Pacific Institute
of Public Policy

MSG: trading on political capital and Melanesian solidarity

Key messages:

- The MSG is the strongest sub-regional grouping in the Pacific, but this needs to be considered in light of the fact that this is the least integrated region in the world.
- The MSG is first and foremost about political co-operation.
- Trade is the most visible activity of the alliance.
- The MSG Free Trade Agreement has had limited impact on member country economies, but has strengthened its political resolve to engage at a regional and global level.
- Establishing the new MSG secretariat signals a bold new phase for Melanesian co-operation.
- MSG leaders need to define their vision for the Melanesian alliance and its future role in regional economic and political affairs.

Briefing Paper:

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The Melanesian Spearhead Group (MSG) is the strongest sub-regional political and economic alliance in the Pacific. Its members Papua New Guinea, Solomon Islands, Vanuatu and Fiji, constitute over three quarters of the population, land area and GDP of the broader Pacific group of nations[1].

The MSG was founded in 1986 as a means of advancing common political goals. Over time the interests of the organisation evolved into co-operation on a number of fronts, most prominently promoting free trade between member countries. Indeed, trade has become the most visible focus of the group.

The first MSG Free Trade Agreement (MSG-FTA) between members was signed in 1993, and covered three countries[2] and just three products[3]. The MSG-FTA contained a commitment that member countries would grant each other 'most favoured nation' (MFN) status, which meant any concessions granted by a MSG country to a non-MSG country would be passed on automatically to their MSG neighbours. It therefore ensured members of the group were always on the best possible trading terms. By 1998, the MSG-FTA had expanded to include Fiji and cover over 180 products. In 2005 a revised agreement was adopted with the aim of further integrating the economies of member countries.

The MSG Constitution was agreed in 2007, and a secretariat established in May 2008. During the opening ceremony of the new secretariat building in Port Vila, Vanuatu the PNG Prime Minister, Grand Chief, Sir Michael Somare, declared the Melanesian bloc had

> *proved the earlier cynics wrong. They said that we were too fragmented, too parochial in our interests and too poor to make the organisation work. We shall overcome whatever difficulties that confront our countries.*

Establishing a permanent secretariat signals a bold new phase for the MSG, pointing to the prospect of greater Melanesian co-operation in the future. This briefing paper reflects on the trade dimension of the MSG alliance, tracing the shift from political co-operation to economic integration, and in doing so suggest that a more ambitious trade integration program offers the group opportunities for enhanced economic growth and regional political influence.

1. The broader Pacific group of nations includes the fourteen island states of the Pacific Islands Forum, viz: Papua New Guinea, Solomon Islands, Vanuatu, Fiji, Nauru, Kiribati, Marshall Islands, Federated States of Micronesia, Palau, Tonga, Samoa, Tuvalu, Niue, Cook Islands.

2. Papua New Guinea, Solomon Islands and Vanuatu.

3. Tea, canned tuna, and beef.

Moving from a political initiative to a trade-based alliance

The MSG founding members sought to harness a spirit of solidarity between the newly independent nations, with the sub-regional bloc serving as a "voice for the liberty of all Melanesians against the tentacles of Western colonisation."[4] At the inaugural meeting in 1986, Grand Chief, Sir Michael Somare stated

> *The establishment of the MSG sets the legal foundation for the governance of our Melanesian people, which will be the basis for our existence. This shows that our Melanesian spirit, brotherhood and solidarity is united and we ask for the non-interference in our affairs by regional powers as we face the challenges ahead.*

Member countries continue to make public statements of political support for pro-independence movements, especially in relation to the Melanesian populations in West Papua and New Caledonian. The Kanak Socialist Front for National Liberation (FLNKS) has observer status at MSG meetings, and recently leaders have considered inviting Timor Leste and West Papua to join the group.

While political co-operation evolved over time to encompass issues of immigration, customs and security, it is trade and the MSG-FTA that is arguably the best known and most visible instrument of the organisation.

The first MSG-FTA was born out of the Leaders' Summit in Port Vila, Vanuatu in 1992. Signed the following year in Rabaul, Papua New Guinea, the agreement provided for free access to goods and services between member countries. The guiding principle was greater trade co-operation and liberalisation to encourage competition and efficiency, thus improving the economic and social wellbeing of member countries. The free trade agreement also anticipated opportunities for efficient MSG exporters to prosper in a familiar environment.

An emphasis on protection

The inclusion of Fiji in 1998 fundamentally changed the dynamics of the original trade agreement. Fiji, with a more urbanised, commercial and industrial-based economy, was able to take greater advantage of the commercial terms of the MSG-FTA. Moreover, without Fiji, the scope for economic gain was limited due to the small size and duplication of domestic industries and commodity exports. With the exception of Fiji, members excluded sensitive goods from duty reductions by placing them on a 'negative list'[5].

4. J. Koanapo (2008), 'Modernising the MSG', *Daily Post*, 29 May 2008.

5. Negative listing works on the basis that all goods will eventually be traded duty free, except for those explicitly exempted and detailed in the 'negative list' of each country.

By 2005, and following lengthy negotiations, it was agreed that there would be gradual liberalisation of the negative list goods, reducing to zero tariffs by January 2013. Further clauses offered protection to 'infant industries'[6] although renowned economist Satish Chand (2006) points to biscuit manufacturing in Fiji "as a rare example of the successful use of this strategy".

In reality many protected industries contributed little to the economies of member states, and in some cases actually had a net negative impact. In the case of chicken products in Vanuatu, the protection measures meant the nominal tax rate for imported chicken meat was 55 per cent, and yet it was still cheaper to import the finished product than purchase the necessary inputs to establish local poultry farms.

Assessing the economic impact

At the end of negotiations that delivered the revised agreement in 2005, Fiji officials considered the agreement as a missed opportunity for deeper economic integration. PNG officials view the MSG-FTA as being largely irrelevant in terms of national economic development, and Solomon Islands and, to a lesser extent, Vanuatu, have questioned the benefits on offer from the agreement.

Despite the concessions of reduced tariffs, the MSG-FTA has failed to significantly increase trade flows between the Melanesian countries. Between 2003-05, total trade flows between MSG countries was approximately US$30m, which equates to about six per cent of all trade into the sub-region. The scope for improvement has been limited in part by the protections built into the agreement, and the fact that trade liberalisation was occurring between similar, mainly commodity-exporting countries of relatively small size.

Revenue implications are generally proportional to trade flows, and as such government incomes have not been significantly reduced. Vanuatu, the MSG country most reliant on import duties, lost about 100 million vatu (US $1 million) or two per cent of total annual revenue as a direct result of the 2005 agreement. In comparison, it has been estimated that implementing the EPA[7], PICTA[8] and PACER[9] trade agreements could lead to losses in excess of 20 per cent of total revenue in Vanuatu.

Ultimately, consumers (and voters) judge a trade deal at the checkout. It is difficult to discern with any accuracy, the direct effect of the MSG-FTA on actual prices of goods in stores, mainly due to the lack of available data and

6. Infant industries are protected from established competitors from other countries until they can attain similar economies of scale.

7. Economic Partnership Agreement

8. Pacific Islands Countries Trade Agreement

9. Pacific Agreement on Closer Economic Relations

complexity of tax arrangements. It is, however, known that the retail price of rice imported to MSG countries from Fiji did drop noticeably for some time after the introduction of the revised trade agreement in 2005 (but has since adjusted upwards, in part due to the world commodity trends). Conversely, Vanuatu beef exporters increased prices to the Solomon Islands as tariffs fell. Limited competition within and between MSG countries effectively benefits producers and sellers at the expense of their customers. Prices for consumers do not fall when wholesalers and retailers can absorb increased profits in oligopolistic market conditions (i.e. the absence of robust competition).

A simplistic measure of a trade deal is the change in tariff rate. Delving further, we need to assess the complex relationships between trade flows, domestic competition, tax revenues, prices, and the shifting attitudes of governments, producers and consumers. This will enable a better understanding of the wider socio-economic landscape, and how it affects the political will to for trade liberalisation and economic reform measures.

In the absence of such detailed research, it is difficult to paint a complete picture of the success or otherwise of the MSG-FTA. What we can tell is that since the 2005 revised agreement, there has been more exposure to, and as a result more understanding of, the realities of living in a global economy. This in turn has delivered a better understanding of the complexities of trade policy, which MSG governments have used to their benefit at the regional political level.

Operating in a global context

MSG offers member countries a significant platform from which to engage with the international community, and its trade function has strengthened its political clout within the region. Those excluded from the alliance often express concern of the potential for sub-regional fragmentation and factionalism. At the Pacific Islands Forum Leaders' meeting in Nadi (2006), the Prime Minister of Samoa, Tuila'epa Malielegaoi argued that MSG posed a "risk to the cohesiveness" of the broader Pacific organisation, suggesting that sub-regional groupings could lead to destructive factionalisation.

When the MSG was first conceived, Australia and New Zealand supported the Forum to the exclusion of the (then) new sub-regional group.

However, it is impossible to deny the existence of the group or to marginalise its interests. Melanesia's natural endowments (population, geography and resources) mean it will always be a power broker among Pacific nations.

Indeed, criticism, alienation and the rise of alternative sources of support (China in particular and Asia in general) has served to reinforce the spirit of Melanesian solidarity, which was most notable at the elaborate launch of the Chinese funded secretariat building in Port Vila in May, 2008.

Regional trade agreements such as the MSG-FTA, which liberalise between select groups of countries, have been criticised for undermining the multilateral WTO[10] trading system, by creating a complex 'spaghetti bowl' of different preferential arrangements. Under WTO, tariff reductions and a host of other trade rules are negotiated by 152 members. The other significant criticism is that regional agreements can lead to inefficient trade diversion away from efficient producers outside the region, in this case towards inefficient MSG producers.

The MSG is, however, viewed as a legitimate, indigenous co-operative endeavour, which translates into domestic support for the MSG-FTA over other agreements such as PICTA, PACER (with Australia and New Zealand) and WTO. Parochial support for the MSG-FTA therefore empowers Melanesian governments to shift towards trade liberalisation and resistance to protectionist pressures at a time when discussion of other (non-regional) agreements tend to stimulate anti-trade sentiment.

The next phase of trade discussions across the region need not compromise the MSG-FTA so long as they retain some of the MSG concessions. But in the longer term, MSG markets will need to mature and actively compete in the global economy. Retaining protective barriers, even under the guise of MSG solidarity, must only be used as intended: to develop emerging competitive industries, and not as a means of import substitution, nor keeping afloat uncompetitive businesses.

Despite the broad vision of Melanesian co-operation, sovereignty of individual states, quite rightly, remains paramount. Co-ordination, which involves a sacrifice of sovereignty at some level, is much easier where high levels of trade and economic dependence are already in existence, and/or there are shared foreign policy imperatives.

Moreover, Fiji and Papua New Guinea are defined by the United Nations as 'developing countries' while Vanuatu[11] and Solomon Islands are classified as 'least developed countries' (LDCs).

LDCs are given preferential treatment for exports to developed countries, which diminishes the possibility for a common MSG position on international trading relationships. This came into play during the EPA negotiations with the European Union (EU) in 2007, during which PNG and Fiji broke ranks to sign an interim agreement with the EU in order to protect preferences for canned tuna and sugar.

MSG members need to give further consideration to the underlying principles of unity and collective bargaining in light of the different treatment they receive from global institutions and bilateral partnerships.

10. World Trade Organisation

11. Vanuatu's imminent graduation from LDC status has been subject of much international lobbying.

The way forward

There is clearly great potential for the MSG to lead from the front on a range of Pacific issues. Stronger and more effective trade relations can promote economic prosperity and bring about a more powerful political presence on regional and global platforms. While the group has consolidated its political base, it's members have generally failed to capitalise on trade relations to bolster domestic economic growth.

At a time when PICTA and PACER are increasingly dominating regional trade discussions, renewed commitment to developing MSG trade policy may be essential to ensure the relevance of the group, both regionally and globally. To maximise the benefits of the MSG-FTA, it will be important to move beyond simply reducing tariffs on an individual country basis, and move towards closer political and economic integration. Closer co-ordination of trade policy will make it easier to forge regional positions on liberalisation with the outside world. For example, the application of separate negative lists, while enabling individual countries to retain greater 'policy space', has limited the scope to unite behind a common list of MSG 'sensitive' products.

Harnessing the political will for such integration will be difficult as some MSG countries negotiate with the WTO on wholesale tariff liberalisation, and others pursue regional bilateral agreements (e.g. the potential for PACER deals with Australia and New Zealand).

The MSG could benefit from visionary leadership, to move it beyond its current state of complacency vis-à-vis Melanesia's regional comparative advantage (i.e. its endowments of population, geography) and shift towards developing its regional competitiveness through improved use of its endowments.

The opening of the permanent secretariat is an encouraging signal of commitment, marking such a shift and we look forward to this institution taking a leading role in terms of:

- ensuring effective implementation of the MSG-FTA
- resolving any future disputes more efficiently
- identifying new areas of co-operation
- tailoring trade assistance to country needs
- contributing to the design and implementation of trade capacity-building programs
- securing 'aid for trade' funding.

Redefining the vision for the Melanesian alliance should highlight its future role in regional economic and political affairs, including its position with regards to the Pacific Islands Forum.

In a increasingly regionalised global order, it is in everyone's interest for improved dialogue and co-operation between the MSG and the other Forum nations, including Australia and New Zealand.

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This briefing paper is based on extensive research and interviews with key Pacific stakeholders, and has been subject to peer review. A more detailed background paper on this topic is also available.

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