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The Importance of Trade and Productive Capacity Post-2015: Lessons from the Pacific

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Background

The Sustainable Development Goals (SDGs) that will be adopted in 2015 include a commitment to promote trade in the least developed countries (LDCs) and small island states such as the Pacific Island Countries (PICs). Much of this commitment involves market access delivered through the World Trade Organization (WTO).[1] But market access alone will be meaningless without an increase in productive capacity. The SDGs must better reflect the trade and development-related needs of the PICs and of LDCs.

This issue of *Commonwealth Trade Hot Topics* draws lessons from the four Pacific Diagnostic Trade Integration Studies (DTISs), a series of comprehensive trade analyses aimed at improving countries' ability to access global markets and to benefit from trade. The DTISs are performed under the multi-agency Enhanced Integrated Framework for Trade Related Technical Assistance to Least Developed Countries, an initiative based at the WTO Secretariat in Geneva, Switzerland. The paper argues that in addition to market access, focus should be placed on behind-the-border measures including infrastructure, rules of origin, negotiating capacity, standards and targeting aid for trade.

One major shortcoming of the Millennium Development Goals (MDGs) was their failure to include dimensions of structural economic transformation or to integrate the development of productive capacities (Basnett and Keane, 2013). The goals generated funding and political attention for social development but not for trade and economic development.

PICs – which comprise 22 tiny, open economies and territories – have struggled to benefit from globalisation and from their greater outward orientation facilitated through liberalisation.[2] Most have large goods-trade deficits and all face tariff preference erosion (the difference between tariffs on their own exports and those from other countries). Their economic growth and human development performance is in many cases below the developing country average and aid per capita remains the highest in the world.

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1 Particularly points 17.10 and 17.12 of the SDGs.

2 The 14 small island members of the Pacific Islands Forum are Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Nauru, Niue, Palau, Papua New Guinea, Republic of Marshall Islands, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. Eight associate members and observers, not all of which are independent states, are New Caledonia, French Polynesia, and Tokelau (associate members), Wallis and Futuna, American Samoa, Guam, the Commonwealth of the Northern Marianas, and Timor Leste.

Table 1: Human Development Index, GDP Growth, GDP Per Capita and Net ODA (2012)

	HDI rank and value	GDP growth (in percentage)	GDP per capita (current $)	Net ODA (per capita, current $)
	Median*: 94 (0.712)	Low- and middle-income country** average: 3.8	Low- and middle-income country** average: 3,966	Low- and middle-income country** average: 78.44
Pacific	113 (0.65)	2.8	3,927	815.65
Data by Country				
Fiji	96 (0.702)	2.30	4,467	122.71
Kiribati	121 (.629)	2.81	1,736	641.55
Marshall Islands	n.a.	1.90	3,471	1,446.29
Micronesia, Fed. Sts.	117 (0.645)	0.43	3,155	1,112.62
Palau	52 (0.791)	5.25	11,006	722.75
Papua New Guinea	156 (0.466)	8	2,184	92.76
Samoa	96 (0.702)	2.89	3,620	638.84
Solomon Islands	143 (0.53)	3.90	1,835	554.91
Tonga	95 (0.71)	0.84	4,494	745.75
Tuvalu	n.a.	0.17	4,044	2,483.77
Vanuatu	124 (0.626)	2.25	3,183	410.17

*Source: Author's calculations based on Human Development Report 2013 and World Development Indicators. Accessed May 2014. *Median value calculated using all countries included in the Human Development Index. **Low-, lower-middle- and upper-middle-income countries (excluding PICs), as classified by the World Bank at February 2014.*

Trade can help development in the PICs by increasing formal employment and reducing aid dependency, helping these countries attain their development goals. Small states benefit particularly from trade given that their own domestic markets are small. Given their limited domestic production bases, PICs require good access to international markets. Trade fuels the economic engine to raise government revenues and build the formal employment needed to achieve the development goals to which governments have committed. Ultimately, trade development can help the PICs operate autonomously and with reduced donor support.

The PICs are among the countries likely to be worst-affected by climate change. Their governments are therefore committed to time-bound targets for maximum global temperature rises. The current draft of the SDGs mentions an 'Action Area' on climate change, but the issue remains highly contentious. Sea-level rise and extreme weather-events as a result of climate change threaten tradeable agriculture and subsistence farming in the PICs – a spur to the expansion of formal employment.

Other trade issues such as subsidies in the fisheries sector – also mentioned in the latest SDG draft – are strongly supported by the PICs, given the instability and uncertainty around trading arrangements for fisheries, which could lead to the overexploitation of stocks, particularly tuna. For some countries in the region, such as Solomon Islands, tuna is a high-value export, and its production and processing provide much-needed jobs.

Pacific island governments have stated that the success of the SDGs depends on how they are implemented. They also want the SDGs to go further than the MDGs, demanding a focus on 'equality and fairness' among trading partners, referring explicitly to the importance of Aid for Trade (AfT).

While preferential market access has helped, the MDGs overlooked productive capacity. The PICs lack the capacity to meet the demand for their products and services. Building such capacity requires measures to transform the economic structure to propel it into higher value-adding activities in services and processing. Better roads, international transport and utilities are critical, but so too are 'softer' infrastructure aspects such as skills and information and communication technology (ICT). The Pacific island governments are right to emphasise the importance of AfT, if it means development assistance to build infrastructure and develop productive capacity.

Governments also demand continued special and differential treatment. PICs' capacity and geographic constraints increase trading costs, meaning that they do not trade on an equal footing with other countries. More creative thinking is needed in this area.

Learning the lessons from diagnostic studies in the Pacific

Six major findings are highlighted here from the Diagnostic Trade Integration Studies (DTISs) completed over recent years in Kiribati, Samoa, Solomon Islands, Tuvalu and Vanuatu – all LDCs except Samoa which is scheduled to graduate in 2015 (most of the findings also apply broadly to other PICs). The DTISs are a series of comprehensive trade analyses aimed at improving countries' ability to access global markets, to reduce barriers to trade and to benefit from trade. The DTISs are performed under the Enhanced Integrated Framework for Trade Related Technical Assistance to LDCs, an initiative based at the WTO Secretariat in Geneva but supported by the World Bank, International Monetary Fund, UN Development Programme, International Trade Centre and the UN Conference on Trade and Development.[3]

1. Market access is not enough

Six PICs are members of the World Trade Organization. Four Pacific LDCs have duty and quota-free (DFQF) access to the USA and Europe (under Everything But Arms and the Generalised System of Preferences), as well as to China. The South Pacific Regional Trade and Economic Co-operation Agreement (SPARTECA) gives PICs DFQF access to Australia and New Zealand. The region is engaged in negotiations towards a trade agreement with Australia and New Zealand, the Pacific Agreement on Closer Economic Relations (PACER Plus) which would give those countries reciprocal access to markets. Twelve states are members of the Pacific Island Countries Trade Agreement (PICTA). The Melanesian Spearhead Group (MSG) Trade Agreement involves the four main independent Western Pacific countries: Fiji, Papua New Guinea, Solomon Islands and Vanuatu.

The May and June 2014 drafts of the SDGs called for further market access for LDCs and developing countries. However, the Pacific DTISs have found that, while welcome, market access alone is not increasing trade to a level that contributes rapidly enough to economic growth and social development. Net goods and services trade has fallen over the last decade despite an increase in market access. During three decades of trade liberalisation, international market access has risen, tariffs and trade barriers have fallen, and inward access has risen but exports of Pacific island goods and services as a proportion of economic output have remained static: around 36 per cent on average. Non-oil exporting LDCs worldwide have also suffered a decline in trade as a proportion of GDP over recent decades. For all LDCs globally the proportion is lower, at 26.6 per cent.[4] In contrast, for small states in general, exports of goods and services are considerably higher, at 47.2 per cent of GDP. In LDCs, particularly in the Pacific, trade has not contributed as expected to employment, government revenues or poverty reduction. More attention needs to be placed on other behind-the-border measures.

2. Build productive capacity

To benefit from preferential market access, which erodes over time given the tendencies towards reductions in trade taxes, sufficient productive capacity is essential. Put simply, the PICs have opportunities to export their products (for which considerable demand exists in developed markets), but they cannot produce enough, in consistent enough quality, to meet that demand or to integrate into supply chains. Table 2 shows the size of European Union import markets for the top two exports from PICs: palm oil and tuna. In 2009 PICs accounted for about 12 per cent of EU palm-oil imports, falling to around 9 per cent in 2013, while the share of tuna import increased marginally.

3 See http: //www.enhancedif.org.

4 World Bank.

Table 2: Top Export Products from the Pacific Island Countries to the European Union

Product	Export (2009 to 2013 average) in '000 US$	Size of EU import market (2009 to 2013 average) in '000 US$	PIC share in total EU imports (in percentage)	
			2009	2013
Palm oil	351,213	3,239,591	12	9
Tuna	96,531	2,408,576	4	5

Source: Author's calculation based on ITC TradeMap. Accessed May 2014.

Solomon Islands provides a typical example: the economy has good market access as a WTO member and party to several international agreements. Markets are very open but the economy remains undiversified and vulnerable to adverse market shifts because of a high dependence on unprocessed logs, which have accounted for up to 75 per cent of exports on average. Since independence in 1978 exports have declined as a proportion of economic output. Economic output has underperformed the region, while aid per capita has risen to one of the highest levels in the world.

The shortfall in productive capacity in Solomon Islands stems from poor national and international transport links, limited financial development, land ownership problems and poor infrastructure. The current approach – global integration through trade agreements accompanied by fiscal austerity – is falling short of its objectives, and policy-makers are recognising that the enhancement of productive capacity, which means the transformation of economic structure, is vital. This requires a focus not only on exports but also on imports and the possibility of selective import substitution: the costs of imports are high because of trade costs.

3. Tackle sanitary and phytosanitary requirements

In some cases, the countries that can meet the demand that exists for their products find sanitary and phytosanitary (SPS) requirements an even bigger barrier to exports than in other regions. A well-known example is kava, a traditional mildly narcotic root crop originating in Vanuatu. European countries banned the product due to health concerns, followed by Australia, New Zealand and the USA. An estimated one-third decline in kava exports from Vanuatu the following year cut yearly exports earnings by 20 per cent and has had a major impact across the region. PICs have since struggled to meet the strong SPS requirements in neighbouring Australian and New Zealand markets for products such as taro, an indigenous root crop which is often exported to Pacific communities living in Sydney and Auckland. Vanuatu beef has also faced SPS challenges in export markets such as Japan and Australia. Donor initiatives such as the Pacific Horticultural Market Access programme have aimed to overcome SPS barriers in Australian and New Zealand markets, particularly for potential new export products such as spices.

The Pacific island governments cannot afford to fight cases such as kava at the WTO dispute settlement body, although exports to some markets have reopened following lobbying and scientific assessments by the World Health Organization.

4. Improve rules of origin

Even when productive capacity does exist and SPS requirements are met, rules of origin (RoO) are often too complicated to allow PICs to make use of trade agreements. The inability to input and use sourced material can restrict countries' ability to export within global value chains (GVCs). Calls have come from the region, and elsewhere, for a definition of RoO based on a change in tariff headings rather than value-addition. At the last WTO Ministerial in Bali in December 2013 the LDC group also called for guidelines on RoO.

For example, the SPARTECA agreement with Australia and New Zealand, which account for most Pacific island exports, stipulates that 50 per cent value must be added locally. This is too restrictive given severe productive capacity constraints. Almost all goods exports from the Pacific island LDCs are to Australia and New Zealand, so these are the markets that matter most. However countries such as Canada allow duty and quota-free market access for products with 25 per cent value-addition in LDCs, an example from which the Pacific region and trading partners may learn.

Similar complexity applies to RoO proposed for fish under the comprehensive Economic Partnership Agreement (EPA) with the EU. Several PICs (LDCs and non-LDCs) hope to obtain 'global sourcing' of fish, which means they could acquire fish from outside the circle of EPA signatories, process it and export it to the EU tariff-free. However, despite the severe productive-capacity constraints already described, which for fisheries include a lack of cold storage facilities, the EU offers global sourcing to PICs only if they have an EPA – a free trade agreement – with the EU. The costs that will result from the removal of tariffs towards the EU under an EPA, coupled with the introduction of other regulatory measures (including the abolishment of export taxes – permitted under the WTO), are seen to outweigh the benefits by many PICs despite their need to expand formal employment opportunities by increasing fisheries processing.

The trade goals included in the zero draft of the SDGs focus on the multilateral trading system, not on the large regional agreements that now shape the global trade landscape. These agreements could further marginalise PICs, and there is a need to ensure that this new wave of regional agreements promote, rather than undermine, the achievement of the SDGs for the Pacific.

5. Simplify negotiations

Most PICs, even the larger ones like Fiji and Papua New Guinea, lack the resources to cope with the complexity that characterises modern trade negotiations. The DTIS study in Tuvalu in 2010 found that the single trade officer was out of the office for 40 per cent of the time and spent 55 per cent of her time on international meetings and associated preparation and debriefings. Even an average-sized PIC trade department might have only half a dozen officials covering all issues.

By comparison the Japanese, European or US trade delegations at international meetings alone may have over 200 members. It is impossible for small island governments to negotiate on an equal footing, and these inequalities need to be addressed, including through staff training in negotiations. But other issues also need to be considered that are, to some extent, tactical. These include standardising and reducing the range of issues on the table; not leaving all issues undecided until the last moment; and holding negotiations and meetings in Pacific island capitals. Several negotiations have either failed or ended in poor outcomes for the region, including the most recent regional negotiations for an EPA with the EU.

6. Prioritise the services sector

The PICs are distant from major markets and face problems of transport, infrastructure, size and economies of scale. However, the steady rise in trade in services, which depends less on physical distance and fragmentation – from 39.2 per cent of GDP in PICs in 2005 to 50.0 per cent in 2013 – bodes well. A tourism and accompanying construction boom has taken place in several PICs. An upturn in labour export to Australia and New Zealand was described by the World Bank as one of the more successful development interventions anywhere in recent years.[5] ICT holds particular promise for this remote region. One or more SDGs that provide explicit support to the growth of productive capacity in such services, and the new opportunities arising from trade in services, would reap significant rewards.

Harnessing momentum within the trade community

WTO members have converged on a trade agenda that goes some way to adapting to the changed landscape of global trade and investment patterns. The Bali package agreed in the WTO at the end of 2013 goes beyond trade liberalisation to include trade facilitation, RoO and a services waiver allowing developed countries to make certain concessions to LDCs that they do not provide to other countries. All of these are responses to the changing trade environment and the specific call from LDCs like Solomon Islands for a broader range of trade and development instruments. The SDGs should remain development-oriented, continuing to inspire the WTO rather than falling in line with WTO rules.

WTO members have agreed to provide resources for trade facilitation and have developed a work programme that focuses on reducing trade costs. The exact amount and how it will be implemented are open for discussion. Many PICs find it difficult to measure the cost of trading and trade competitiveness, but country and product-specific analysis shows that high trading costs undermine trade competitiveness and the ability to benefit from preferential market access.

In the Pacific, reducing the cost of trading will involve not only improving trade logistics and infrastructure, but also increasing the capability of

5 World Bank (2010), 'The Development Impact of a Best Practice Seasonal Worker Policy', Policy Research Working Paper 5488, http: //www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2010/11/30/000158349_20101130131212/Rendered/PDF/WPS5488.pdf.

governments to negotiate with the private sector and to regulate the trade-logistics sector effectively. While AfT should focus on reducing the cost of trading in a measurable way, it should also align to other interventions to increase productive capacity, create jobs and, ultimately, transform economic structures.

LDCs have called for specific measures to facilitate trade, such as simpler RoO. These rules matter because they increasingly determine the ability of countries to integrate within new emerging production networks. Ensuring that the rules countries offer in their system of GSP are commensurate with those offered under free-trade agreements could generate greater incentives to include countries, and regions such as the Pacific, within supply chains.

Services, agriculture and fisheries remain the sectors with the greatest economic potential in the Pacific. These sectors are connected, not least because the farming and fishing industries supply hotels and restaurants. Services hold particular promise with the increasing use of ICT and developments in labour export. The Bali WTO Ministerial went some way towards emphasising implementation of the LDC services waiver. An explicit mention within the SDGs of the role of services as a driver of all trade and economic growth could help to ensure that this sector receives the attention it deserves. However, merely explicitly mentioning the issue is unlikely to be enough. If trade issues reside solely with WTO members, concrete outcomes will be very difficult to achieve given the slow progress made to date on the Doha round of trade negotiations. Genuine concerns exist that post-2015 trade-related issues left to the WTO will repeat the experience of MDG 8.

While market access alone is not enough, some areas exist where improved access remains important, including on services and goods market access in some emerging markets, some of which provide access with many exceptions and omissions.

Finally, in the absence of a stronger multilateral trading system, mega-regionals such as the Transatlantic Trade and Investment Partnership and, more relevant to the Pacific islands, the Trans-Pacific Partnership, could bring in new challenges for small states and LDCs. Most of the latter countries are excluded from these mega-regional negotiations, and the post-2015 development agenda is not a priority for countries negotiating them. The nature of trade commitments made under the SDGs and, more importantly, their implementation, will prove critical.

The SDG agenda must acknowledge the limitations of the previous focus in the MDGs on market access. The trade-related SDGs should aim at increasing productive capacity, creating jobs and, ultimately, transforming economic structures. AfT needs to be well targeted. Scope exists for harmonising and providing more liberal rules of origin under countries' GSPs towards the Pacific. Focusing on addressing behind-the-border issues and overcoming the supply-side constraints that suppress the ability to meet external demand could better assist PICs in using trade as a driver of structural transformation and hence poverty reduction.

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International Trade Policy Section at the Commonwealth Secretariat

This Trade Hot Topic is brought out by the International Trade Policy (ITP) Section of the Economic Policy Division of the Commonwealth Secretariat, which is the main intergovernmental agency of the Commonwealth – an association of 53 independent states, comprising large and small, developed and developing, landlocked and island economies – facilitating consultation and co-operation among member governments and countries in the common interest of their peoples and in the promotion of international consensus-building.

ITP is entrusted with the responsibilities of undertaking policy-oriented research and advocacy on trade and development issues and providing informed inputs into the related discourses involving Commonwealth members. The ITP approach is to scan the trade and development landscape for areas where orthodox approaches are ineffective or where there are public policy failures or gaps, and to seek heterodox approaches to address those. Its work plan is flexible to enable quick response to emerging issues in the international trading environment that impact particularly on highly vulnerable Commonwealth constituencies – lease developed countries (LDCs), small states and sub-Saharan Africa.

Scope of ITP Work

ITP undertakes activities principally in three broad areas:

- It supports Commonwealth developing members in their negotiation of multilateral and regional trade agreements that promote development friendly outcomes, notably their economic growth through expanded trade.
- It conducts policy research, consultations and advocacy to increase understanding of the changing international trading environment and of policy options for successful adaptation.
- It contributes to the processes involving the multilateral and bilateral trade regimes that advance more beneficial participation of Commonwealth developing country members, particularly, small states and LDCs and sub-Saharan Africa.

ITP Recent Activities

ITPs most recent activities focus on assisting member states in their negotiations under the WTO's Doha Round and various regional trading arrangements, undertaking analytical research on a range of trade policy, emerging trade-related development issues, and supporting workshops/dialogues for facilitating exchange of ideas, disseminating informed inputs, and consensus-building on issues of interest to Commonwealth members.

Selected Recent Meetings/Workshops Supported by ITP

5-7 November 2014: *7th South Asia Economic Summit (SAES VII): Towards South Asia Economic Union* and the Launch of the Publication on *Regional Integration in South Asia: Trends, Prospects and Challenges*, held in New Delhi, India

14-15 October 2014: *LDC IV Monitor's Launch of the Publication on the Implementation of Istanbul Programme of Action for LCDs*, held in New York, USA

3 October 2014: Commonwealth-UNCTAD Discussion Session at the 2014 WTO Public Forum: *South-South Trade and Sub-Saharan Africa: Issues and Way Forward*, held in Geneva, Switzerland

5-6 May 2014: Regional Meeting on '*WTO and Post Bali Agenda*', held in Dhaka, Bangladesh

28-29 April 2014: Regional Meeting on '*WTO and Post Bali Agenda*', held in Accra, Ghana

24-25 April 2014: Regional Meeting on '*WTO and Post Bali Agenda*', held in Nairobi, Kenya

10-11 December 2013: Regional Workshop on '*South-South Trade and Regional Value Chains in Sub Saharan Africa*', held in Nairobi, Kenya

5 December 2013: WTO MC9 side event: *Panel Session on Integrating Trade Issues in Post-2015 International Development Framework*, held in Bali, Indonesia

4 December 2013: WTO MC9 side event: *Discussion Session on the Future of Aid for Trade*, held in Bali, Indonesia

3 December 2013: WTO MC9 side event: *UNCTAD-Commonwealth session on Reflections on Global Trade: From Doha to Bali and Beyond*, held in Bali, Indonesia

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