

Submission 20 - Supplementary Submission - Questions on Notice

Possible questions that may be asked

1. Do you believe PACER Plus is the solution to promoting trade and investment in the Pacific?

a. If not, what alternative trade and investment arrangements should be investigated?

Yes. If PACER Plus leads to overcoming the binding constraints to investment, trade, and growth, it can become a valuable vehicle for transforming the FICs. However, it must be acknowledged from the outset that overcoming their binding constraints will require them to do much more than simply implement their PACER commitments. These alone, while a start, must be supported by unilateral policy decisions that are at the heart of good economic management. FICs have generally failed to do this up to now in any sustainable way, and so hopefully they will adopt the PACER Plus framework to seize such reform opportunities. After all, the main economic problems confronting FICs are domestic supply constraints that can only be tackled at home by governments, supported by the developed PACER Plus partners along with other aid donors.

Options for increased trade in goods, for example, are limited because the FICs cannot compete with Asian exporters either on costs or productivity. The only activities where the Pacific has done well are in “niche” markets that can fetch a price premium to more than cover the high costs of international trade and the wage cost and productivity disadvantages, e.g. Fiji Water, Pure Fiji.

The ASEAN-Australia-New Zealand Free Trade Area (AANZFTA) that came into force in Australia in 2010 means the FICs no longer enjoy preferences originally afforded via SPARTECA. Alternatives exist with regards to trade in services (tourism, BPO, etc) and mobility of natural persons. However, doing this competitively requires access to foreign investment, a major means by which services are traded internationally through commercial presence, and significant human capital in education and training.

2. What will be the potential economic impact of PACER Plus, and how can these countries best overcome any short-term costs, such as loss of tariff or customs revenue?

PACER Plus should stimulate investment (particularly investment from A&NZ), innovation, productivity, and economic growth and employment. The concerns about loss of tariff revenue are over-blown for most FICs as tariff reductions are to be introduced very slowly and for the most part custom duties are a small part of government revenues that should be offset by VAT

or other domestic tax reforms e.g. to direct taxes. Some FICs have already introduced a VAT in anticipation of losses of customs duties.

However, some of the smaller FICs are likely to suffer substantial government revenue losses from tariff cuts under PACER Plus because their economies are so small and narrowly based that alternative taxes such as VAT are unlikely to be feasible through excessive administrative costs and lack of domestic supply chains i.e. a tax base. Prime examples are the US compact FICs of the Republic of the Marshall Islands and Federated States of Micronesia where efforts to introduce a VAT have collapsed. While these FICs trade little with A&NZ they will nevertheless incur large government revenue falls from PACER Plus tariff reductions by virtue of their Compact agreement with the US, which requires them to extend MFN tariffs to its exports. The US has indicated that it would require compact FICs, including Palau, to implement this MFN clause following adoption of PACER Plus, although the pace may be negotiable.

Vanuatu which to date has not had any income taxes is now considering the introduction of an income tax. Nauru also has a narrow tax system with no income tax per se.

3. Are there any measures/arrangements that New Zealand is currently pursuing in the Pacific to promote trade and investment, beyond PACER Plus, that Australia should take note of?

- (i) Pacific Trades Partnership (NZL) – builds on the Canterbury Reconstruction Programme by offering trained Pacific carpenters the opportunity to work in New Zealand’s construction industry - an industry with persistent skills shortages and increasing demand.
- (ii) Fishing industry – recruitment of trained and experienced fishers from Kiribati and Tuvalu in 2018 for work in New Zealand with a view to having them return with experience and income for home.

4. Could you please elaborate further on why the Australian Government should consider labour mobility critical to its approach with the Pacific?

Labour mobility can be beneficial to both the FICs and to Australia (in overcoming labour shortages). However, labour mobility is an important bargaining chip that A&NZ should use to generate domestic reforms in the FICs that would boost their growth prospects.

If Australia is to maintain the current GDP growth rate per capita, with its aging population and falling fertility rate, modelling indicates we will need some 2 million extra workers with technical and vocational skills by 2050 – this

translates into an annual net inflow of some 70,000 foreign-born, vocationally-skilled workers (see Chand and Clemens, 2020).

Many of these jobs are currently filled by students, those on temporary visas, and some over-qualified locals. The FICs, especially PNG with its historic and cultural links to us, and with their close proximity to Australia, will be well positioned to supply these workers given their “youth bulge” and rapidly expanding population. But to take advantage of these opportunities the FICs will need to invest in upskilling its workers to meet jobs likely to emerge in future, such as in Aged Care.

Labour mobility has been viewed mainly as an instrument of aid. However, Australia has to increasingly see it as a means of delivering economic benefits to all stakeholders. The emphasis has to be on meeting skill shortages in Australia, and in support of upskilling of the youth of today for circular flows in the Pacific driven by market signals.

5. How can the Australian Government assist Pacific countries to examine competition policy and potentially foster regional cooperation in this space?

Most of the FICs are too small and do not have the necessary skills or legal systems to enforce their own competition policies. Therefore, a regional competition policy mechanism, based on that of Fiji, could be considered.

6. How would the COVID-19 pandemic be impacting on the Pacific islands' traditional revenue sources - particularly tourism, fishing, health care, and labour remittances?

The COVID-19 pandemic has essentially stopped tourism. This is devastating for the six FICs very dependent on tourism: Cook Islands, Fiji, Palau, Samoa, Tonga, and Vanuatu. The pandemic has also halted recent attempts to resurrect national airlines. Although, some of these airline initiatives were probably unviable.

Tuna fishing has been disrupted as the pandemic has interfered with the use of locals on Distant Water Fishing Vessels to check on catches and with the unloading of catches.

The pandemic has put a strain on health care services; these were mostly stretched to begin with. Samoa is especially affected as it has recently also had a measles outbreak leading to many deaths.

Remittances have suffered badly from the suspension of airline traffic. Tonga, Samoa, and Vanuatu, which have relatively high seasonal worker numbers, are most affected. Australia has begun to respond to this situation by allowing the temporary migration of 200 seasonal workers from Vanuatu to pick fruit in the Northern Territory.

7. Given the present environment, in that international travel and tourism flows may not eventuate in the foreseeable future, what interim solutions can the Australian Government consider to support tourism and labour mobility for promoting trade in services?

The FICs will need to adopt innovative ways to use IT services to promote activities that can replace the physical movement of people. Education provision of courses throughout the FICs by the University of the South Pacific is already IT-intensive. Hence, it may be easier in the Pacific than elsewhere to foster IT-intensive activities, e.g. some opportunities for increased trade in services. Given past investment in ICT infrastructure, BPO (business process outsourcing) has grown in Fiji. This infrastructure may warrant boosting, and ICT services made more competitive, to enhance the regional delivery of information, tertiary education, and healthcare. Fiji should consider becoming a tele-medicine “hub” like Cuba, with its advanced IT and medical training.

8. You note the need to secure access to land for private investors. Considering most land in the Pacific is held under customary ownership and is contingent on Pacific cultural values and norms, how can Australia appropriately assist in this space that is culturally-appropriate?

Secure access to and transferability of land is the most important binding constraint confronting most of the FICs (except for Fiji and Vanuatu). Most business and investment activities need secure access to land, and without it, become “footloose” and incapable of expansion. With not being able to use land as collateral, accessing finance becomes very difficult and expensive.

Fiji, and more recently PNG, have made significant progress in the adoption of long-term, secure leases of custom-held land that is underwritten by the state and cemented through the sharing of gains between the landowners, the tenants, and the Government. PNG can provide important lessons to other FICs on how to reform land policies.

9. Why are the Pacific Labour Scheme and the Seasonal Worker Program important for Australian-Pacific economic relations? What should be done to encourage more female participation?

These labour mobility schemes foster better relationships as they introduce Pacific islanders to the ideas of good governance observed in Australia that they can take back home.

The schemes are sustainable by being founded on voluntary participation that delivers economic rewards to all stakeholders. Female participation could be encouraged by allowing more workers in hospitality, nursing, and similar occupations that are majority female.

While greater female participation is desirable, it should be done carefully as the absence of mothers can detrimentally affect families more than the absence of fathers.

10. What can the Australian Government do to promote and boost opportunities for Pacific Islanders to live and work in Australia?

The A&NZ governments have already helped the FICs through seasonal worker programs. Australia has especially assisted with its expanded visa programs and schemes.

But greater engagement of industry is needed in the design of TVET curriculum at the Australian Pacific Training College (APTC), and enabling internships to be linked regionally, including in Australia, Fiji, New Zealand, and PNG. This could enable FIC workers to circulate between Australia and the Pacific islands, as well as across the region. This is the motivation for the proposed 'Pacific Skills Visa'.

11. Do you believe a new services agreement across the Pacific would lead to greater supply and competition in sectors such as education, ICT and business services, energy, and transport and tourism?

The expansion of digital services between the FICs and Australia could be very useful in all of these areas. The new subterranean cable from PNG to Australia through Solomon Islands will help, as will the recent expansions of the cables through Tonga and Fiji.

12. Is Aid for Trade an important part of Australia's relationship in the Pacific, and how can it be improved? Any standout examples of success?

There are no obvious standout cases of success, but some are in their infancy.

The Australia Infrastructure Finance Facility (AIFF) was considering funding jointly with the ADB investments to flood-proof Nadi, in Fiji, the major Pacific tourist hub. This initiative has, however, been put on hold due to COVID-19.

13. What is China's trade relationship with Pacific island countries, and how does it differ to Australia's and what advantages does Australia have over China, if any?

The FICs' trade and, to a lesser extent, investment activities with China have expanded in recent years. China is an important source of competitive imports for the Pacific, thereby benefiting FIC consumers and businesses. The FICs export mainly minerals to China, especially bauxite from Fiji (Xinfa Aurum Exploration that ended in 2018) and nickel from PNG (the \$2 billion Ramu Nickel project by Metallurgical Corporation of China & Porgera Gold, a joint venture between Barrick and Zijin Mining Group). Australia's trade with the FICs is relatively small. A&NZ are the most important sources of tourists for the FICs.

China has been the world's factory for manufactured products over the past several decades and has invested in the Pacific. Large state-sponsored Chinese firms, such as the China Railway Corporation, have established in PNG, and are likely to expand on the back of investments funded under the Belt-and-Road-Initiative (BRI). This could benefit the FICs since Chinese firms can build infrastructure more competitively than Australian firms, even though questions often surround the quality of Chinese construction. However, A&NZ out-compete China in providing access to preferred labour markets and in providing key services such as education and healthcare.