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**Mr Peter Mandelson**  
Commissioner for Trade  
European Commission  
200 rue de la Loi  
B – 1049 Brussels  
**BELGIUM**

Dear Commissioner

I write to you with reference to a letter dated 20 October which was addressed to Hon Tavola from Messrs Manservisi and Falkenberg (attached as Annex I).

2. I wish to thank the Commission for sharing with our region its assessment of the current state of the Economic Partnership Agreement (EPA) negotiations and the outlook for progress until the end of next year. Because of the importance of the issues raised in the above letter for the entire future relationship between the European Union and the Pacific ACP States (PACPS), I wish to set out below our region's own position on the current state of EPA negotiations between our region and the European Commission.

3. Let me say at the outset that there seems to have been little progress on the negotiations to date, implying, of course, that the outlook for progress until the end of next year is somewhat bleak. I propose to offer my own views below in support of that assessment.

4. Before doing so, however, may I reiterate once more the position of the PACPS in relation to the proposed EPA between our region and the EU. As stated in our publication, *The Way Forward*, that was presented to you shortly after you assumed your current position, the PACPS firmly believe that the EPA represents a potentially invaluable, historic and unique basis for the further strengthening of our relationship in the years to come.

5. In that regard, it has always been and remains the position of our region that the EPA is more than a narrow free trade agreement (FTA), otherwise it would have been called just that. It is a *partnership* agreement and must go beyond trade liberalisation to include a wide range of economic and trade cooperation measures and arrangements as formal commitments on both sides upon which our relationship can build over time in pursuit of the objectives set out in the Cotonou Agreement and in our Joint Road Map agreed at the launch of regional negotiations in September 2004. We are pleased that you

made that point in your recent address to the European Socialist Party Conference in calling EPAs not FTAs but rather development tools. We agree entirely.

6. At the same time, and as also agreed in that Joint Road Map, the EPA must build on PACP regional integration initiatives and the pace of trade liberalisation between the PACPS and the EU must be a function of the degree of that integration and realised in a flexible and asymmetrical manner. With that in mind, and given the importance PACPS place on regional economic integration, they consider that any EPA must be carefully designed to allow for the greatest possible participation by all PACPS, despite their disparate circumstances and capacities to participate in all aspects of international trade, at least at their current stages of development.

7. In the latter regard, I am pleased that there has been some understanding between our two sides with respect to EPA **architectural issues**. The Commission's proposed EPA structure is of the same general typology as that the PACPS have proposed and which we are convinced is WTO-compatible. However, there seems to be sufficient goodwill on both sides to proceed with the Commission's proposal as the chosen architecture since the realisation of objectives can be met using such architecture. The Commission's proposed architecture is explicit, welcome recognition that PACPS are unique and that, to be successful, an EPA must be tailored to the needs of our region. It is on that basis that we can say that at least some progress has been achieved and it is our hope that, over the coming months, that recognition will be reflected in discussions on important substantive issues.

8. Over the past year there have been more meetings held than in the past. However, there is very little to show for it. There is, of course, technical work still underway and some responses to our non-papers being awaited in order to progress the negotiations. In the meantime, the deadline of 31 December 2007 for the conclusion of EPA negotiations beckons uncomfortably.

9. Our region is committed to work earnestly and in good faith to conclude the EPA negotiations in a timely fashion and we believe that substantial negotiating progress can be made in 2007 through an intensification of exchanges. That is assuming constructive responses are received from the Commission to our various proposals made to date. To be constructive, those responses must reveal a genuine willingness to understand the unique position of the PACPS and to reflect that position in an EPA tailored to the region, not be merely a blanket reiteration of Commission 'red lines', insisting on including specific topics of interest to the Commission while intransigent on positions that really matter to our region. In the latter regard, I must stress that PACPS cannot negotiate under pressure due to the pressing deadline. We will not merely rush to conclude negotiations due to the deadline and risk ending up with a bad EPA. That would be disastrous. PACPS must be convinced that, on balance, an EPA would deliver significant benefits to them and enable achievement of the economic and trade cooperation objectives set out in the Cotonou Agreement and reiterated in our Joint Road Map. Otherwise, PACPS will question their support for the EPA and the EPA process, as we have configured it, is likely to be placed in jeopardy.

10. The PACPS are confident that, even if our negotiations extend beyond **the deadline of 31 December 2007** as set by the Cotonou Agreement, there would still be sufficient time to conclude satisfactorily our negotiations without there being adverse implications for our trading relations.

11. To date, however, the responses from the Commission to our various submissions have not been such as to give us much encouragement that we will be able either to achieve the above balance or to meet that deadline. In July 2006, for example, PACP officials passed to the Commission officials as a non-paper a draft **EPA negotiating text** (attached as Annex II) in order to expedite the negotiations as best we could. Having had received no response from the Commission, PACP Trade Ministers at their meeting on 16 November agreed that it be submitted to the Commission as a formal negotiating document, which I am pleased to do at this time.

12. Since that Ministerial decision, we have received an informal response from the Commission to our non-paper. While adding detailed provisions on trade facilitation, competition policy and harmful tax policies that the Commission wishes to see included in an EPA, the Commission has offered little, if any, positive response on the key substantive issues of basic importance to the PACPS. Of course we anticipate modifications of our negotiating text. However, the comment by Messrs Manservisi and Falkenberg that the text will require “*substantial amendment before it can become a mutually agreeable EPA*” is somewhat loaded to the extent that we can anticipate major review and write-up. I wonder how much more of the benefits will be lost in that exercise.

13. With a view to advancing our negotiations, therefore, I would like to summarise briefly below for your information and consideration the basic components of an EPA that our region considers would deliver the benefits required to achieve our mutually-agreed objectives.

14. Given their small size and the structure of their economies, few PACPS have significant goods exports and even fewer exports of manufactured products. At the same time, however, for several PACPS **trade in goods** with the EU is an important element of their economies and they are seeking to conclude a trade in goods agreement as part of an EPA that would enable them to enhance their current market access. For those PACPS not yet exporting goods to the EU, a number have aspirations of exploiting EU niche markets for their products over the medium- to longer-term as a way to develop their economies.

15. To achieve those aims, PACPS seek two changes to the current Cotonou regime. First, PACPS seek Everything-But-Arms (EBA) equivalent (i.e., duty- and quota-free) market access for their products into the EU. That access could well serve to encourage much-needed investment in the export sector of PACPS. Given the small size of the PACP manufacturing sector, such guaranteed access could easily be justified by the unique circumstances of our region while not possibly jeopardising EU manufacturing interests.

16. The second change sought is with respect to rules of origin, closely linked to EBA market access above and of fundamental importance for the success of the trade in goods component of the EPA. With relatively small domestic production sectors at best, manufacturing in the PACPS usually requires the importation of most intermediate goods from outside the PACPS themselves, be those goods from Asia, Australia, New Zealand or elsewhere. Cumulation with African and Caribbean States as proposed by the Commission in a non-paper (attached as Annex III) is unrealistic for obvious reasons. This was recognised at the launch of regional EPA negotiations with the PACPS in 2004 when it was acknowledged that, because of the lack of factor endowments in the region

relative to the other ACP regions, it would be best to devise rules of origin particularly for the PACPS.

17. For that reason the PACPS will not negotiate using the overall ACP template and based on the value addition approach. After careful consideration, the PACPS are proposing rules of origin based on a change of tariff sub-heading (CTSH) approach. Simple and inexpensive to administer by our small firms, that approach would enable our producers to access intermediate goods from outside the PACPS at the lowest possible cost and manufacture goods for export to the EU on a competitive basis. With such a system in place, more and more PACPS could be encouraged to participate in the trade in goods agreement. A non-paper on rules of origin was forwarded to the Commission for its consideration in March 2006 and there have been several brief discussions on the subject between our two sides since then. Again, on the instructions of PACP Trade Ministers I have pleasure in forwarding our rules of origin proposal to you as a formal document for negotiations in the near future. Because of the critical importance of basing the PACP-EU trade in goods agreement on the CTSH approach for the success of the agreement, we urge that our position be taken fully into account and reflected positively in conclusions reached by the Commission in its review of rules of origin currently underway.

18. Given the obvious significance of **sugar** exports to the EU for at least one of our members, the PACPS are seeking agreement from the EU on arrangements that would secure the best possible access for the region's sugar into the EU market from 1 January 2008.

19. **Fisheries** comprise the region's common and most important resource and the PACPS are widely known for their cooperative approach to fishery issues over many years. It is most disappointing to the PACPS, therefore, that the Commission has signalled a 'red line' in this regard, placing an obvious obstacle to any further negotiations on a multilateral fisheries partnership agreement (MFPA) as part of an EPA. The Commission's preference for bilateral fisheries agreements rather than an MFPA, our region's preferential mechanism for bringing so many benefits to the PACPS, would represent the nadir of our development cooperation.

20. Collectively, the PACPS have in their Exclusive Economic Zones (EEZs) the largest tuna stock in the world. The vulnerable Micro-States comprising the PACPS hold great expectations that these shared natural resources will be the key to their development and will facilitate their integration into the global economy which, to date, has been so unkind to them given the inequity of the global trading and capitalistic systems. However, if at the end of these negotiations the EU will only be interested in its access to the stock, rather than assisting the PACPS to utilise and manage the tuna stock to achieve their own developmental objectives, then it would certainly be a sad day for the long-established cooperation between our region and the EU.

21. Let me stress that there was never any intention on the part of PACPS to negotiate an MFPA outside an EPA. Indeed, fisheries is an area where fruitful, long-term cooperation could take place between the PACPS and the EU for their mutual benefit, particularly given the likely scarcity of resources in numerous global fisheries in the years to come. PACPS are proposing a coherent, well-integrated approach linking trade, fisheries and development all within an EPA, the objectives being to improve access for their fishery products into the EU market through the trade in goods component of the EPA, to secure assistance in developing their fisheries sector, including conservation and

management measures, and to promote increased EU investment in the region's fishery sector. This will require a modification of existing fisheries rules of origin based on the sovereign rights of the PACPS to the fishery resources of the 200-mile EEZ recognised under international law and aimed at promoting the PACP fishing industry and investment in the sector. PACP Fisheries and Trade Ministers at their meeting on 14 November approved in principle an MFPA negotiating text as part of an EPA. The draft will be forwarded to your officials shortly for discussion early in 2007. In exchange for EC assistance to the sector and in a spirit of partnership, as part of the MFPA the PACPS are prepared to offer a highly valuable, guaranteed degree of access to the region's fisheries over the long term, while maintaining the EU's existing bilateral fishery access agreements with three PACPS. Our region looks forward to technical level discussion on fisheries issues raised in our proposal with a view to making advances in this key area and realising a change in the EU's position towards an MFPA.

22. In contrast to trade in goods, **trade in services** is, in principle, an area of great and immediate interest to all PACPS, the economies of many of which are service-oriented. A well-designed trade in services component of an EPA would no doubt be welcomed by all PACPS and form the basis of much fruitful economic and trade cooperation in future as well as serve to strengthen regional integration. While PACPS are, of course, interested in all four modes of supply, at this stage in the development of their service sectors it is only Mode 4 ('temporary movement of natural persons') in which all PACPS have a priority export interest and can derive greatest and immediate benefit. However, the market access proposed informally by the Commission is so narrowly prescribed as to offer few, if any, genuine benefits for the PACPS given the current state of development of the region's service sector. As made clear in negotiating paper on Mode 4 (attached as Annex IV) presented to your officials in June 2006, PACPS are not seeking access to the EU market for unskilled workers as implied in the letter above-cited. Rather, access is sought for skilled PACP nationals with post-secondary qualifications for which, as our non-paper highlighted, there is already a clearly demonstrated demand in the EU. Such an arrangement, negotiated directly between the PACPS and the EC, would be totally compatible with the WTO General Agreement on Trade in Services.

23. Our region appreciates the bilateral aspects of trade in services within the EU and in areas where the competence lies with individual EU Member States we would certainly welcome the Commission facilitation on our behalf. At the same time, the PACPS cannot negotiate with relevant EU Members because of resource constraints and we would look to the Commission to represent our case to those countries on our behalf as well.

24. Again, based on the recent decision of PACP Trade Ministers, I submit as a formal negotiating document our region's proposal with respect to Mode 4 as a contribution to the negotiation of the overall trade in services component of the EPA. In doing so may I simply observe that if the EPA does not address PACP Mode 4 interests we can envisage reluctance on the part of PACPS to become a party to any EPA. As a consequence, if only a minority of PACPS become party to a trade in goods agreement as part of an EPA and the remainder not even participate in the trade in services element of the EPA, that would result in a PACP-EU EPA with only a few regional parties. The majority of PACPS would opt for alternative trading arrangements as envisaged by Article 37(6) of the Cotonou Agreement. But if their main trading interest lies in services Mode 4, what good would such alternative trading arrangements be in any case? Their 'partnership' with the EU would be largely devoid of content and efforts to promote regional economic integration through the EPA fruitless. Therefore, from the perspective of

this region, at least, would be a disastrous consequence of intransigence and a lack of commitment to tailor EPAs to the specificities of our region.

25. All PACPS are keen to attract **investment** from the EU and for that reason have proposed inclusion of investment in the EPA. The PACPS consider their draft investment proposals to be state of the art, catering in great detail with both host and home State rights and obligations, governance, anti-corruption, transparency requirements etc. In the case of our region, however, such provisions are insufficient in themselves. For them to be effective, there is clearly a need for technical assistance to enable PACPS to overcome obstacles to investment and to attract and regulate investment in a professional manner that will protect both national interests and those of legitimate investors. This critical need is addressed in the PACP proposals.

26. As Professors Winters and Martins demonstrated in their 2004 seminal study, business costs in small remote economies are often great disincentives to investment and private sector development. That is most certainly the case in many PACPS. There is a critical need, therefore, for **financial and related instrumentalities** with the capacity and willingness to address the needs of small and medium enterprises (SMEs) in the PACPS. For a number of the micro-PACPS, many of their investment needs could be sufficiently provided for by the institutions of the Cotonou Agreement. The European Investment Bank (EIB) has shown little interest in doing so, being much more concerned with large projects beyond the capacity of most PACPS to host. The Centre for the Development of Enterprise (CDE) and Centre for the Development of Agriculture (CTA), joint institutions under the Cotonou Agreement, each have a definite mandate to serve the needs of PACP SMEs. However, these institutions need to become more effective than they have been to date. If the EPA cannot provide the benefits those institutions are supposed to offer, they will be benefits foregone. Given their assigned, catalytic role under the Cotonou Agreement to stimulate private sector development, PACPS look forward to discussing with the Commission how the operations of the CDE and CTA might be made effective in our region. If that proves impossible, PACPS will be forced to propose alternative arrangements to meet this region's needs, as well as to meet the needs of the region for financing for SMEs that have not been satisfactorily addressed by the EIB nor is the latter likely to do so.

27. Becoming party to a true partnership agreement as outlined above will require significant adjustments and capacity-building in the PACPS. That is not being doubted. Because benefits inherent in EPA provisions will rarely flow in and of themselves, a well-designed Agreement must be accompanied by similarly well-designed and adequate **adjustment assistance**, enabling PACPS not only to make the necessary changes to assume EPA obligations but also to take advantage of the new market access and other opportunities afforded by the EPA. This fact underlines the need for additional resources to address the supply constraints, as the PACPS and other members of the ACP Group have been saying all along.

28. In that regard, PACPS are very concerned that the amount of adjustment assistance and mechanism of delivery proposed thus far by the Commission will be inadequate and inappropriate to meet the needs of the region. While it is true that there has been a nominal increase in 10<sup>th</sup> European Development Fund (EDF) resources over those of the 9<sup>th</sup> EDF, when compared to those available in 1990s, when there were only eight members of the PACP Group as against 15 today, the amount of resources has decreased significantly on a per capita basis – and 10<sup>th</sup> EDF resources will have to be shared Timor-Leste as well. As the study recently commissioned by the Pacific Islands

Forum Secretariat has revealed, the amount of assistance required purely for EPA adjustment over the first five years of the EPA's operation is much greater than the proposed increase in the EDF.

29. Messrs Manservisi and Falkenberg acknowledge the gap in our positions concerning the linkage between the EPA and development cooperation. Much has been said about the additionality of resources, not only by the PACPS but also by the ACP Group as a whole. I will not repeat here the argument that the ACP Group has presented and will continue to present.

30. The discussions on accessing funds over and beyond the EDF to address ACP/PACP adjustment costs have reach new levels. The Finnish Presidency, for example, has spearheaded a move to source additional funding from outside the EDF for EPA adjustment and hopefully the German Presidency will do likewise. We have been advised that €1 billion under the Aid for Trade (Aft) initiative could be sourced from the Commission and a similar amount from the EU Member States. It is understood that two British Ministers, the Hon Gareth Thomas and the Hon Ian McCartney, have written to yourself and Commissioner Louis Michel on the matter. My understanding is that part of the Finnish Presidency's proposal was for the establishment of a special disbursement facility, perhaps an EPA Adjustment Facility, and the PACPS see merit in such a proposal.

31. Obligations enshrined in the EPA and assumed by PACPS will be legally binding. For the EPA to be successful, PACPS will need the certainty that the adjustment assistance required to give effect to the Agreement will be of a similarly binding nature and delivered in an effective and timely fashion. Otherwise, based on past experience and the Commission's inappropriate procedures for the timely and effective delivery of assistance to economic projects as noted recently in, inter alia, the Financial Times, PACPS might well face the unenviable situation of being bound to fulfil obligations they assumed under the EPA without the necessary resources or ability to do so. That is hardly a result that either the PACPS or European Union want to see, of that I am certain.

32. It is for the above reasons that our region has sought additional resources and proposed the establishment of an adjustment facility. It will be vital for the success of our negotiations that our two sides devote considerable attention to this matter over the coming year.

33. Messrs Manservisi and Falkenberg refer in their letter to the negotiations being at a cross-roads. In the view of our region, there has never been any doubt which way our EPA negotiations should proceed. We have demonstrated our commitment to those negotiations through the preparation of detailed, innovative and WTO-compatible proposals in a wide range of areas of central importance to both our sides. To date, by and large they have been met with what certainly appear to be rigid red lines and inflexible positions that do not reflect any genuine willingness to think creatively and arrive at a mutually acceptable solution that addresses the unique needs and circumstances of the 'P' in ACP.

34. While technical discussions must, of course proceed as expeditiously as possible over the coming year, I believe that it is now time for politicians to be brought increasingly into the negotiations. This view, I know, is not favoured by some of your officials. However, it is the politicians who carry the mandate of the PACPS and

technical niceties and packaging of issues that do not meet that mandate will not elicit the political endorsement that is needed for a successful conclusion of the negotiations.

35. Our region is prepared to move forward expeditiously in 2007 as evidenced by the formal negotiating documents I am forwarding under cover of this letter. It is my hope that the Commission is prepared to do likewise.

36. On a Regional Preparatory Task Force (RPTF), the region's position on its establishment remains that unless there is clear commitment on the part of the EC on additional resources for EPA adjustment needs, the functions of the RPTF to coordinate the delivery of EPA assistance remain unclear and the scarce negotiating resources of our region might best be focused on the several substantive areas indicated above.

Season's Greetings



**Hans Joachim Keil**

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