UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

POLICY ISSUES IN INTERNATIONAL TRADE AND COMMODITIES
STUDY SERIES No. 10

REGIONAL TRADE AGREEMENTS AND DEVELOPING COUNTRIES: THE CASE OF THE PACIFIC ISLANDS' PROPOSED FREE TRADE AGREEMENT

by

Robert Scollay

APEC Study Centre
and
Economics Department, University of Auckland
New Zealand

UNITED NATIONS

New York and Geneva, 2001

NOTE

The views expressed in this study are those of the author and do not necessarily reflect the views of the United Nations.

The designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the United Nations Secretariat concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries.

Material in this publication may be freely quoted or reprinted, but acknowledgement is requested, together with a reference to the document number. A copy of the publication containing the quotation or reprint should be sent to the UNCTAD secretariat:

Chief
Trade Analysis Branch
Division on International Trade in Goods and Services, and Commodities
United Nations Conference on Trade and Development
Palais des Nations
CH-1211 Geneva

UNCTAD/ITCD/TAB/11

UNITED NATIONS PUBLICATION
Sales No. E.01.II.D.16
ISBN 92-1-112527-8
ISSN 1607-8291

ABSTRACT

Fourteen of the world's smallest and most vulnerable economies – the Forum Island Countries (FICs) of the Pacific island region – are in the process of forming themselves into a free trade area (FTA). This paper begins by reviewing the characteristics of the FICs and their external trade. It is shown that despite their small size this is in many ways a very diverse group of economies. Standard analysis of FTAs suggests that trade creation effects from a FIC FTA are likely to be small and that there may be a substantial risk of trade diversion. Loss of tariff revenue is a major concern, which needs to be addressed by restructuring of tax and tariff systems in some cases. Quantitative studies have confirmed the small size of the trade creation effects and indicated the size of likely tariff losses, but were somewhat reassuring on the issue of trade diversion. Studies have also highlighted the importance of continuing attention to most-favoured-nation tariff reductions in parallel with the formation of the FTAs in order to ensure that welfare effects are positive. A brief outline of the proposed FTA is provided. The proposed FTA should not be evaluated as a "stand-alone" exercise but as part of a wider process of gradually integrating the FICs into the global economy. It must also be seen in the context of the FICs' existing non-reciprocal free trade arrangements with Australia and New Zealand and the European Union, and the prospective future development of those relationships on a reciprocal basis.

ACKNOWLEDGEMENTS

This paper was written while the principal author was a visiting scholar at UNCTAD's Division on International Trade in Goods and Services, and Commodities in Geneva. The support of the Division and its Director, John Cuddy, is gratefully acknowledged. Grateful thanks are also due to Bijit Bora and Lucian Cernat for their support and advice and for comments, and to an anonymous referee for helpful comments on an earlier draft of the paper. Any remaining errors are of course the responsibility of the author.

CONTENTS

List of figures

List of tables

Appendixes

INTRODUCTION*

The proliferation of regional trading arrangements (RTAs) was a prominent feature of the international trading system in the last decade of the twentieth century. The World Bank (2000) notes that of the 194 agreements notified to the General Agreement on Tariffs and Trade (GATT) or the World Trade Organization (WTO) since the GATT's inception, 87 were notified in the years from 1990. Laird (1999) notes that 45 agreements were notified in the years from 1995 to 1998, with an estimated 62 further agreements which had not yet been notified to the WTO by mid-1998. A new survey by WTO (2000) counted a total of 172 RTAs currently in force with a further 68 under negotiation, some of which are designed to replace existing RTAs.

Not surprisingly, these developments have been accompanied by a lively debate on the effects and implications of RTAs. There are several strands to this debate. One strand concerns the benefits and costs of RTAs for their members, in comparison with other alternatives open to them. A related issue is the effect of RTAs on non-members. A further area of debate related to both these issues is the set of questions regarding how RTAs can be designed to maximize benefits and minimize costs. There is also a long-running debate over whether the spread of RTAs threatens to undermine the multilateral trading system based around the WTO, and a closely related debate on whether the WTO's disciplines and procedures relating to RTAs are adequate to the situation. The implications, negative or otherwise, of the tendency for RTA developments to centre around major trading nations has been a particular focus of debate.

Developing countries have not stood aside from the trend towards RTAs. Developing countries in all major regions of the globe have been and continue to be participants or potential participants in RTAs, and many participate simultaneously in several such agreements. The issues raised in wider debates have naturally also been applied to the questions relating to the place of RTAs in the trade strategies of developing countries, and the contribution which participation in RTAs may make to the development process.

Debate on this last point has a long history and not surprisingly the focus of the debate has tended to shift in line with changing ideas on the relationship between trade and development. In earlier years, when the import substitution paradigm heavily influenced thinking on development issues, proposals for RTAs among developing countries often reflected an interest in exploring a regional as distinct from a national approach to import substitution, through the creation of larger protected markets for the import-substituting industries to exploit. More recently, as outward-looking trade strategies have increasingly become the norm, RTAs have tended more often to be

* On 28 June 2001, the trade ministers of the Pacific Islands Forum member countries announced that they had endorsed a proposal for the establishment of a free trade area between the island country members of the Forum (the Forum Island Countries, or FICs), to be known as the Pacific Island Countries Free Trade Agreement (PICTA). At the same time they endorsed a proposal for a framework agreement, providing for the future strengthening at an appropriate pace of trade and economic cooperation between all Forum members (including Australia and New Zealand), to be known as the Pacific Agreement on Closer Economic Relations (PACER). These agreements will be recommended for approval and signature to the Forum leaders, who will be meeting in Nauru in August 2001.

evaluated for their contribution to the more effective integration of their members into the international economy. Debate also continues, however, on the relation between trade and economic integration and the development of the domestic economy, for example through improved infrastructure facilities.

This paper aims to make a modest contribution to debates surrounding participation by RTAs in developing countries by considering the arguments commonly aired in these debates in the context of a specific proposal to form a free trade area (FTA) among the island nations of the South Pacific, the so-called Forum Island Countries (FICs), which made the political decision in late 1999 to proceed with the negotiation of an agreement on a FTA, referred to in this paper as the FIC FTA. In the process it will be seen that the advantages and disadvantages of a given RTA proposal need to be assessed in the light of the economic characteristics of the participating countries and their trade. It will also become clear that grasping the full implications of a proposal such as FIC FTA requires an understanding of how the proposed arrangement may interact with the members' trade relations with their major developed country economic partners.

The first section of this paper highlights key economic characteristics of the FICs and their major trading and economic relationships. This is followed by a discussion of the factors which are likely to be important in assessing the benefits and costs of the proposed FIC FTA, leading to some preliminary conclusions about its likely economic effects. These conclusions are then tested against some rudimentary quantitative analysis of the implications of the FIC FTA, leading to some further conclusions about FIC FTA's likely economic effects and about the way the agreement should be designed in order to maximize benefits and minimize costs. The main features of the proposed FIC FTA are then outlined and briefly discussed in the light of the conclusions from the preceding analysis. A further section deals with the linkages between the FIC FTA proposals and the existing trade agreements between the FICs and their major developed country trading partners, together with the complications which may arise for the ongoing management of these existing arrangements in the context of the FIC FTA proposal. This section is followed by a brief concluding section.