Oxfam International Briefing Note

Blood from a stone

The tiny island Kingdom of Tonga in the South Pacific is about to make history, by joining the WTO on what are arguably the worst terms ever offered to any country. The appalling terms of Tonga's accession package show that nothing has changed in the way the world's smallest and most vulnerable economies are treated as they seek to join the WTO. It is a further demonstration that the fine words of the Doha Development Agenda mean nothing when pitted against the commercial interests of the world's richest countries.

Key Points

- Tonga has been forced to give up more on tariffs than any of the countries involved in its negotiations to join the WTO, including countries like New Zealand, the USA and the EU, all of whom played active roles in the working party. In fact, its bound tariffs are lower than any other country in the history of the WTO, with the sole exception of Armenia. Tonga will be allowed up to a maximum of 20% tariff on all products.This contrasts with the 350% tariff that the US applies to beef imports, and an equivalent tariff of over 300% that the EU uses to block sugar imports into its market.

- The money to pay for Tonga’s public health, education and other vital services has come largely from import tariffs until this year. Now that it must slash applied tariffs under its terms of accession, it has just introduced radical changes to its tax system to cope with the tariff reductions. If this new system fails to deliver, there is nothing Tonga can do to restore its income from tariffs, because its hands are tied by its WTO commitments

- Tonga has committed more in services sectors of vital public interest (like education) than any of the rich countries on the working party and its overall commitments in services are much more extensive than most other developing countries

- The many commitments to “WTO-plus” liberalization of the economy remove most of the policy space Tonga will need if it is ever to emulate now-developed countries

- Many of the terms extracted from Tonga are of no benefit to its people (eg changes to the intellectual property regime) and will cost a lot of money to implement, money that will not be available for Tonga’s development needs.

The Kingdom of Tonga

Known as 'The Friendly Islands', the Tongan archipelago lies in the South Pacific, surrounded by vast stretches of ocean, through which its island neighbours lie scattered. The closest developed country is New Zealand, three hours' flight to the south west.

Tonga is a monarchy, with limited democratic participation in decision-making. However, there are indications that constitutional reform is likely to occur in the near future. Tonga has a population of just over 100,000, spread over 36 inhabited islands. Like all the islands in the region, Tonga is vulnerable to hurricanes and tsunamis.

While Tonga is not an Least Developed Country (LDC), in many ways it is as vulnerable as an LDC. GDP per head of population is around $1,600 per annum[1], less than one tenth that of New Zealand. Wealth is very unevenly distributed, with a small elite enjoying the lion's share. The economy is dominated by subsistence agriculture, with around 70% of the population engaged in agricultural activity. Only a few crops are commercially grown in Tonga, and these are all commodity crops whose profitability is dictated by fluctuating prices. Squash pumpkin, vanilla, fish products and vegetables are the main exports. Tonga's total exports are valued at only around $20m per annum. Imports (including large quantities of food, as well as petroleum products, motor vehicles and other manufactures) are typically valued at four times that amount. Four countries account for virtually all Tonga's imports: New Zealand, the US, Australia and Fiji. Tonga's trade imbalance is largely compensated by remittances from Tongan nationals living and working abroad, mostly in New Zealand and the United States.[2]

Beyond the ill-defined advantages of having a seat at the table, it is difficult to see any benefits for Tonga in joining the WTO under the current accession package. By contrast, the terms of the deal on offer mean that Tonga stands to lose virtually all its policy space in relation to rural and industrial development as well as control over its services sector. This severely constrains any future government from taking new development initiatives, a very topical concern given the process of constitutional change in Tonga.

Tariffs

Tonga's deal requires it to bind all tariffs (agricultural and industrial) at either 15% or 20%. No exceptions are made, even for alcohol and tobacco. With the sole exception of Armenia, another (much more developed) recently-acceded country, no other country in the world has bound all its tariffs at such low levels.[3]

This is likely to have serious implications for Tonga's tax take. Until this year, import tariffs and other border taxes accounted for most of Tonga's government revenue. Changes to the tax system introduced in anticipation of WTO accession mean that applied tariffs have fallen or will soon fall to a flat rate of 15%. A new consumption tax of 15% has been introduced, intended to replace the lost tariff income. However, there have been major problems in other countries that have introduced such systems, resulting in much less revenue than anticipated. If this happens in Tonga, it cannot raise tariffs again, because it has been forced to bind at or very close to the new applied rate.

Worse still, Tonga will have to comply with any tariff reductions required in the current round of negotiations. This will almost certainly mean further cuts below the new applied rate of 15%.

These very low bindings are lower than the last offer Tonga appeared willing to make before it went into a final round of negotiations in November 2005, which was to bind all tariffs at or below 35%, but exempting alcohol and tobacco. Members of the Working Party evidently found this offer unacceptable and forced Tonga to bind at rates which will effectively transform Tonga into one of the most liberalised economies in the world, removing vital policy space in the process.

The rates of 15% and 20% are extremely low compared to the bound tariffs of other countries[4]:

- Peak tariffs of major industrialized countries exceed several hundred percent in sensitive products (eg. 350% for US on beef imports)
- Australia's peak tariff is 55%
- Neighbouring Fiji's average tariff is 40% and peak tariff is 70%
- LDC members have an average tariff of 79% and peak tariff of 130%.

Tonga's tariffs are also high compared to other countries in accession negotiations:

- Samoa has offered to bind its tariffs at 50% in its accession negotiations
- Vanuatu agreed an average bound tariff of 43% and a peak tariff of 75% before it withdrew its application to accede
- Nepal entered the WTO in 2003 with an average bound tariff of 44% and peak tariff of 200%.

Tonga has historically been heavily dependent on border taxes. Until they were abolished in 2005, across the board import taxes of 25% were in place. On top of the 25%, import tariffs of up to 330% were imposed depending on the nature of the goods. Examples of tariffs as of 2004 are: petroleum 35%, vehicles 45%, foodstuffs 15-25%, alcohol 200% and tobacco 330%. It will be difficult to replace this revenue with the new consumption tax of 15% brought in to replace them.

Other countries in the Pacific have experienced a shock to their revenue base from similar changes. Ten years ago, Vanuatu was forced by the Asian Development Bank to make similar changes to its tax system, with the excuse that this was essential for Vanuatu to be in a position to join the WTO. Collections of the new, poorly-understood tax were very low and it took Vanuatu's tax base ten years to recover from the resulting loss of revenue. Perversely, the tax also raised consumer prices, since it was misused by unscrupulous traders.

This is not the only case in which a tariff liberalisation has resulted in a cut in government revenue. A recent IMF study found that less than 30% of the revenue lost from trade liberalisation over the past 25 years has been recovered through other means[5]. The findings are worst for low income countries and problems with the introduction of VAT and consumption tax systems meant that they were ineffective in maintaining revenues.

Tonga's consumption tax has only been in place for a few months. It is not yet known whether the same problems will emerge as in Vanuatu, but there is some evidence that they will. People are reporting an increase in prices coinciding with the introduction of the TCT, eg chicken increasing from T$3.50 per kilo to T$4.50 per kilo, ice cream from T$59 per large tub to T$90. Prices should have gone down by about 10%, not up, since the border taxes replaced by the TCT totalled 25%.[6]

If Tonga finds out that the new tax system is causing major problems, it will have almost no ability to raise tariffs again, as the difference between the bound rate and the proposed applied rate of 15% is at most 5% for all products. Once the cuts required in this round are made to the bound rates, Tonga will also have to make further cuts to its applied rates.

The current fiscal context for Tonga is also relevant: the country ran a fiscal deficit last year, and needs to find tens of millions of dollars to fund increases in public service wages which the government has promised to implement. A shock to its revenue base would compound Tonga's fiscal problems.

It is likely that the costs of domestic products will rise, relative to imports. This will worsen Tonga's trade deficit and have an adverse impact on local producers, many of whom will find it difficult to compete with imports.

The binding of tariffs at these low rates also represents a problem in Tonga being able to defend local business from unfair business practices used by exporters in order to increase their sales or drive local companies out of business. This is a major problem in other countries when multinationals are able to cross-subsidise their exports to gain market dominance and then raise their prices once local competitors have closed down. It is also a problem when exporters receive large subsidies from their governments (such as the agricultural subsidies provided to farmers in the USA and the EU, both members of the Working Party[7]).

According to the Working Party Report, Tonga has no specific legislation providing for the imposition of anti-dumping, countervailing duty, or safeguard measures, and has no plans to introduce such legislation. Tonga has informed the WTO that it does not intend to use tariff flexibility to address unfair or excessive imports. As a result, there is a risk that some businesses and small producers will not be able to compete with imports, with a consequent loss of sales and income, foreign exchange and jobs.

Tonga has also been deprived for all time of the ability to copy the strategies used by the industrialised countries and the newly industrialised countries (such as the Asian "tiger economies" like South Korea, Taiwan and Malaysia). All these countries used import tariffs to protect local producers for a limited period while they became established and internationally competitive.[8]

The impact is particularly important where Tonga has a basis to be able to compete internationally, such as in the processing of its raw materials. Tonga is already at an extreme disadvantage, being a long distance from major markets, with undeveloped infrastructure and high transport costs. Without the ability to use tariffs to establish 'infant industries', Tonga will face even greater difficulties in being able to develop its local economy, earn foreign exchange and create jobs for its youth.

Loss of ability to promote Tongan business and new industries

The accession deal restricts Tonga from using incentives to promote domestic business, exports, processing of raw materials and diversification of the economy. Along with the low tariffs, these restrictions on incentives undermine Tonga's ability to develop using the same policies that other countries (including all members of the WTO Working Party) have used during their own development.

Tonga currently has laws in place that use incentives to attract foreign investment that will create jobs in Tonga, replace imports, boost exports and diversify its economy. These incentives are contained in the Industrial Development Incentives Act (the IDI Act). The specific criteria include such things as whether the project involves the processing of local resources; substantially contributes to local added value; is labour intensive; has export potential; would have a multiplier effect leading to the creation of ancillary enterprises; or is likely to complement other domestic manufactures

Even though these are criteria that aim to boost Tonga's development, the accession package requires both the criteria and the IDI Act itself to be abolished, on the basis that a number of the criteria are performance standards incompatible with WTO rules. In addition, a previous requirement that foreign service suppliers must have at least 25% local participation of Tongan investors is also abolished.

This will adversely affect existing businesses that have been established under the IDI, and weakens Tonga's ability to ensure that foreign investment within Tonga is for the benefit of Tongans, rather than foreign shareholders. Tonga will also be prevented from instituting these measures in future, even if it is part of the policy or election platform of a future government. These commitments go beyond the current requirements of WTO rules on Trade Related Investment Measures (TRIMS).

Loss of control over vital services

Tonga has made huge commitments in services across all service sectors. Tonga's ability to regulate foreign investors for development will be severely restricted, particularly in sensitive services such as telecommunications, education, hospitals and broadcasting, and Tonga will be under pressure for further privatisation of public services.

GATS recognises the rights of developing countries to make fewer commitments. The relevant Special and Differential Treatment provisions of GATS include opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and attaching conditions when making access to their markets available to foreign service suppliers.[9]

It is well documented[10] that Working Party members have been disregarding these provisions and systematically demanding more services commitments from acceding countries than is the case for WTO members at a similar stage of development (WTO-plus commitments). In fact, poorer countries have typically been asked to give more than rich countries. In the case of Tonga, this has been taken to the extreme.

Services are a major part of Tonga's economy, estimated to amount to 50% of national income.[11] Tonga has undertaken commitments in all eleven of the service categories. By contrast, Solomon Islands has commitments in four sectors and Fiji has commitments in only one sector.

The comparison between Tonga and others is even more dramatic at the level of the individual sectors. Tonga has commitments in 36 sub-sectors (eg. air transport, hospitals and restaurants, and hospitals) out of 53, while Solomon Islands has committed 6 sub-

sectors, and Fiji only 1 sub-sector. Most of the Caribbean countries have agreed to open up less than 10 sub-sectors.

The comparison with New Zealand, one of the most liberalised economies in the world, is also instructive. New Zealand has no commitments at all in one important sector — health — and only limited commitments in the education sector. Overall, it has a similar number of total commitments to Tonga, but many of these are in sub-sectors where there is little public or business sensitivity, such as computer consultancy or ancillary business services. There are also many exceptions attached to the more sensitive sectors, such as health care, education and audio-visual services, imposed by New Zealand in order to retain its flexibility to achieve social, cultural and economic aims.

Tonga's services sector commitments include many of those that have been rejected by many other countries, on the grounds that it may create adverse impacts. They include telecommunications, broadcasting, all forms of education, sewage and sanitation, financial services, hospitals, construction, as well as business and professional services such as lawyers and accountants.

It is of note that Working Party members themselves have entered specific exceptions covering a range of public services, since they maintain significant levels of publicly owned and operated services (for example, over 90% of the EU's water distribution is supplied by the public sector). They have been very cautious in making commitments in services where public access is important (eg. education, health care, broadcasting and mail services). It is worth looking at two sectors in particular: education and telecommunications.

Education: Most countries (including all the working party members) have declined to make any commitments in relation to public education, particularly at the primary and secondary levels. However, Tonga has been induced to radically liberalise all levels of its education system.

Tonga has already experienced the establishment of a private school for the children of the elite. The school was established by foreign businessmen despite an absence of government permission, through the use of a loophole in the legislation.

A future government of Tonga might wish to place restrictions on this and any similar schools. For example, regulate to require them to accept a certain percentage of non-fee paying students from disadvantaged areas, or to pay a percentage of their fees into the state education system. Given the commitments in the accession package, such regulations are likely to be open to challenge as being an "unnecessary barrier to trade" by the businesses concerned.

Telecommunications: As recently as November 2005, Tonga's draft services schedule included only very limited commitments in the telecommunications sector. The final schedule however contains extensive liberalisation of most aspects of telecomms, including voice and internet services. It is hard to avoid the conclusion that last-minute demands from Working Party members led to the sudden change.

The fact that Tonga has liberalised its telecommunications sector in this way is likely to have adverse implications for those living in the more remote islands of the group, as well as for rural people on the main islands. This is because such customers are not

profitable for telecoms companies and the companies will be reluctant to service them. Rich countries have a number of options for ensuring that all the population is covered by a telecommunications network. However, for poorer countries, particularly ones with a widely dispersed population, the only practicable way to ensure such universal coverage is to regulate to require service companies to provide it. However, a recent WTO disputes panel case makes it clear that any such regulation will be in violation of GATS requirements.[12] The only way to avoid this result is to ensure GATS commitments are delayed until a full regulatory structure is in place, and to specify that the GATS commitments are subject to those regulations

Tonga's commitments in telecommunications contrasts starkly with the process set up by New Zealand to protect its national interest in such a key service. Before the New Zealand government sold off a portion of Telecom New Zealand (the main telecommunications supplier), it agreed a comprehensive contract of sale, which imposed what it describes as 'social obligations' on the newly privatised monopoly.[13] These obligations ensure that rural service delivery is maintained (with installation charges capped, regardless of actual cost), local calls remain free for residential customers, and basic phone charges remain reasonable by being linked to inflation. The New Zealand government has also limited the shareholding in Telecom of any single overseas entity to less than 50 per cent and requires that half of the Board members are New Zealand citizens.

Costs of compliance

Tonga has already undertaken many major reforms to its laws and practices to comply with WTO requirements, but a lot more are needed. For the benefit of foreign companies, it is promising major reforms in areas of little or no benefit to ordinary Tongans, such as intellectual property rights, the customs valuation system and quarantine regulations for imports into Tonga.

Tonga will need help to undertake these reforms. The actual costs are unknown, but could be enormous. One World Bank report stated that reforms to intellectual property rights, customs and quarantine alone can cost a year's development budget even in the more advanced developing countries. For less advanced countries, the relative costs are even higher. Also, even if Tonga does get financial and technical assistance with the reforms, that money and help is likely to be part of the overall aid allocation, diverted from other development priorities that are funded by the donor countries. Also, any staff and other resources Tonga itself puts in to these reforms mean there is less funding for other areas of Tonga's economy.

Tonga is required to implement the agreements on Trade Related Intellectual Property Rights (TRIPs) by 30 June 2008, on Customs Valuation by 1 January 2008 and all other agreements, including the complex and costly Agreement on Sanitary and Phytosanitary Measures (SPS) immediately. This is far shorter than other recently acceded countries, such as:

- 13 year transition period on TRIPs pharmaceuticals for Cambodia and Nepal
- 5 year transition period for SPS for Cambodia
- 3 years for the Agreement on Technical Barriers to Trade for Cambodia and Nepal

Tonga has also been required to take on commitments that have been proposed in current WTO negotiations on trade facilitation, but not agreed. This includes an obligation to do its best to ensure that foreign corporations are consulted *before* any new law “relating to trade” takes effect. “Where possible”, the laws must be published at least 30 days before they come into effect. This gives foreign corporations much greater ability to influence the laws of the country than Tongans themselves (businesses, NGOs, and other interest groups) enjoy.

Conclusion

Oxfam International reiterates its call for fair treatment of developing countries as they seek to join the WTO, particularly for LDCs. The following recommendations are made in relation to LDCs, and also Tonga, as the only non-LDC small island developing state currently seeking accession:

- The WTO Secretariat should provide resources to help implement the Decision on the Accession of Least-Developed Countries, and should also provide the services of impartial experts;
- The WTO should develop a fair and objective system that will enable LDC accession packages to reflect the development needs of the acceding country, rather than the demands of Working Party members;
- There should be full recognition that LDCs are entitled the full benefit of Special and Differential Treatment, all extended implementation periods and all exemptions enjoyed by founding member LDCs;
- LDCs that are in the process of acceding should be allowed to take full advantage of the new process, if necessary by retracting any ‘LDC-plus’[14] concessions already made in bi-lateral or multi-lateral negotiations.

[1] The Working Party report (WT/ACC/TON/17/WT/MIN(05)/4) para 4 states that total GDP is US$163m for a population of 102,000, although other sources suggest the total income per head of population may be as high as $2,800 per annum.
[2] Sources for data are the Working Party Report and New Zealand Ministry of Foreign Affairs website: http://www.mfat.govt.nz/foreign/regions/pacific/country/tongapaper.html
[3] Armenia joined the WTO in 2003. It bound all tariffs at 15%. This is above its maximum applied tariff in 2001, which was 10%, so its situation is quite different to Tonga's, as Tonga is having to slash tariffs to bring them into line with the bound rates it has committed to. For details of Armenia's bound and applied tariffs, and those of all other members, see World Trade Report 2004: http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report04_e.pdf
[4] World Trade Report 2004
[5] Baunsgaard and Keen (2005), *Trade Revenue and Trade Liberalisation* IMF Working Paper WP/05/112.
[6] Interviews with Tongan consumers in the capital, Nuku'alofa, in October 2005.
[7] When a country applies for accession to the WTO, a 'Working Party' is formed, comprised of any WTO member countries who wish to participate. This working party negotiates with the applicant (both as a group and in separate, bi-lateral discussions). The members of Tonga's working party are: Australia, Canada, China, the EU, India, Japan, Korea, Malaysia, Mexico, New Zealand, Chinese Taipei, Turkey and the United States.
[8] For a recent analysis of the use of industrial tariffs, see Chang, Ha-Joon "why developing countries need tariffs" (South Centre 2005) http://www.maketradefair.com/en/assets/english/sctadp.pdf
[9] Full text available at: www.wto.org/english/docs_e/legal_e/26-gats.doc
[10] Grynberg, R., V. Ognivtsev and M.A. Razzaque (2002) *Paying the Price for Joining the WTO: A Comparative Assessment of Services Sector Commitments by WTO members and Acceding Countries*, London: Commonwealth Secretariat.
[11] Working party report, para 170.
[12] Details of the case can be found at: www.polarisinstitute.org/polaris_project/public_service/news/july_2004.html (last checked by the author October 2005).
[13] A brief summary of the arrangements is available at: www.maf.govt.nz/mafnet/publications/ruralbulletin/mar-2002/march-2002-15.htm (last checked by the author October 2005).
[14] LCD-plus commitments are commitments which are greater than those applying to LDC members of the WTO.

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