do with their money than spend it on maintenance and new capital development in a business it owns. Greater continuity is required for the development of a commodity trade into a value added consumer products industry than is possible from the political process.

165. As a result of these conclusions, many governments have decided to reorganise their commercial activities as businesses and run them on business like lines. Ultimately, to permit the businesses access to fresh sources of capital, they have been sold to the private sector. This also coincides with the need for some FIC businesses to obtain strategic alliances with outside partners, in the way of the Solomon Taiyo export fish eventuate, and the interest that exists in some businesses in Europe to play a greater role in the Pacific.

166. The role of Governments is to create the climate in which such developments can occur. It is a crucial role of government to ensure that infrastructure from telephones to customs officers, function efficiently, honestly and as cheaply as possible. It is vitally important that potential European, or other, investors know where they stand and are faced with a few simple rules rather than a web of complex regulations with obscure objectives. Rules can be tough but they must be seen to be fair, sensible and processes must be seen to have predictable outcomes. It is essential that interest is not blunted by delays such as that reported with the copra processing project in Vanuatu. Investors from Europe and elsewhere must be made to feel welcome and not treated as though there is a residual suspicion that the investor may be intent on theft.

167. Governments do not necessarily have to encourage value added processing with expensive incentives. Although these can finally clinch a deal in some cases, if they persist for too long they can debilitate the enterprise and leave it flabby and unprepared for the challenges of the world market place. Far more important is for Governments to build up the capability of their businesses and make them aware of the facilities that exist. Both the South Pacific Trade Offices in New Zealand and Australia have reported that they are not used as much as they feel that they could be. These are excellent facilities and it does appear that one reason for the under use is lack of knowledge of their existence.

³⁰ Figure used by Tupuola Taita, Director of Agriculture and Fisheries, 18th August 1992

168. The production of value added products must begin in the market place. Unless the producer has a clear idea of what the market is interested in, the most excellent products will not have a market. Having said that provided products are of a high quality and appropriate liaison has been maintained with the Pacific Trade Office in Europe, Europe is now such a huge market that it is virtually certain that somewhere almost anything will find a market. Frequently the problem for producers from the Pacific is the inability to find a partner in a large market that is small enough to take the relatively small quantities on offer and ration them to a range of prospective consumers. The key to success is to ensure that the successful market is the one that offers the highest price. This is where strategic alliances with businesses that already are established in the market are very important. Success is picking the right partner is where much of the work must be applied and it would be worthwhile for the government to consider assisting this part of the process.

DEVELOPMENT OF SERVICES TRADE

169. It will be in the development of the important services trade that the FICs manage to build up the experience and the confidence to deal with large businesses from Europe and Japan. The possibilities for the development of time zone based exchanges for electronic data based translation, graphic and data processing work is limited primarily by the imagination of the participants. Two examples of this are beginning in the FICs, and because of the particular time zone advantages, Western Europe will be the main market.

170. Irrespective of the future of the Maastricht Treaty and the SEM, this trade will increase rapidly and it is virtually beyond the control of governments and unlikely to be subject to taxes and impossible to subject to quotas. It also a trade where recent improvements in telecommunications in the Pacific and where in trade with Europe the differences in time zones give many of the Pacific Islands clear competitive advantages over other similarly placed remote small communities.

171. Tourism is currently the largest service industry, and is looking forward to a big expansion of activity in, the Pacific. Tourism drives airlines and as the Tourism industry is largely a private sector business, it is important that the essential airline services also be driven by private sector incentives, initiatives and constraints. If Governments see the ownership of an airline as essential to their security or a high priority on their agenda, the very least that must be accomplished is that the airline be corporatised, required to operate on commercial principles and be freed to enter strategic alliances with other airlines in the region to maximise the utilisation of their capacity and to minimise the potential for making losses.

PART 7

CONCLUSION AND POLICY RECOMMENDATIONS

172. This study explores the effects on the FICs, of the introduction of the SEM, and canvasses the total impact of SEM and how they relate to the other changes occurring in Europe. It concludes that while SEM is designed to integrate the economies, it might be said that the other forces at work, including the reforms to the Common Agriculture Policy, the Uruguay Round, and the integration of the EC and EFTA are designed to better integrate the European Community into to Global Economy.
173. The SEM is but one of many changes in the relations between Europe and the countries of the Pacific. Political Independence, largely achieved by the 1970s was the first step towards developing modern nations in the Pacific. However, most of the FICs now find themselves more dependent on concessional access to European markets through the Lome Convention, and the distributions of European aid and grant monies than they were at independence.
174. SEM process will make little immediate impact on FIC exports, although it will create opportunities in the future. To take advantage of these opportunities FICs will need to reorientate their policies to give highest priority to making their economies internationally competitive. This will involve cost reductions in their key industries and enhance the potential for normal profitable multilateral trading relations.
175. These policies will be assisted by more transparent access to Europe following SEM. The major benefit of the SEM in the FICs could come from the increased wealth and competitiveness of the European Market. This could lead to an increase in the demand,

and better prices for certain commodity exports and for services like tourism. European tourism is a growing source of tourists to the South Pacific, although still dwarfed by Australia and New Zealand as markets.

176. In the areas of financial and other professional services, the exploitation of tax free status and time zone differences have enormous potential. While offering a greater potential for trade with Europe these policies are likely to reinforce the shift that has taken place away from Europe and even Australia and New Zealand. Increasingly the focus of economic activity will move towards the faster growing economies of Japan, China and South East Asia as outlets for trade, tourism and services and as sources of consumer goods, technology and even aid.
177. Most of the FICs need to appreciate more fully that agriculture is their most important source of employment and economic activity and will remain so. To permit agriculture to help meet the aspirations of their peoples the FICs will need to attract private capital as well as official aid into production, processing, packaging, and marketing. There will need to be changes in policies to bring that about.
178. Becoming internationally competitive will involve FICs overcoming both the traditional handicaps and man made handicaps. Traditional handicaps are the problems of isolation, distance, communications and small populations. The more recent problems include high cost structures, inadequate maintenance of physical capital, inappropriate institutional structures, and inadequate investment in human capital. A more entrepreneurial culture will help overcome the problems of small populations and small total output.
179. There will need to be improvements in the infrastructure of several economies to take full advantage of modern methods, both in price reductions and improved technology. These will demand and assist a greater focus on the development of the human capital of the region and the maintenance of physical capital. There will need to be an improvement in the standards and the professionalism in the manufacture, presentation and marking of goods that can only come about if accompanied by a liberalisation of imports to assist the creation of a more discerning local consumer market. There will need to be a review of institutional structures, including a search for models more appropriate than those copied from Australia and New Zealand, the least dynamic Pacific economies.
180. FIC economies are strongly advised to follow an outward focused market led similar pattern of development and several are beginning to. In the context of achieving self-sustaining development for the FICs, the successful conclusion of the GATT round, the reform of the CAP and the successful integration of the French Pacific Territories into the Pacific Economy will have greater long term significance than SEM. The total potential that these developments offer will be realised only if the policy decisions that are made that allow the growing private sector to take advantage of the many opportunities that remain to be exploited.

POLICY RECOMMENDATIONS

181. That Policy Makers in the FICs be encouraged to:

- **Note:** that opportunities created by the SEM include, the greater transparency of access into Europe and the greater wealth created as a result of a larger more competitive market.

- **Note:** that SEM will better increase the integration of the economies of the European Community, and the proposed reforms to the CAP, the Uruguay Round and the integration of the EC with EFTA will have the effect of better integrating Europe with the World Economy.
- **Note:** that as barriers to trade are eliminated and economies increase their integration there will be a weaker case for concessional access such as that provided for by the Lome Convention.
- **Note:** that with the Cost of the integration of Eastern Europe into the World Economy, with growing budgetary problems in most industrialised countries, and with other pressing demands on financial resources it is unlikely that the World Volume of aid will increase and it is more likely to be capped or diminish.
- **Note:** that the prudent course of economic management for FICs is to orientate policies to an outward looking market led strategy, anticipating that aid flows will be reduced.
- **Note:** that prudent a prudent outward looking management strategy, requires that FIC economies must become more internationally competitive and take advantage of the opportunities presented by their location in the "Eye of the Cyclone" of economic growth in the Pacific Basin.
- **Note:** that international competitiveness in the Pacific implies a smaller role for the government in the day to day running of businesses and a greater encouragement of private sector and foreign investment, with the objective of encouraging successful businesses and encouraging strategic alliances between local and foreign firms.