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**Dynamic Trade Policy for Small Island
Developing States: Lessons for
the Pacific from the Caribbean**

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Abstract

Small island developing states (SIDS) have common economic challenges and are faced with high costs for energy, infrastructure, transportation, trade logistics and public administration. These challenges are increasingly undergirded by new concerns such as the high incidence of chronic non-communicable diseases, demographic transitions, high levels of outward migration, and the rising cost of adapting to climate change. There is therefore an increased need for small states to pursue a multifaceted, innovation driven growth agenda and for development agencies to rethink development options and strategies. From a trade standpoint, these countries are now required to break out of the commodity and low value-added traps that have historically affected the agriculture, manufacturing, tourism and wider service sectors. This has become particularly urgent in the context of anaemic growth among traditional trade partners in the developed market economies. As such, the issue of how SIDS can enhance productive capacity, export diversification and global competitiveness by moving up global value chains needs to be considered. This paper aims to examine the growth and trade performance of the Caribbean and Pacific regions and evaluates the trade policy framework and its scope for economic transformation.

JEL Classification: O24, P45, F13, O31, R23, R58

Keywords: small island developing states, the Caribbean, the Pacific, trade policy, economic growth

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1. Introduction

It is well accepted that small island developing states (SIDS) have common economic challenges and are faced with high costs for energy, infrastructure, transportation, trade logistics and public administration. These challenges are increasingly undergirded by new concerns such as the high incidence of chronic non-communicable diseases, which is having a negative impact on productivity; demographic transitions, evident in the low birth rates and high levels of outward migration (e.g. 'brain drain' or the emigration of highly qualified people); and the rising cost of adapting to climate change.

These endemic and interlinking trends suggest that there is an increased need for small states to pursue a multifaceted, innovation-driven growth agenda and for development agencies to rethink development options and strategies. From a trade standpoint, these countries are now required to break out of passive trade policy approaches that engender commodity and low value-added traps (i.e. the production and export of basic and standardised goods and services that face purely price-based competition) that have historically affected competitiveness and developmental impact of the agriculture, manufacturing, tourism and wider service sectors in developing countries (Harrison and Rodríguez-Clare 2010). This has become particularly urgent in the context of anaemic growth among traditional trade

partners in the developed market economies (Hartmann and Pyka 2011). As such, the issue of how SIDS can enhance productive capacity, export diversification and global competitiveness by moving up global value chains and employing dynamic trade policy mechanisms needs to be considered. Can the existing trade policy practice and strategy achieve the desired results?

In this regard, the Caribbean region is an interesting case study to be considered when assessing the Pacific region and other small state regions because of its long and deep integration into the global political economy and the extent of the risks and vulnerabilities the region faces in relation to several of the issues outlined above in the contemporary context. Indeed, there are growing concerns that the Caribbean's trade and economic performance has been eroding in multiple spheres at a fairly rapid rate and that urgent attention and action is required to address, if not reverse, current trajectories and the expected outcomes. Trade performance is at the top of the list of concerns for the Caribbean region, given its high dependence on trade and the significant developmental impact trade has on the wider economy and society.

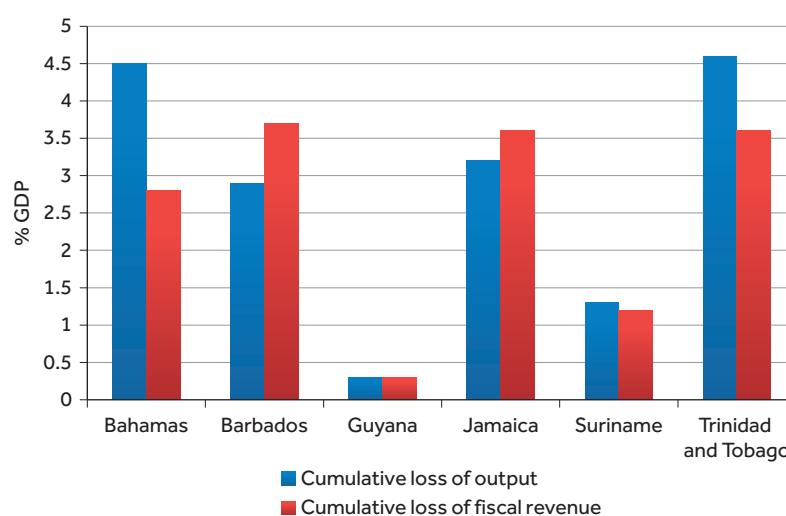
This paper aims to examine the growth and trade performance of the Caribbean and Pacific regions and evaluates the trade policy framework and its scope for economic transformation.

2. SIDS' Trade and Development in Perspective

The ongoing global economic downturn together with the intersecting problems of global finance, climate change and the food and energy crises (see, for example, Addison et al. 2011) have had a very significant impact on SIDS in terms of export losses and increased indebtedness. For example, the Caribbean region experienced a major dip in economic performance. For the period 2007 to 2011, it is estimated that most countries in the region experienced a significant

drop in output and loss of fiscal revenues, as depicted in Figure 1. The countries that experienced the lowest degree of impacts were Guyana and Suriname, the two main commodity exporters of the region, which were buoyed by increased demand for raw materials from China, Brazil and other large exporting economies. The biggest impacts were seen on tourism-exporting economies such as Barbados, The Bahamas and Jamaica. Trinidad and Tobago, a hydrocarbon

Figure 1. Loss of output and fiscal revenue, 2007–2011



Source: Mercer-Blackman and Melgarejo (2013).

exporter, was affected by the slowdown in its main export markets in North America and Europe, as was the case for the tourism-dependent economies.

This varied economic performance is evident when gross domestic product (GDP) growth rates are analysed for the period 2008 to 2012 (see Table 1). Several Caribbean countries experienced a major fall in annual growth rates in this period. Two countries had negative growth in 2008 (The Bahamas and Jamaica), seven in 2009, six in 2010, two in 2011 and three in 2012. This shows how enduring the

impact of the global economic downturn was and that impacts were evident for a long time.

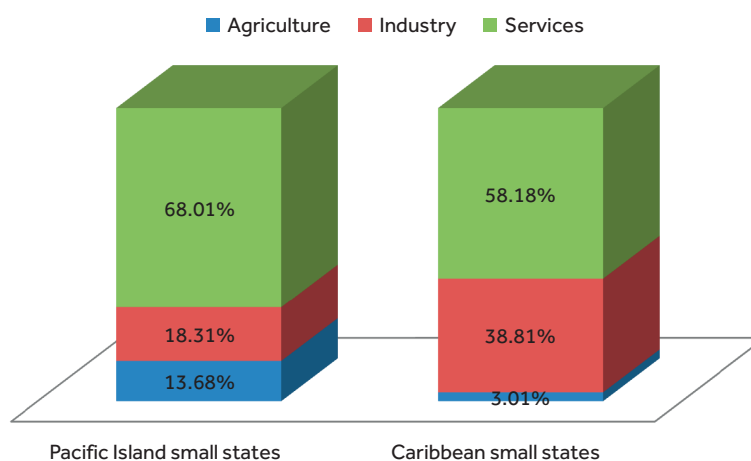
The increasing level of fragility and instability in the contemporary context is evident in many regions of the developing world and particularly for small states in the Commonwealth, whose share of world trade has declined from approximately 0.7 per cent in 1980 to 0.46 per cent in 2013. The contemporary crises have also brought into sharp relief the larger structural and systemic factors related to the structure of accumulation and the role these economies play in the global economy (Desphande and Nurse

Table 1. Annual GDP growth rates, 2008–2012, for several Caribbean countries

Country	2008	2009	2010	2011	2012
Antigua and Barbuda	0.1	-12	-7.1	-1.8	4
The Bahamas	-2.3	-4.2	1.5	1.1	1
Barbados	0.3	-4.1	0.3	0.8	0
Belize	3.2	0.7	3.3	2.1	3.8
Dominica	7.5	-1.1	1.1	-0.1	-1.4
Dominican Republic	3.1	0.9	8.3	2.9	2.7
Grenada	0.9	-6.6	-0.5	0.8	-1.2
Guyana	2	3.3	4.4	5.4	4.8
Haiti	0.8	3.1	-5.5	5.5	2.9
Jamaica	-0.7	-4.4	-1.5	1.7	0.7
St Kitts and Nevis	4.1	-5.6	-3.2	1.7	-1.2
Saint Lucia	3.5	0.6	-1	1.2	-1.6
Suriname	4.1	3	5.2	5.3	3
Trinidad and Tobago	3.4	-4.4	0.2	-1.6	1.5

Source: World Bank, World Development Indicators, 2014.

Figure 2. GDP composition by sector for select SIDS in 2011



Source: World Bank, World Development Indicators 2011.

2012). As such, it is argued that recent developments have compounded the long-term trend of slow growth and limited export diversification in under-performing economies that has been evident for at least the last three decades.

The structure of the economy of the Caribbean and Pacific Island small states is captured in the GDP composition by sector, as illustrated in Figure 2. Based on data for 2011, this figure shows that the GDP of the Caribbean region by sector is such that services dominate, with over 58 per cent, compared with industry at 38 per cent and agriculture at a very small proportion of 3 per cent. For the Pacific, the proportion of GDP from agriculture is ten percentage points more than it is in the Caribbean, while that from industry is 20 percentage points lower in the Pacific than in the Caribbean. Services make up a higher proportion of GDP for the Pacific at 68 per cent than for the Caribbean.

The comparison between the Caribbean and the Pacific from a trade perspective gives opposing results to those based on the GDP composition by sector. As Table 2 illustrates, at

first glance the Caribbean and Pacific economies look somewhat different. The Caribbean has a stronger orientation towards service exports than the Pacific, as 76 per cent of the latter's exports are goods. The Caribbean data exclude data from Trinidad and Tobago, which is the largest exporter, accounting for as much as 60 per cent of the total regional exports on account of the high value of hydrocarbon exports. As such, with Trinidad and Tobago included, the export profile of the Caribbean would look more similar to that of the Pacific, with goods accounting for 60 per cent of exports.

The importance of fuels from Trinidad and Tobago is reflected in the composition of merchandise exports for the Caribbean (see Table 3). Fuels account for the highest percentage, nearly 50 per cent, of Caribbean merchandise exports, followed by manufacturing (31 per cent) and primary exports (20 per cent). The Pacific is more heavily weighted towards primary exports (78 per cent), with fuels and manufacturing at 16 and 6 per cent, respectively.

The trade in services sector in the Caribbean and Pacific regions is heavily skewed towards

Table 2. Proportion of goods and services in exports, 2013

Region	Goods	Services
Caribbean (excluding Trinidad and Tobago)	40%	60%
Pacific Islands	76%	24%

Source: Commonwealth Secretariat, Flagship Report (2015).

Table 3. Composition of merchandise exports, 2013

Region	Fuels	Manufacturing	Primary
Caribbean	49%	31%	20%
Pacific Islands	16%	6%	78%

Source: Commonwealth Secretariat, Flagship Report (2015).

Table 4. Export performance of major services, 2000–2013 (US\$ billion)

	Caribbean		Pacific	
	2000	2013	2000	2013
Other business services	0.45	0.52	0.33	0.31
Transport	0.75	0.56	0.17	0.40
Travel	5.04	6.67	0.31	0.79

Source: Commonwealth Secretariat, Flagship Report (2015).

travel and tourism, with this sector accounting for approximately 80 per cent of service exports for the former and 46 per cent for the latter in 2013 (see Table 4). Other business services declined marginally over the period 2000 to 2013 for the Pacific, while it rose slightly in the Caribbean. Transport declined in the Caribbean, whereas it more than doubled in the Pacific. Overall, the data show a high reliance on the travel and tourism sector in service exports for both regions.

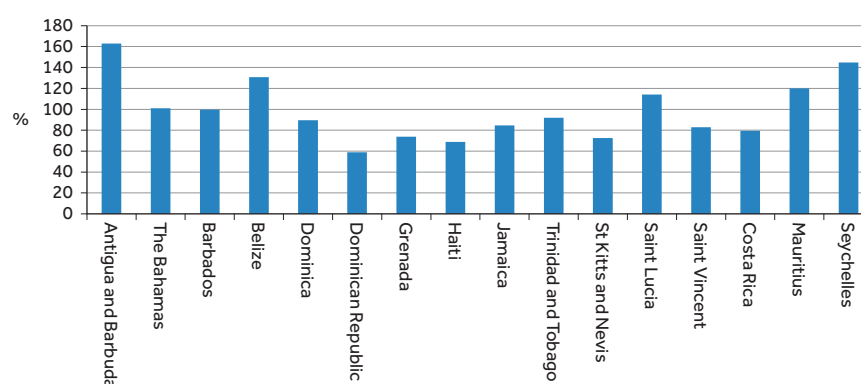
What the above suggests is that, for SIDS, economic vulnerability not only is a result of small size and environmental limitations, but is also related to the mode of insertion of these economies into the global political economy.

SIDS have extremely high commodity specialisation of trade, such specialisation usually being in the export of low value-added raw materials and commodities, which have declining terms of trade and fetch low (and volatile) prices in global markets. Tourism, which is the major service export, also suffers from low levels of local value-added and high levels of external control. From a trade and competitiveness standpoint these economies are increasingly vulnerable as illustrated by the commodity and service specialisation of exports, the geographic concentration of markets, the competition among SIDS for these markets and the dependence on strategic imports (e.g. food, energy, pharmaceuticals).

3. Caribbean Growth and Trade Performance

Trade is often considered the lifeblood of small economies such as those in the Caribbean, as exemplified by the high level of economic openness and high trade to GDP ratios. As Figure 3

shows, there are several countries that have trade to GDP ratios in excess of 100 per cent, such as Antigua and Barbuda, Belize and Saint Lucia, and all the other Caribbean economies

Figure 3. Trade to GDP ratios: the Caribbean and select small states

Source: UNDP HDR, 2014.

Table 5. Select examples of trade agreements signed by the Caribbean

Trade agreement	Type of agreement	Trade and development opportunities
2008, Economic Partnership Agreement (EPA with the EU)	Comprehensive Regional Trade Agreement (RTA)	Preferential market access Trade facilitation Development cooperation (European Development Fund, United Kingdom and German donor resources)
CARICOM and Caribbean Single Market and Economy (CSME)	Regional Trade Agreement (RTA)	Market access, rules of origin, free movement of skilled persons
2000, Caribbean Basin Initiative (CBI with the United States)	Bilateral	Market access, rules of origin
1994, CARICOM Columbia Free Trade Agreement (FTA)	Bilateral	Market access, rules of origin
1992, CARICOM Venezuela Free Trade Agreement (FTA)	Bilateral	Market access, rules of origin
2001, CARICOM Dominican Republic Free Trade Agreement (FTA)	Bilateral	Market access, rules of origin, investment promotion
2003, CARICOM Costa Rica Free Trade Agreement (FTA)	Bilateral	Market access
2013, Trinidad and Tobago and Panama Partial Scope Trade Agreement	Bilateral, Partial Scope Agreement	Market access, rules of origin

Sources: Belize Trade and Investment Zone 2015.¹

are above 60 per cent. This is a characteristic feature of small states and is also evident in Costa Rica, Mauritius and Seychelles. The trade to GDP ratios illustrate exposure but do not identify specific risks. To appreciate the impact of the contemporary economic downturn and to understand the exposure/risk scenario, it is suggested that a composite set of ratios are needed to capture the position of the Caribbean relative to other regions.

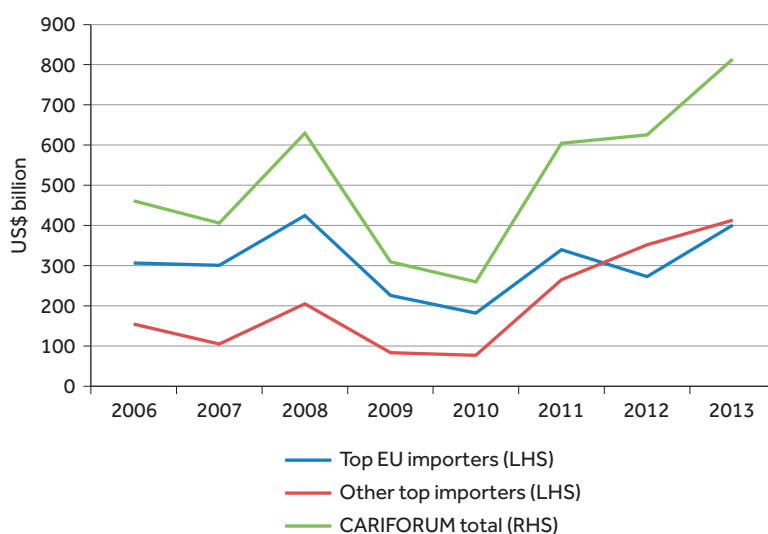
The Caribbean region is signatory to at least seven partial scope agreements and one comprehensive trade arrangement with the EU (see Table 5). The CARIFORUM–EU Economic Partnership Agreement (EPA) that was initialled on 16 December 2007 is the first regional group within the African, Caribbean and Pacific Group of States (ACP) to secure a comprehensive agreement with the European Union (EU) that covers not just goods but also services, investment and trade-related issues such as innovation and intellectual property (Nurse et al. 2008). The EPA reinforces and widens duty-free quota-free access for CARIFORUM (CARICOM plus the Dominican Republic)² goods in EU markets. In the services sector, the EPA provides market access for Caribbean firms and professionals in

terms of cross-border trade, investment, consumption abroad and temporary movement of persons for business purposes, communications, construction, distribution, environmental purposes, financial purposes, transport, tourism and entertainment.

The EPA redefines trade and development cooperation between the EU and CARIFORUM countries in terms of the erosion of preference and the shift to reciprocal trade. The EPA is likely to have wide-reaching implications for Caribbean development, both in terms of new business, investment and export opportunities and its relation to challenges for key sectors and regional firms owing to further trade liberalisation. At the conclusion of negotiations, CARIFORUM's principal negotiator, the former Director-General of the Caribbean Regional Negotiating Machinery (CRNM), Ambassador Dr Richard Bernal, argued that the region 'has secured opportunity for trade expansion, economic development and the improvement of the welfare of the CARIFORUM people'.³ How has the region fared under the EPA?

During the 2006 to 2013 timeframe, CARICOM and the Dominican Republic experienced a volatile shift in exports to their top importers. The pattern that was observed across

Figure 4. Trends in CARIFORUM's exports to the top importing markets, 2006–2013



Source: ITC Trademap 2013.

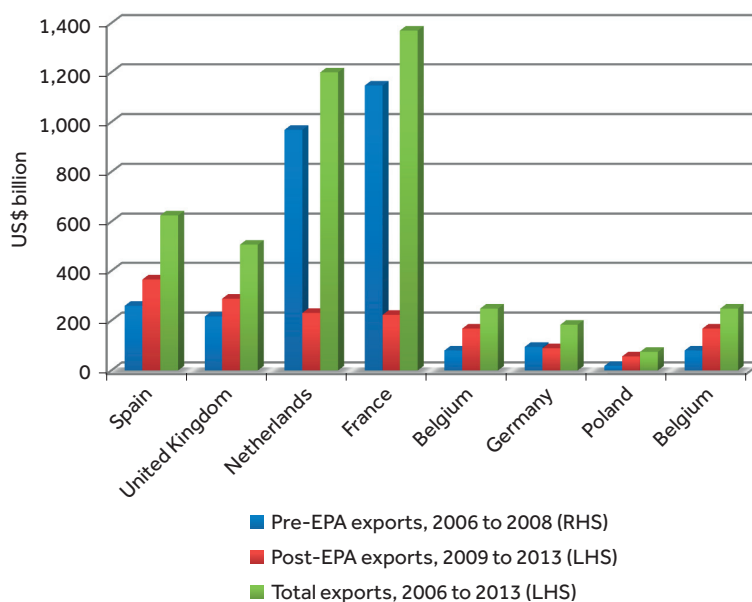
all import markets was a peak in 2008 followed by a dramatic decline thereafter, with a steady rise from the trough in 2010 (see Figure 4). For EU imports, there was a double dip and then a recovery in 2011/12. By 2013, EU imports had not surpassed the peak of 2008.

CARICOM's main EU importers were the Netherlands, Poland, Belgium, Germany, Spain, France and the United Kingdom, valued between US\$180 and US\$425 billion (see Figure 5). The Dominican Republic's main EU importers

were the Netherlands, Germany and the United Kingdom. The two EU countries with the largest declines in Caribbean imports in the post-EPA period were the Netherlands and France.

The Caribbean's experience of the EPA shows that these agreements provide only the platform for market access. The direct role of the EPA on CARIFORUM's export trends to date have been hard to pinpoint owing to limited monitoring of the agreement's implementation. Reducing the proportion of total exports made up of primary

Figure 5. CARIFORUM's exports to top EU markets, pre- and post-EPA periods compared, 2006–2013



Source: ITC Trademap 2013.

goods and basic services is an important indicator of diversification. However, the signing of trade deals, such as those outlined in table 5, alone has not proven to be enough to diversify exports, trade and foreign direct investment. The Caribbean region's trade performance before and after the signing of the 2008 EPA illustrates this point.

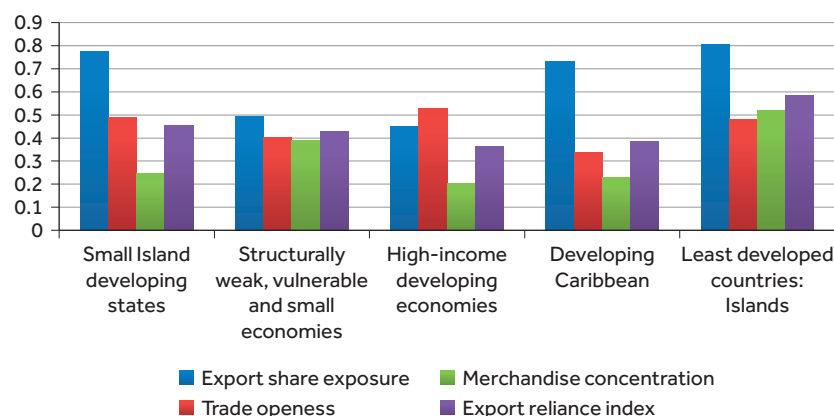
3.1 The Structure of the Trade Economies

Figure 6 provides a more panoramic view of the economic and trade exposure that the Caribbean faces by providing data on the key components that make up the export reliance index: (1) export share exposure, (2) trade openness and (3) merchandise concentration. Comparison with other regions or categories of countries is provided to illustrate the relative position of the Caribbean. The Caribbean overall export reliance index score places it as a

middle tier region when compared with least developed countries/islands (high tier), SIDS (middle-upper tier), structurally weak, vulnerable and small economies (middle tier) and high-income developing economies (middle tier). What the data also suggest is that the Caribbean's area of greatest exposure is the high levels of export shares to developed economies in both merchandise and services exports. The trade openness and the merchandise export concentration indicators are within the medium range relative to other regions and categories of countries. What this suggests is that Caribbean economies have high levels of integration into the global economy and have historically exported low value-added goods and services and thus have been vulnerable to cyclical and systemic shifts in the global economy.

As illustrated in Table 6, during the period from 2000 to 2012, Caribbean countries

Figure 6. Indices of economic and trade exposure for the Caribbean and other regions



Source: UNCTAD 2007.

Table 6. A comparison of the export diversification of select SIDS and other countries –entropy index, 2000–2012

Exporter	2000–2003	2005	2006	2007	2008	2009	2010	2011	2012	Overall level of diversification, 2009–2012
Pacific	0.20	0.20	0.21	0.21	0.22	0.20	0.21	0.21	0.21	0.21
CARICOM	0.19					1.15	1.09	1.10	0.68	1.01
Latin America (CACM and Mercosur)						1.60	1.31	1.34	1.02	1.32

Source: UNCOMTRADE Database Statistics, United Nations 2010.

Note: For the entropy index, high numbers indicate more diversified export activities and lower numbers indicate less diversified export activities.

demonstrated rather limited diversity within their extra-regional export activities, which were narrowly focused on the production of a few categories of products, that is, those in the agriculture, manufacturing, fuels, and ores and metals sectors. From this viewpoint, it is

evident that the experience of the Caribbean over the last two to three decades has been one of limited diversification, as shown by the narrow range of low value-added, low-technology goods and services exports (Nurse and Greene 2013).

4. The Case of the Pacific Compared

More than half (68 per cent; see Figure 2) of the GDP of the Pacific region comes from services; however, excluding services related to the tourism industry, these countries' exports are largely focused on goods. Regarding the trade in goods, mineral-based exports remain the backbone of the Pacific Island exports. As illustrated in Figure 7 the top four commodity exports are (1) minerals fuels, oils and distillation products, etc.; (2) pearls, precious stones, metals, coins, etc.; (3) ores, slag and ash; and (4) iron and steel.

However, the smallness and remoteness of the Pacific Island countries has hindered their economic development in the world economy, on account of high transportation, distribution and marketing costs. Furthermore, the main commodity exported from the Pacific countries is primary-based products at the low end of the value chain (see Figure 7). For example, New Caledonia, which has about 25 per cent of the world's known nickel reserves, retains a small share of the global value-added on account of low levels of local ownership in the industry, high levels of expatriate labour and professional

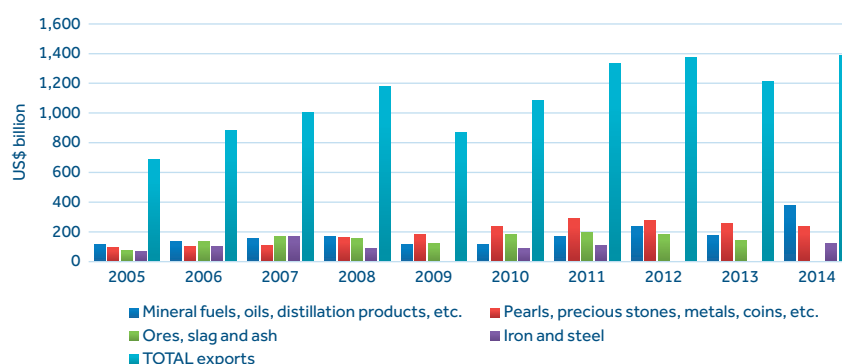
skills and the significant tax holidays for foreign investment.

The Pacific is signatory to at least eight bilateral and multilateral trade agreements, one of which includes an interim EPA with the EU (see Table 7). Learning from the experience of SIDS within the Caribbean region, several policy prescriptions focused on bolstering trade performance can be considered.

Similar to its Caribbean counterparts, the Pacific region has a limited range of exported commodities. The Pacific region is even more dependent on one or two areas of trade, facing resource constraints and structural challenges. Using the entropy diversification index, all of the Pacific economies demonstrated a lack of export diversification for goods during the 2009 to 2012 period, particularly in comparison with other developing regions (see Figure 8).

The above analysis suggests that the signing of trade agreement deals alone may not be enough to facilitate economic and export diversification. In short, what is being argued is that the traditional passive trade policy agenda of negotiated market access and trade

Figure 7. The Pacific's top four exported commodities, 2005–2014



Source: UNCOMTRADE Database 2015.

Table 7. Select examples of trade agreements signed by the Pacific

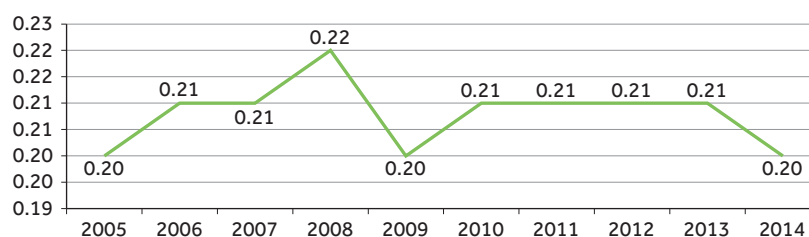
Trade agreement	Type of agreement	Trade and development opportunities
2001, Pacific Island Countries Trade Agreement (PICTA)	Preferential Trade Agreement	Phased market access, temporary movement of persons
1981, South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA)	Preferential Trade Agreement	Market Access, Economic and Technical Cooperation
2002, PACER Plus framework agreement for the gradual integration of the Forum Island Countries	Preferential Trade Agreement	Movement towards a free trade area then customs union
1994, The Melanesian Spearhead Group Trade Agreement (MSG)	Reciprocal Trade Agreement	Market access, rules of origin
1976, Australia-Papua New Guinea Trade and Commercial Relations Agreement (PATCRA)	Partial Scope Agreement	Market access
2007, Interim EPA with the European Union – Pacific group, Fiji and Papua New Guinea	Preferential Trade Agreement	Market access for goods only, technical cooperation for import standards, cooperation on customs and trade facilitation, and improvement on rules of origin for processed fisheries products from the Pacific
1989, The Asia Pacific Economic Cooperation (APEC) forum	Cooperation Forum	Voluntary non-discriminatory liberalisation on a most-favoured nation basis – trade and investment liberalisation; business facilitation; and economic and technical cooperation
1971, The Pacific Islands Forum (PIF)	Preferential Trade Agreement	Economic cooperation, regional cooperation and integration

liberalisation are not adequate to address key areas such as fostering a new entrepreneurship culture and building strategic relationships to facilitate market penetration. Indeed, it can be argued that what is needed is a targeted innovation framework with industrial upgrading as its principal objective.

In summary, the focus of trade policy needs to move from just negotiations and market access to trade facilitation and market entry programmes. The focus should thus be on targeted industrial and technological upgrading through emerging and strategic export sectors. Table 8 outlines a range of niche products from the Pacific regions that have export potential. What

is proposed is an industrial upgrading strategy based on natural resources, where the local and regional producers are able to ensure that some level of intellectual property value is captured and to deepen the Pacific's share of global value added. This is in contrast with the traditional export and resource-based industrialisation approach in which the Pacific operates at the base of the global value chain.

An example of a niche goods trade that has the potential for increased domestic and regional value added is kava, which comes from the Pacific region and has been used as a traditional beverage by Pacific islanders since ancient times.⁴ Kava exports have been facilitated by

Figure 8. The Pacific's overall diversification level in top exported goods, 2005–2014

Source: UNCOMTRADE Database Statistics, United Nations 2015.

Table 8. Key niche products from the Pacific regions with export potential

Region	Key niche products
Melanesia (Vanuatu, Solomon Islands, Fiji, Papua New Guinea)	High-value plantation timber, fairtrade sugar, bottled water, virgin coconut oil, coconut products (cosmetics, furniture, etc.) fresh tuna (sashimi), 'single source' cocoa and coffee, kava, fresh fruit and vegetables, indigenous nuts, fresh flowers, preserved spices, organic beef, pearls
Polynesia (Samoa, Tonga, Tuvalu, Cook Islands, Niue)	Virgin coconut oil, cosmetics, black pearls, noni juice, dried organic fruits, spices, 'single source' cocoa and coffee, kava, fresh fruits and vegetables (particularly squash), indigenous nuts, fresh fish, vanilla
Micronesia (Kiribati, Marshall Islands, Nauru, Palau)	Virgin coconut oil, coconut products, import substitution

Source: Wesley Morgan, 2013.

migration from Fiji, Tonga and Vanuatu. For example, Fiji, the key producing country, currently exports kava to Australia, the USA, New Zealand, Kiribati and the United Kingdom, generating earnings between \$7 million and \$8 million annually (Fiji Government 2013). Kava is also exported to Kiribati and Tuvalu from Fiji. Originally targeted at the Pacific islander diasporas, kava has expanded into the mainstream markets in Australia and New Zealand. For example, the Australian company Taki Mai makes bottled kava drinks, which are popular with the Fijian community and Australian young people as an alternative to alcohol. Australian overseas aid has funded kava production in Fiji as a health supplement and a bottled beverage for export. Taki Mai has been able to benefit from Australian international aid funds to further develop production in Fiji. The value of kava is such that it costs approximately A\$30 per kilogram in the Pacific

countries but can sell for about A\$1,000 per kilogram in Australia. This suggests that there is significant scope for Pacific islander producers to move up the value chain and expand their share of margins in the trade.

The example of kava illustrates the key points highlighted in the following quote from the Pacific Island Forum⁵:

In general, export creation requires that countries prioritize investments towards their productive capacity for trade. Access to new markets is necessary, but it is not sufficient to ensure export-led growth. Pacific island economies want to develop and diversify their exports, both in terms of products and services, and markets. To truly harness open markets, integrate into global value chains, and seize new (or niche) opportunities, firms and citizens will need to overcome information barriers, distance and high trading costs.

5. Strategic Areas for Trade and Innovation Governance

Improving overall productive capacity is an important step for SIDS to enhance their participation in international trade in goods and services. Trade expansion is closely linked to the issue of private sector development. SIDS face a serious challenge in enhancing their competitiveness owing to high transaction costs in moving goods across borders, along with various other trade barriers that mitigate their market access opportunities (ITC 2014).

In this regard, trade facilitation can be utilised as a tool for boosting the productivity, competitiveness and innovation of small and medium-sized enterprises and diversification of their export portfolio.

A few countries in the Caribbean region have been pursuing technological change and implementing foresighting and national innovation studies, intellectual property audits, cluster initiatives and innovation start-ups. While these

efforts have been welcome, the evidence suggests that more resources and focus are required to enhance innovation performance. Sustained growth, development and global competitiveness are increasingly reliant on productivity gains generated through innovation. Attaining such outcomes requires much more than just increased investment or the up-skilling of the workforce – strategic and systemic approaches are required, aimed at:

- promoting innovation-driven enterprises;
- diasporic entrepreneurship and engagement;
- strategic government procurement;
- aid for trade/innovation.

5.1 Promoting Innovation-driven Enterprises

The issue of small size has not often been adequately addressed in the literature on industrial upgrading. Small states face several distinct challenges in this area, such as small markets and weak demand for innovation-driven enterprises from potential research and development users. This is the result of a variety of factors: local firms often consider research and development to be too expensive, it may be more convenient to rely on imported technologies, and innovation may be viewed as something beyond their capabilities. In this regard, small states generally lack the financial and human resources required to actively pursue innovation, making technical assistance or foreign direct investment key to technological upgrading. At the same time, the greater the investment in domestic research and development, the greater the potential for absorbing and utilising external research and innovation. This suggests that small states need to be proactive in terms of promoting innovation-driven enterprises and increasing investment in research and development, both at the firm level and in government.

In this regard, cluster development and value chain integration are important mechanisms for small firms to overcome some of the challenges associated with diseconomies of scale. For example, it has been observed that, ‘for small firms in less developed countries, participation in value chains is a means of obtaining information on the needs of global markets and of gaining access to those markets’ (Pietrobelli

and Rabellotti 2006). Participation in clusters and global value chains are no panacea. For instance, it is argued that, at the same time that global production is being fragmented and made accessible to a wider range of producers, some of the production segments are becoming more commodified owing to ‘low barriers to entry, global oversupply and declining terms of trade’ (Amighini 2006). This suggests that the real issue at hand is how to move up global value chains or facilitate industrial upgrading.

In this regard, it is increasingly recognised, if not accepted, that foreign direct investment and the participation of large domestic firms have not been sufficient to shift the path dependencies of most small economies. It is also recognised that a more dynamic and proactive policy agenda is required to break out of the commodity traps that are evident, even in global value chains. The promotion of innovation-driven enterprises is viewed not as a replacement but as a complement to foreign firms and large local corporations because innovation-driven enterprises ‘retain high technology capabilities in the country and to lure back the scientific, technological and entrepreneurial diasporas’ (Perez 2011). In effect, what is being proposed are institutional arrangements to facilitate the growth of start-up companies.

Because most of the literature on innovation focuses on the issues of larger developing economies, its emphasis has been on the manufacturing and agro-processing sectors, as opposed to the service (e.g. tourism, financial services, creative industries) and intellectual property sectors (e.g. copyright, traditional knowledge, geographical indications). These are the sectors that predominate in small developing states and have significant growth potential in the emerging knowledge-driven global economy. It is therefore recommended that greater emphasis be placed on new forms of innovation in the service and intellectual property sectors.

Another area in which there is significant potential for innovation is the sectors that are major users of foreign exchange and in which the region has a high level of exposure, for example the energy sector and food and health. Given the trajectory of the global economy and its impact on small states in terms of climate change, energy and food price rises and the increasing financial and social cost of chronic non-communicable diseases, there is a clear need to reduce the region’s exposure in these areas. Rather than

just seeing these trends as a challenge, these sectors should be viewed as major opportunities for restructuring the region's economies and moving them towards more sustainable and green development pathways.

5.2 Diaspora Engagement and Entrepreneurship

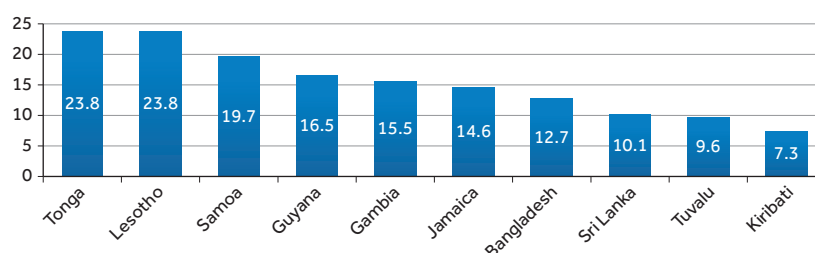
Small states are also in the unenviable position of having the highest 'brain drain' rates, with sizable proportions of the tertiary-educated population migrating. The weak absorptive capacity of the home economies has been the key driver of this process of emigration. This loss of talent and entrepreneurship can be potentially addressed through return migration, diaspora investment, and entrepreneurship schemes. The diasporic economy – through remittances, diasporic tourism and trade – are key growth areas for most small developing economies (see Figure 9). Diasporic entrepreneurs can help expand trade and create markets for nostalgic and cultural exports (see Box 1 for case study of Melie Lei Langi). Diasporic entrepreneurs have had positive trade impacts on both the recipient and the sending countries, as diaspora engagement and networks can help reduce informational asymmetries and operate as co-creators and institutional influencers.

The diasporic economy and market can be considered as strategic resources in that firms

that are able to tap into these markets are able to transcend the limitations of small market size, which is a structural constraint in small economies. It is also important to note that the diasporic market often offers a bridge into mainstream markets where emigrants are located, thus allowing for market presence and the establishment of firms abroad. In tandem, diasporic entrepreneurs tend to have a network base (e.g. hub-to-hub ties) that spans both the sending and receiving countries and as such are often able to overcome the hurdles of doing business or trade between the two jurisdictions. The benefits of such networking tends to be pronounced where the business, trade and financing institutions are weak and hence the barriers to running a successful business are higher as is often the case in small economies.

The Pacific and Caribbean regions are good candidates to employ diasporic engagement as a mechanism to deepen and widen trade. Both regions have some of the highest remittance/GDP rates in the world along with some of the highest emigration and brain drain rates (see Figure 10). In relative terms, there are significant potential growth opportunities, given the size of the diasporic market, if emigration rates, remittances and brain drain rates are used as a proxy. Financial remittances are a key aspect of the transnational relationship but this is only the tip of the iceberg. The diasporic economy includes flows associated with sectors such as

Figure 9. Top ten Commonwealth country remittances as a percentage of GDP, 2012



Source: World Bank 2014.

Box 1: Case Study – Melie Mei Langi

'Melie Mei Langi' was first established in 2002 as a Tongan remittance service provider. It has since grown to offer services and branches in several countries: Tonga (11), Fiji, American Samoa (1), New Zealand (1), Australia, Hawaii (1) and United States (5).

Melie Mei Langi also operates as a supermarket business and established a meat importing business to Tonga. This gives its overseas clients the option to send remittances or to purchase groceries for pick up in Tonga. According to Melie Mei Langi, 'many of our Australian and New Zealand customers have found our shopping services to be very useful and it can account for up to 40% of transactions sent to Tonga.'

telecoms, tourism, transportation and trade in nostalgic, ethnic or niche goods. It also includes the monetisation of intellectual property through copyrights in the media and creative industries as well as geographic indications embedded in specialty goods. Countries also benefit from diasporas by tapping into networks of trade, scientific and professional diasporas. These economic flows also facilitate investment by diaspora communities and encourages brain circulation (e.g. return migration, mobility of professional services) that redress the challenges associated with brain drain (i.e. the emigration of the tertiary educated).

5.3 Strategic Government Procurement

A potentially useful area of intervention by small states in the effort to enhance innovation and global competitiveness is strategic government procurement (for a perspective on the Caribbean, see Shillingford-McKlmon and Gayle-Sinclair 2014). Strategic government procurement aims to conduct government purchasing activities in a manner that would lead to increased innovation. Government procurement procedures can be optimised to either (1) stimulate the development of new products (goods, services and/or systems) or (2) promote incremental innovations where existing products are tailored to meet the needs and requirements of the local market. This approach ensures that public procurement encourages new capabilities (Lember et al.).

Government consumption accounts for a significant portion of GDP in small economies. In the Caribbean, for example, reported government expenditure accounted for 8–21 per cent of total GDP in Antigua, Barbados,

Table 9. Government expenditure as a proportion of GDP, selected Caribbean countries, 2012

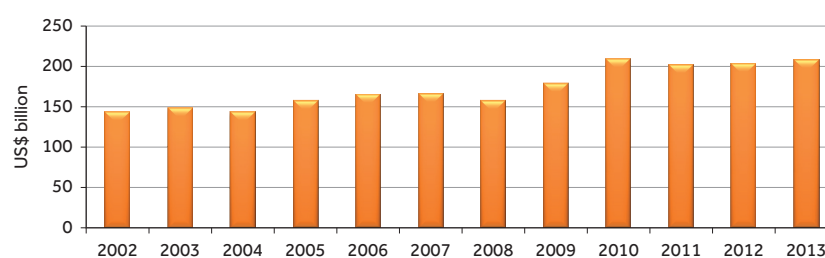
Country	Government expenditure as a proportion of GDP (%)
Antigua and Barbuda	20.8
Jamaica	34.1
Saint Lucia	23.2
St Vincent and the Grenadines	26.1

Source: World Bank Indicators 2012.

Dominica, Grenada, Guyana and Jamaica in 2012 according to World Bank Indicators (see Table 9). This represents an accessible source of investible funds that small states can mobilise on their own account. As such, this is a key tool for inducing increased innovation that focuses on the creation of new products and even more so for the innovation of existing products in new markets. The idea is that strategic government procurement (SGP) will stimulate markets to a point where innovation is induced naturally or as a result of increased economic activity (Lember et al. 2014).

The procurement process within most Caribbean governments tends to be decentralised with procurement contracts tendered from differing Government agencies. A more strategic and policy oriented use of the current procurement contracts may generate positive benefits for technological innovation (Shillingford-McKlmon and Gayle-Sinclair 2014). Governments like Barbados and Trinidad and Tobago already have procurement programmes targeted at small and micro enterprises. As such the aim would be to adopt similar policies targeted at innovation-driven enterprises.

Figure 10. The Pacific region's total official development assistance disbursements, 2002–2013



Source: OECD/DAC (2013).

Government procurement has become an important area of trade policy as it is estimated to account for approximately twenty percent of global GDP. The World Trade Organisation Agreement on Government Procurement (WTO GPA), a plurilateral agreement to which 45 WTO Members are party, allows for mutual opening of procurement markets through fair and transparent conditions for competition. However, most members of the WTO, and especially developing and small states, are not party to the GPA. However, an increasing number of free trade agreements contain public procurement provisions that are legally binding and facilitate varying degrees of liberalisation. As such there is a growing trend of incorporating government procurement into trade and industrial development. In effect, public procurement strategy allows governments to give preference to domestic suppliers in specific industries, thereby promoting their sustained growth and competitiveness. For example, the GPA specifically caters for those states with ambitions of pursuing industrial policy in the development of green technology to sustain the environment (Mosoti, 2014).

From this perspective SGP is a potentially useful area of intervention by small states in the effort to enhance innovation, global competitiveness and sustainable development. Strategic government procurement aims to conduct government purchasing activities in a manner that would lead to increased innovation. Government procurement procedures can be optimised to either (1) stimulate the development of new products (goods, services and/or systems) or (2) promote incremental innovations where existing products are tailored to meet the needs and requirements of the local market. This approach ensures that public procurement encourages new capabilities (Lember et al., 2014).

SIDS should utilise SGP to foster innovation for example, through the use of pre-commercial procurement aimed at inciting exploration or reducing risk for strategic investments especially to find solutions where there are no 'off the shelf' remedies to fulfil an identified need. Government procurement in this scenario could lead to the development of a new product or process that can be commercialised successfully. Similarly, SGP could encourage more efficient utilisation of Government investment if procurement policy for government goods and services were

focused on industries in which Government has invested large sums of money geared toward research and development.

5.4 Aid for Trade/Innovation

Strategic global cooperation and partnerships can ensure more effective support towards building the resilience of SIDS and can thus allow them to exploit areas in which they have a market advantage. In the Pacific region, besides bilateral support provided by countries such as the USA and New Zealand, development organisations such as German International Cooperation (GIZ) have also provided trade and development support. The value of official development assistance has grown in the last decade from US\$ 144 million in 2002 to \$208 million in 2013.

The 2014 'Grant Agreements' within the Pacific region have led to donor cooperation, namely between Germany and the USA, in the areas of climate change adaptation and the environment. These involve a series of climate protection projects covering topics addressing energy efficiency as well as nature conservation and adaptation to climate change, all under the broader goal of achieving sustainable development. The approach brings together several individual implementing actors on the ground within the overall policy implementation process. This strategy may be expanded to other sectors in which the Pacific countries show a comparative advantage for growth. Through the identification of ongoing projects with trade-related impacts, opportunities for complementary strategic partnerships could be built.

In 2009, the Pacific region in its Aid for Trade Strategy (amended for 2013 to 2017) prioritised its needs along with the corresponding necessary resources. This document outlined target areas in their overall goal for improving trade-related infrastructure and building productive capacity. Specific objectives identified for the region's Aid for Trade agenda included:

- to promote 'trade-related adjustment';
- to improve 'institutional capacity for trade policy and regulations'; and
- to 'effectively address the barriers inhibiting the region's ability to increase its competitiveness, reduce inefficiencies and enhance the beneficial opportunities found in regional economic integration' (ITC 2013).

Aid for innovation should be linked to Aid for Trade, with alignment made between trade and innovation policy agendas. A sector-wide approach by donors would reduce overlap and create further synergies. Furthermore, the creation of regional clusters (i.e. regional public goods) can facilitate sector innovation.

As seen with the CARIFORUM region under their EPA, further resources were allocated under the European Development Fund (EDF). Commitments under the Pacific's interim EPA could be similarly leveraged to support economic growth. To this end, the Pacific's EPA

includes a chapter on technical barriers to trade, as well as sanitary and phytosanitary measures, aiming to help exporters meet EU import standards. It also includes a chapter focused on facilitating trade, for example through more efficient customs procedures and better administration procedures (European Commission 2014). Consequently, the Pacific can strategically pursue trade and development goals by linking ongoing projects that aim to achieve the agreement's objectives with additional resources available under their EPA, while facilitating development cooperation.

6. Conclusion

The foregoing analysis of trade policy in Caribbean and Pacific SIDS suggests that passive approaches have had limited impact on these economies in terms of moving up global value chains and that more dynamic and proactive mechanism are required to promote economic diversification and global competitiveness. The SIDS regions have negotiated several trade agreements which have widened market access. However, penetration into new markets has proven to be elusive or slow at best. On account the SIDS economies are faced with increasingly undiversified trade, high debt and low growth scenarios. Breaking out of this framework requires bold and dynamic policies. In summary, what is proposed is a coordinated and synergistic approach to industrial upgrading, which could be referred to as innovation governance. The goal is to develop a process whereby government, industry, cluster-level private

organisations, diasporas and donor agencies collaborate on interventions to enhance innovation, productivity and, ultimately, market penetration.

The analysis calls for a shift in thinking that embraces the notion that even small states can proactively participate in industrial upgrading by facilitating the growth of innovation-driven enterprises, engaging in diasporic trade and entrepreneurship, promoting strategic government procurement and going beyond aid for trade to engender aid for innovation. From this standpoint a more stakeholder-outreach approach to trade policy and innovation governance is required to build inter-institutional linkages and collaboration. It is also suggested that a pluralistic and networked approach is what is required to build the needed synergies in the contemporary knowledge-economy.

Endnotes

- 1 Source: <http://www.belize.org/tiz/caricom-bi-lateral-agreements>
- 2 CARICOM is a regional grouping of developing archipelagic states. It has 15 full members: Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat (UK), St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Suriname, and Trinidad and Tobago.
- 3 Statement taken from the Caribbean Regional Negotiating Machinery, RNM UPDATE 0716, 'The EPA Negotiations Completed', available at: http://www.crnrm.org/documents/updates_2007/rnmupdate0716.htm (accessed 1 October 2008).
- 4 Kava originally derives from the root of a pepper plant. It has a distinctive taste and causes relaxing or euphoric feelings with symptoms such as numbness in the user's lips and tongue (SBS 2015).
- 5 Source: <http://www.tradeforum.org/article/A-strategy-to-support--development-in-the-Pacific/#sthash.jVM99wSq.dpuf>

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ANNEX I

List of the 52 Small Island Developing States According to Region

Caribbean region	Pacific region	Atlantic, Indian Ocean, Mediterranean and South China Sea (AIMS)
1. Anguilla	1. American Samoa	1. Bahrain
2. Aruba	2. Cook Islands	2. Cape Verde
3. Antigua and Barbuda	3. Federated States of Micronesia	3. Comoros
4. The Bahamas	4. Fiji	4. Guinea Bissau
5. Belize	5. French Polynesia	5. Maldives
6. Barbados	6. Guam	6. Mauritius
7. British Virgin Islands	7. Kiribati	7. Sao Tome and Principe
8. Cuba	8. Marshall Islands	8. Seychelles
9. Dominica	9. Nauru	9. Singapore
10. Dominican Republic	10. New Caledonia	
11. Grenada	11. Niue	
12. Guyana	12. Northern Mariana Islands	
13. Haiti	13. Palau	
14. Jamaica	14. Papua New Guinea	
15. Montserrat	15. Samoa	
16. Netherlands Antilles	16. Solomon Islands	
17. Puerto Rico	17. Timor-Leste	
18. St Kitts and Nevis	18. Tonga	
19. Saint Lucia	19. Tuvalu	
20. St Vincent and the Grenadines	20. Vanuatu	
21. Suriname		
22. Trinidad and Tobago		
23. US Virgin Islands		

Source: UN-OHRLLS (2015).

ANNEX II: Data Tables

Pacific Countries' GDP Composition by Sector (%)

No	Pacific Country	Agriculture	Industry	Services	Details
1	American Samoa	27	12.4	60.2	Tuna fishing and tuna processing plants are the backbone of the private sector, with canned tuna the primary export. Two tuna canneries accounted for 13.1% of employment in 2013
2	Cook Islands	5.1	12.7	82.1	Lacks natural resources, periodic devastation from natural disasters, and inadequate infrastructure. Agriculture, employs more than one-quarter of the working population and provides the economic base (export of copra and citrus fruit). Black pearls are the Cook Islands' leading export
3	Fiji	12.7	18.2	69.1	With forest, mineral and fish resources, Fiji is one of the most developed and connected of the Pacific Island economies. High volume of remittances from diaspora and tourist industry. Sugar is a major export but this is threatened by EU preferential erosion pending 2017
4	French Polynesia	2.5	13.0	84.5	Tourism-dominated service sector accounted for 85% of total value added for the economy in 2009, employing 80% of the workforce, with small manufacturing and primary sector industries (pearls farming and fishing)
5	Guam	NA	NA	NA	US national defence spending is the main driver of Guam's economy, followed by tourism and other services
6	Kiribati	26.3	9.2	64.5	Few natural resources and is one of the least developed Pacific Island countries. Earnings from fishing licences and seafarer remittances are important sources of income
7	Marshall Islands	4.4	9.9	85.7	US assistance under 'Compact of Free Association' (up to US\$1.5 billion, 2004–2024) and military presence vital. Limited industry and potential for tourism
8	Nauru	6.1	33	60.8	Earnings from Nauru's export of limited phosphate remains an important source of income. Few other resources exist
9	New Caledonia	1.4	26.8	71.8	New Caledonia has about 25% of the world's known nickel reserves. Substantial development support from France (equal to more than 15% of GDP) and tourism are key to the economy
10	Niue	23.5	26.9	49.5	Few resources and a small population. Shortfalls supplemented by grants from New Zealand. Subsistence farming and some industry. Efforts to promote tourism and financial services
11	Northern Mariana Islands	1.7	2.9	95.4	Substantial US support; in 2013 federal grants accounted for 35.4% of total revenues. Small agriculture industry and growing tourism sector (employs approximately one-quarter of the workforce and accounts for roughly one-quarter of GDP)

12	Palau	3.2	20.0	76.8	The economy consists of tourism and other services such as trade, subsistence agriculture and fishing. There is a growing and increasingly competitive tourism industry owing to its proximity to Guam, increased air travel to the Pacific, rising prosperity of Asia and foreign investment in infrastructure. Beneficiary of the COMPACT with the USA. The USA provided Palau with roughly US\$700 million in aid for the first 15 years following commencement of the Compact in 1994 in return for unrestricted access to its land and waterways for strategic purposes. There were over 125,000 business and leisure tourist arrivals in the fiscal year 2014, a 13.4% increase over the previous year
13	Papa New Guinea	26.3	39.0	34.8	Richly endowed with natural resources, but exploitation has been hampered by rugged terrain, land tenure issues and the high cost of developing infrastructure. Agriculture provides a subsistence livelihood for 85% of the people. Mineral deposits, including copper, gold and oil, account for nearly two-thirds of export earnings
14	Samoa	11.4	30.1	58.5	Agriculture, including fishing, employs roughly two-thirds of the labour force and furnishes 90% of exports, featuring fish, coconut oil, nonu products and taro. The services sector employs approximately 50% of the labour force. Tourism is an expanding sector accounting for 25% of GDP
15	Solomon Islands	51.9	10	38.1	The bulk of the population depends on agriculture, fishing and forestry for at least part of its livelihood. The islands are rich in undeveloped mineral resources such as lead, zinc, nickel and gold.
16	Timor-Leste	5.2	72.8	22.1	As of December 2014, oil accounts for 90% of government revenues; however, there is little job creation on the island as a result. The underlying economic policy challenge the country faces remains how best to use wealth from oil and gas to lift the non-oil economy onto a higher growth path and to reduce poverty (US\$16.5 billion National Petroleum Fund)
17	Tonga	18.1	21.1	60.8	Narrow export base in agricultural goods. Squash, vanilla beans and yams are the main crops. Reliant on external aid and remittances. Tourism is the second largest source of hard currency earnings following remittances
18	Tuvalu	24.5	5.6	70	The country is isolated, almost entirely dependent on imports, particularly of food and fuel, and vulnerable to climate change and rising sea levels, which pose significant challenges to development. The main export revenue is from the fishing sector. Remittances are also important for the economy
19	Vanuatu	25.1	10.8	64.1	Based primarily on small-scale agriculture, which provides a living for about two-thirds of the population. Fishing, offshore financial services and tourism, with nearly 197,000 visitors in 2008, are other mainstays of the economy. Efforts are under way to boost the tourism sector and cruise ship industry

Source: CIA (2014).

ANNEX III

The Pacific Region's Total Exports of Goods During the 2010 to 2014 Timeframe

Country code	Pacific country	Total export value, 2010 to 2014 (US\$)	% export share
598	Papa New Guinea	30,618,161,968	74
540	New Caledonia	4,877,808,584	12
90	Solomon Islands	2,401,441,671	6
626	Timor-Leste	1,421,767,525	3
258	French Polynesia	851,969,527	2
242	Fiji	831,210,617	2
316	Guam	204,881,189	0.5
584	Marshall Islands	100,908,740	0.2
570	Niue	56,531,713	0.1
16	American Samoa	54,284,707	0.1
548	Vanuatu	43,776,268	0.1
882	Samoa	4,589,909	0.01
776	Tonga	4,511,141	0.01
520	Nauru	3,439,005	0.01
184	Cook Islands	3,253,203	0.01
585	Palau	815,239	0.002
296	Kiribati	501,572	0.001
798	Tuvalu	467,117	0.001
	Total	41,480,319,695	100

Source: UNCOMTRADE Database 2010.

The Pacific Region's Top Exported Commodities During the 2010 to 2014 Timeframe

	Commodity	US\$
<u>71</u>	Pearls, precious stones, metals, coins, etc.	12,917,948,864
<u>72</u>	Iron and steel	1,914,243,989
<u>26</u>	Ores, slag and ash	8,280,617,904
<u>27</u>	Mineral fuels, oils, distillation products, etc.	10,658,211,090
<u>44</u>	Wood and articles of wood; wood charcoal	6,274,852,896
	Other commodities	21,278,443,404
	TOTAL	63,945,995,971

Source: UNCOMTRADE Database 2010.