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A CASE FOR TRADE-BASED DEVELOPMENT ASSISTANCE?

FIJI AND THE SUGAR PROTOCOL

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ABSTRACT

Fiji exports sugar to the European Union under the preferential market access provisions of the 1975 Sugar Protocol. This paper argues that substantial economic and social benefits have accrued to Fiji as a result of the international trade generated by the Sugar Protocol. However, both the preferential prices and the guaranteed access that Fiji has to the European Union sugar market under the Sugar Protocol may start to erode in the next 12 years. Therefore, Fiji's sugar industry should begin a process of trade-led adjustment in which preferential prices and market access are used both to sustain efficiency improvements and minimize the social consequences of restructuring.

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1. INTRODUCTION

Development assistance can take several forms. One important form of development assistance is concessional aid. Concessional aid is a transfer from a donor to a recipient. Multilateral donors, bilateral donors and national governments accept that development assistance in the form of concessional aid maximizes the inflow of foreign exchange to the recipient. Moreover, from the point of view of the donor concessional aid may be a superior form of development assistance because it can be better targeted in line with donor priorities such as poverty alleviation or private sector development. Concessional aid is thus the usually-preferred form of development assistance: it is a cost-effective way of easing foreign exchange and savings gaps.

This paper takes a contrary position. It argues that in the specific case of Fiji trade is a more effective form of development assistance. Further, it argues that in the specific case of Fiji's sugar sector the social efficiency gains fostered by trade can be used to sustain a case for preferential market access. The paper proceeds as follows. The following section outlines the role of sugar in the Fiji economy. Section 3 introduces the Sugar Protocol, under which a substantial portion of Fiji's sugar is traded. Section 4 details the economic impact of the Sugar Protocol. Section 5 details the social impact of the Sugar Protocol in Fiji. In this

light, Section 6 examines the comparative merits of trade and aid for the Fiji economy. It is argued that the Sugar Protocol is an appropriate means by which trade-based development assistance can be channelled to Fiji. In light of the previous discussion, section 7 examines the strategic issues confronting Fiji's sugar sector in the medium and long term. Section 8 examines the prospect for trade-led restructuring in the sugar sector. Section 9 concludes the paper.

2. SUGAR IN FIJI'S ECONOMY

i. The sugar sector

Fiji is one of the largest Pacific island countries. With a per capita GNP in 1993 of US\$2130 Fiji is classified by the World Bank as a lower-middle income developing country. Further, with an average life expectancy of 71 years, infant mortality of approximately 22 per thousand, and an adult literacy rate of 89 per cent, Fiji has a high level of social development (UNICEF 1996). For most of the period since its independence in 1970 Fiji has pursued an employment-oriented development strategy focused upon the continued exploitation of its natural resources. As a consequence, agriculture has been and continues to be a major area of economic activity in Fiji.

Table 1 provides some indicators of the role of agricultural production in the Fiji economy. Table 1 demonstrates that agriculture has provided around a fifth of Fiji's GDP. In addition, agriculture remains a major employer: more than 75 per cent of all households work on a full-time or a part-time basis in crop production, livestock, forestry and fisheries (World Bank 1995). Since its introduction in the 1880s sugarcane farming and processing has dominated commercial agricultural activity. Although the significance of sugarcane farming has declined somewhat in recent years the sugar industry as a whole was worth approximately F\$320 million in 1995--more than 12 per cent of GDP. Sugarcane farming accounted for more than 40 per cent of the total agricultural sector in 1995. Moreover, sugarcane processing accounted for almost 30 per cent of the total manufacturing sector in 1995 (Fiji Bureau of Statistics various issues: Table 3.3). At the same time, sugarcane farming and processing remains the largest single source of employment in Fiji. Sugar provides direct employment for more than 25 per cent of the economically active population. Moreover, while it is no longer the country's largest earner of foreign exchange, Table 1 demonstrates that it did provide some 40 per cent of exports by value in 1992 and as such made a major contribution to easing the trade constraint that Fiji's small open economy faces. In sum, sugarcane farming and processing remains the most important component of the Fiji economy. Granted, garment manufacturing and tourism have been of increasing importance in recent years. However, the long-term outlook for the garment industry is problematic (Akram-Lodhi 1992), while tourism has been subject to significant cyclical oscillations

(Akram-Lodhi 1996).

In 1993 sugarcane farming in Fiji was done on 23454 registered farms. Three-quarters of sugarcane farmers were Indo-Fijian, while the remainder were from the indigenous Fijian community. According to the World Bank (1995), the average size of a sugarcane farm was 4.2 hectares. The average area harvested was 3.11 hectares, the average cane yield was 48 tonnes per hectare, and the average gross revenue received was F\$8314. Most sugarcane farms are small production units operating for most of the year with household labour. Thus, 61 per cent of sugarcane farmers produce on average less than 150 tonnes of cane per year. Moreover, 24 per cent of sugarcane farmers operate holdings of one hectare or less and produce on average 50 tonnes or less of cane a year.

Sugarcane farming is subject to long production cycles, inflexible resource allocation and the uncertainty of the weather. In Fiji, production uses self-provided seed cane, animal draught power and limited quantities of agro-chemical fertilizers. In addition to family labour, hired labour is used during the harvesting season. Cane harvesting is performed manually under a complex gang system which involves farmers working alongside some 13500 seasonal harvesters, many of whom are landless migrants. Cane cutters come from both the indigenous Fijian and Indo-Fijian communities. Cane harvesters receive an average rate of F\$7.50 for every tonne of cane cut. This translates into an average daily wage paid of approximately F\$8.50, almost 40 per cent below the mean average for all industries. However, in addition to wage costs the farmer hiring the cane harvesters often bears the cost of providing housing and meals for the temporary labour.

Sugarcane is processed into raw sugar at mills owned by the Fiji Sugar Corporation (FSC), a publicly-listed company in which the government owns 70 per cent of the shares. Four mills are capable of producing 500000 tonnes of sugar a year. The FSC also possesses storage and handling facilities. A majority of employees in the FSC come from the indigenous Fijian community. The earnings which accrue to farmers and the FSC from processing are based on an average price earned from sugar sales in all markets, after making some deductions for certain costs. Farmers receive an average of 72 per cent of the processing proceeds in four payments, with the remaining 28 per cent going to the mill.

Sugar marketing is performed by the Fiji Sugar Marketing Company, a Government owned private company funded by a commission on the export sales of sugar. With only one per cent of domestic production being locally consumed, almost all production is exported. The most important buyer is Tate and Lyle, a UK transnational. Forty-five percent of exports go to the European Union through the United Kingdom. Other significant markets include

Malaysia, Japan, Singapore, Korea, Canada and the United States.

ii. Current issues in the sugar sector

The most important issue facing the sugar industry is that of access to land. Although only 260000 hectares is used for agricultural production, most of the land on which sugarcane is produced is not owned by the farmers who operate it; it is rented on long-term transferable leases of 30 years' duration, leases which define the way in which the land can be used. Indeed, some 83 per cent of land in Fiji is communally owned by indigenous Fijians on the basis that this land cannot be sold (Akram-Lodhi 1997). As a consequence, there are currently some 30000 leases administered by the Native Land Trust Board (NLTB) on behalf of indigenous Fijian landowners. The rents paid by leasehold farmers are not determined on a land market. Rather, they are regulated by the Agricultural Landlord and Tenant Act (ALTA), which sets rents equal to 6 per cent of the unimproved capital value of the land and then transfers the rents to the NLTB. Operating expenses of the NLTB are covered by a deduction from the rents and a grant from the government. The unimproved capital value of the land is in theory determined every five years. Rents as proportion of crop value vary tremendously. Conflicting data from the World Bank (1995) and our own research (Prasad 1995) suggests that rents for sugarcane land may vary from a low of F\$50 per hectare to a high of F\$350 per hectare.

Leases under the ALTA framework begin to expire this year. While only a small number of leases actually expire this year farmers with leases that expire after 1997 have been finding it very difficult to borrow against the remainder of their leases for two reasons. First, it is likely that rents will rise substantially after 1997. Second, the NLTB is currently following a practice of closely assessing the land requirements of the landowning units prior to considering renegotiation with tenants. This uncertainty over the extension of their tenure has made it difficult for some farmers to maintain production and more particularly productivity-enhancing farm investment. Given the importance of the agricultural sector in the pattern of economic activity in the country the inability to maintain efficiency-enhancing farm investment is a major concern.

There is an urgent need to enhance the efficiency of sugarcane farming and processing in Fiji. The industry rapidly expanded in the 1970s and 1980s. Some of this expansion occurred outside the traditional sugarcane-growing areas. Expansion outside the traditional cane fields into productive land was constrained by higher transportation costs, which reduced efficiency. Expansion outside the traditional cane fields which moved into less suitable land witnessed decreases in average yields and increases in the variability of production. In either case, efficiency declined. The problem of declining efficiency was

worsened by three interrelated factors. First, payment systems are based upon the quantity of cane produced rather than the quality of the cane produced. Second, payment systems do not preclude the burning of the cane fields, which despite reducing the sugar content of the cane is commonplace: in the period 1991 to 1996 some 30 per cent of the total tonnage crushed at mills was burnt. Third, as a consequence of transport problems, mechanical problems and scheduling problems Fiji has high cut-to-crush times. Some 40 per cent of cane takes more than 24 hours to crush (World Bank 1995). This reduces the sugar content of the cane. However, it has minimal impact upon the payment received by the farmer because the payment is based upon quantity. As a consequence of these three factors, insufficient regard is given to the quality of the sugarcane that is produced. Paying insufficient attention to issues of quality has the effect of acting as a disincentive towards the modernization of production and processing facilities.

Other problems compound a lack of attention to quality. The use of unimproved planting material rapidly diminishes productivity on sugarcane farms. The limited use of agro-chemical fertilizers hampers productivity gains. The research and extension system is weaker than it should be due to a loss of skilled labour and a decline in investment since the early 1980s. The cost of labour in sugarcane harvesting and processing is a comparatively high proportion of total cost, especially in the latter stages of processing. The freight and insurance costs faced by Fiji are especially high as a consequence of the country's comparative isolation from major markets. In addition, the relatively modest size of Fiji's sugar production and its limited domestic market for goods means that both the size of ship which serves Fiji is small and there is less two-way shipment on Fiji's shipping routes, both of which serve to increase costs.

However, undoubtedly the most important issue facing the sugar sector after the issue of land is that of the prices received for its product. The mechanics of sugar pricing cannot be discussed without introducing the Sugar Protocol.

3. THE SUGAR PROTOCOL

The Sugar Protocol replaced the Commonwealth Sugar Agreement (CSA) of 1950. The CSA was a preferential agreement between the United Kingdom and Commonwealth countries wherein the UK guaranteed to purchase specified quantities of sugar for a negotiated price which in the period between 1951 and 1973 exceeded the world market price by an average of 165 per cent (cited in Herrmann and Weiss 1996).

The CSA was incompatible with the foreign trade regulations of the then European Community (EC). Therefore, when the UK was negotiating its terms of accession it sought,

in conjunction with pressure from the Africa, Caribbean and Pacific (ACP) states and Tate and Lyle, to have a new Community-wide preferential agreement for sugar agreed. The Sugar Protocol agreed between the EC and the ACP countries came into force in 1975 under the auspices of Protocol 3 of the Lomé Convention. However, formally the Sugar Protocol is independent of the Convention. While it has an unlimited duration the Sugar Protocol can be denounced by its signatories if two years' notification is given.

Under Article 1 of the Sugar Protocol the EC agreed to import 'at guaranteed prices, specific quantities of cane sugar, raw or white, which originate in the ACP States and which these countries undertake to deliver to it'. Under Article 5 the price paid for such sugar is negotiated annually and is agreed to equal the price range obtained within the Community. Thus, subject to certain provisions, it is possible to state that as a consequence of the Protocol the European Union (EU) applies its internal sugar regime to ACP sugar exporters. Arising out of the Common Agricultural Policy (CAP), the EU's sugar regime determines production quotas, producer price guarantees and export subsidies. Article 3 of the Sugar Protocol stipulated the quota amount of sugar the EC agreed to import from specific ACP countries. Finally, under Article 7 any failure to deliver the agreed quantities of sugar results in a loss of quota equivalent to the shortfall. Any shortfall is then divided among remaining ACP producers. The total preferential quota set for all the signatories was quantified in 1975 as being equivalent to 1304700 metric tons of white sugar. The total preferential quota has not been changed as a consequence of sugar production exceeding consumption within the Union. It has however been periodically reallocated between the signatories to the Protocol.

The Sugar Protocol thus commits Fiji to deliver specific quantities of sugar to the European Union at prices which are guaranteed and which are based upon the price of sugar set annually under the EU's CAP. In 1975 Fiji was allocated 163600 metric tons of sugar, equivalent to 13.4 per cent of the total preferential quota. Currently, Fiji has a preferential quota of 165348 metric tons, equivalent to 12.7 per cent of the total preferential quota. For the period 1990-92 Fiji's quota allocation amounted to an average of 42 per cent of the country's total sugar production and 46.6 per cent of the country's total sugar exports. Fiji received a price which averaged between 2.5 and 3 times the world market price for these exports.

The widening of EC membership to Portugal resulted in supplementary preferential access for sugar to the European market which started in 1995 under the Special Preferential Sugars (SPS) agreement, designed to fulfil the EU refiner's deficit. Under the SPS the EU determines an additional annual preferential import quota based upon raw beet production in

Portugal, production levels in the French Overseas Departments and refiner's needs. The increased quota is first allocated amongst four countries who traditionally exported to Portugal: Cote d'Ivoire, Malawi, Swaziland and Zimbabwe. The balance is shared on a pro-rata basis amongst the signatories of the Sugar Protocol.

The SPS price has been fixed for a 6-year period and is subject to renegotiation prior to its expiry. It is set at between 83 and 85 per cent of the price ACP countries receive under the Sugar Protocol. Deducted from the price is a refiner's margin and a special reduced tariff which together amount to 8.1 per cent of the price. This deduction is designed to assist the EU in complying with its international obligations under the Uruguay Round Agreement to lower its levels of subsidy. The SPS is thus consistent with the EU's World Trade Organization (WTO) obligations.

In the first year of its operation supplementary preferential access to the EU market under the SPS agreement amounted to 334100 metric tons. Under the pro-rata stipulations of the SPS agreement Fiji exported 48045 tonnes in the agreement's first year of operation. For Fiji, the SPS provides a further incentive to direct sales towards preferential markets.

In addition to the preferential prices Fiji receives under the Sugar Protocol and SPS, Fiji also has a small amount of quota access to the United States under the Generalized System of Preferences. This sugar is sold at preferential prices averaging between 1.5 and 2 times the world market price. However, US sugar imports have been declining over time and Fiji only receives 0.9 per cent of the US quota. Thus, as long ago as 1988 Fiji's quota was only 9000 metric tons. Fiji's remaining production is sold on the world market at the prevailing price, although the country has entered into long-term delivery agreements with Malaysia, Japan and Singapore.

4. THE ECONOMIC IMPACT OF THE SUGAR PROTOCOL

The primary benefit of the preferential quota arrangement under the Sugar Protocol for Fiji has been twofold. First, under the Treaty of Rome the EU's CAP is designed to stabilize the living standards of Europe's farmers by providing support to agricultural production, distribution and marketing. As a consequence, European sugar production quotas are agreed and European internal sugar prices are stabilized. As the Sugar Protocol guarantees that its signatories receive the EU internal sugar price, Fiji obtains a price for its sugar which is usually in excess of the world market price. In the early 1990s the Union's price was roughly double that of the world market price. Second, as a major purpose behind the CAP is to stabilize prices Fiji is subject to less fluctuation in the price it receives for the sugar it exports to the Union. Whereas in the period between 1975 and 1991 the world price of

sugar varied year by year around its average price on the order of 41 per cent, the European Union's price of sugar varied year by year around the average internal sugar price by only 8.7 per cent (Herrmann and Weiss 1996). Therefore, the Sugar Protocol significantly reduced the variability of export earnings that a reliance on world market prices would have produced. It has been estimated that the Sugar Protocol reduced the year by year variation in Fiji's sugar export earnings by just under 40 per cent (Herrmann and Weiss 1996). Thus, the Sugar Protocol has been an important source of both price stability and sales security, factors which are of major importance to a country such as Fiji which produces only a small percentage of the world's sugar.

The benefits of price stability and sales security to the Fiji economy can be witnessed in a range of areas: increased production, increased employment in the farm and mill sector, increased incomes for landowners, growers and millers, and the attendant impact that such income increases have had on living standards in the sugar community. Such benefits arise as a consequence of the fact that the Sugar Protocol has been responsible for a transfer of income from the EU to Fiji. In aggregate, for the period 1980-90 the transfer received by Fiji from the price subsidy implicit in the Sugar Protocol has been estimated as being worth 3.72 per cent of GDP (McDonald 1994). In 1992 the transfer was estimated to be worth F\$90 million. Such levels have been sustained over the life of the Protocol. Thus, over the period 1975-91 the average annual transfer to Fiji arising from the Sugar Protocol has been estimated at ECU 26.5 million. This amount is equivalent to a transfer per person of some ECU 37.75 per year (Herrmann and Weiss 1995). It is instructive to compare this transfer with that received by Fiji between 1975 and 1995 under the European Development Fund, the official development assistance of the EU. Between 1975 and 1995 Fiji received assistance equivalent to approximately ECU 8.87 million per year. This amount is equivalent to assistance per person of some ECU 12 per year. Thus, the Sugar Protocol generates transfers from the EU to Fiji some three times greater than that supplied under official development assistance.

The Sugar Protocol also has an economic impact in Europe. Unlike the sugar regime of the CAP, imports under the Sugar Protocol and the SPS are not self-financing. They fall within the export refund budget and thus have a cost beyond those transfers from consumers to producers which are a consequence of price support schemes. However, despite this cost the Sugar Protocol and the SPS has been of net benefit to European sugar producers and refiners. For the producers, imports under the Sugar Protocol and the SPS effect European production agreed under the CAP. The amount imported under the Sugar Protocol and the SPS is currently equal to approximately 1.6 million tons. Under the terms of the CAP an equivalent amount of European production can be exported and producers then receive a subsidy equal

to the difference between the world price and the European internal support price. As a result of the Agreement on Agriculture of the Uruguay Round Agreement the value of subsidized exports must fall by 36 per cent by the year 2000, using 1986-90 as a reference period for the value of subsidized exports. Further, the quantity of subsidized exports must fall by 21 per cent by the year 2000. However, the 1.6 million tons exported by European producers as a consequence of ACP imports is exempted from the commitment to cut export subsidies. Therefore, European producers are able to maintain exports of 1.6 million tons of sugar at a price which is higher than the price their remaining exports of sugar receive. Since the conclusion of the Uruguay Round European sugar producers have been better off as a consequence of the Sugar Protocol.

In addition to sugar producers, sugar refiners in Europe also benefit from the import of ACP sugar. The EU import of ACP sugar allows the refining sector to maintain its capacity utilization, and in so doing reduces the per unit cost of refining.

5. THE SOCIAL IMPACT OF THE SUGAR PROTOCOL IN FIJI

The social benefits of the Sugar Protocol have been widely distributed across Fiji. This has helped moderate the level of poverty in rural areas and contributed to social stability throughout the country.

The nature of land arrangements in Fiji discourages resource accumulation on the basis of land. The NLTB has a preference for lessees with single holdings. The consent of the NLTB and the Ministry of Lands is required for the transfer of land ownership. As a result, land holdings remain largely fixed in size. Much of the expansion of farm acreage in the 1970s and 1980s was not so much a consequence of land reallocation as rather a result of the opening up of new, less productive lands in the existing sugar regions.

In this light, it would appear difficult for farmers to increase their wealth through resource accumulation. Recent Government estimates support this view. Living standards surveys suggest that 600 tons of cane generated an average annual net income of F\$13000 in 1994. However, it would appear that only 250 farmers produced on average more than this amount of cane. The same surveys suggested that growers who produce less than 200 tons of cane are likely to be in poverty. Indeed, it appeared that in 1995 one in three rural households could be classed as living below the poverty line (World Bank 1995). Preferential prices have thus not been to the exclusive benefit of large farmers. Granted, large farmers will have received a disproportionate share of the transfers generated by the Sugar Protocol. However, it can be argued that the key beneficiary of preferential prices has been smallholders. By providing renumerative prices the Sugar Protocol has maintained social

efficiency by promoting production and employment amongst the far more numerous smallholder farmers who would otherwise in all likelihood have been unable to sustain the livelihood security of their households. Therefore, it is possible that the Sugar Protocol has acted as an employment-generating social safety net for the one in three living below the poverty line. Confirmation of this hypothesis awaits publication of the results of the Household Income and Expenditure Survey conducted in 1990.

Moreover, for those growers on comparatively low incomes the long term arrangements of the Sugar Protocol have allowed commercial borrowing, using crop liens to finance efficiency-enhancing capital improvements in agriculture. Indeed, long term resource flows have been generated amongst those who are comparatively poor which facilitate the provision of education, health and housing needs. Granted, farmers have accrued debt. For example, a 1992 Sugar Cane Growers Council study noted that sugar farmers had an average outstanding debt burden of F\$11500 (Prasad 1995). However, the social benefits generated by the acquisition of such debt means that the primary negative impact of debt should be seen as the constraint it creates upon the ability of farmers to take the risks associated with diversification.

Farmers have not been the only group to benefit from the Sugar Protocol. Wages for 13500 seasonal cane harvesters depend in large part upon the ability of Fiji to sell its sugar to the EU under the Sugar Protocol. The World Bank (1995) has argued that rural wage labour is amongst the most impoverished group in the country. The ability of this group to sell their main productive asset--their capacity to work--depends upon the Sugar Protocol. Similarly, in the milling sector high union densities and a well established industrial relations framework has ensured that factory and field employees of the FSC have benefitted from both the preferential prices and sales security guaranteed by the Sugar Protocol.

At the same time, the benefits of the Protocol have not been focused upon one community. Indigenous Fijian landowning groups have also benefitted. Higher prices for crops drives up the capital value of the land that is farmed, and will thus eventually drive up the rents that are paid. Any decline in sugar prices could affect land rentals and indigenous Fijian landowning groups. Moreover, sugar provides an important avenue through which greater numbers of indigenous Fijians are being incorporated into the farming and milling sectors. The increase in the number of growers from 15000 in 1975 to more than 23000 in 1996 came not only from a restructuring of existing holdings but also from large numbers of indigenous Fijians utilising their traditional lands in existing sugar regions to enter the sector. The proportion of indigenous Fijians in sugarcane farming increased steadily after independence, to stand at more than 30 percent by the end of 1995. The Sugar Protocol has

facilitated social and economic stability by having an impact on farmers in the indigenous Fijian community, thus deepening the equity outcomes of preferential trade. A sharp decline in sugar prices would seriously affect this trend. Perhaps more importantly, it would also effect relationships between Fiji's main communities.

Overall, sugar income has been distributed across the sugar regions of the economy; while some have benefitted more than others, it can be argued that no one group in the countryside has benefitted disproportionately. In addition, the indirect contribution of sugar proceeds to public goods such as education and health will have had benefits well outside the sugar region. Moreover, the aggregate multiplier effects of the economic activity generated by the Sugar Protocol will have been spread outside the sugar region and across the country: the jobs and income generated by the Protocol will have facilitated increases in the effective demand for goods and services produced outside the sugar sector. Finally, and importantly, transfers which operate through transparent prices offer less scope for the pursuit of rent-seeking activity. Therefore, any decline of sugar incomes would extend well beyond production, exports and employment in the sugar sector. It would effect the level of social development in the economy as a whole, and in so doing adversely impact upon the level of social efficiency in the Fiji economy.

6. TRADE VERSUS AID

Fiji engages in the international economic relationships in order to increase national income. International economic relationships have the effect of increasing the level of foreign exchange available to Fiji. This allows Fiji to overcome insufficient domestic savings, facilitating the domestic investment which enhances growth. By easing the scarcity of foreign exchange, international economic relations increase Fiji's ability to purchase the investment and consumer goods and services which the country requires but does not produce. In so doing, increases in welfare are promoted.

In Fiji, international economic relationships in the form of increasing inflows of foreign direct investment have been significant in recent years (Akram-Lodhi 1992). However, in evaluating the efficacy of the Sugar Protocol it is helpful to place foreign direct investment to one side and to focus upon the other two general forms of international economic relationships. The first is official development assistance from bilateral and multilateral agencies; the second is international trade. Like foreign direct investment, both have the effect of easing the foreign exchange and savings gaps which hinder the economic development of the country. However, it is a matter of some controversy as to whether trade or concessional aid is a superior form of international economic relationship for an economy such as Fiji.

At the most general level, if concessional aid is simply a free transfer from a donor to Fiji then the value to Fiji of the foreign exchange received in the form of concessional aid will always exceed the value to Fiji of an equivalent amount of foreign exchange received from exports (Thirwall 1976). This is because exports have additional costs associated with them which concessional aid does not: the cost of transforming domestic resources into goods and services which are capable of being sold on world markets. Moreover, from the point of view of the donor concessional aid is a superior form of development assistance because it can be better targeted in line with donor priorities such as poverty alleviation or private sector development. It is for this reason that many in the EU would like to transform the transfers Fiji currently receives under the Sugar Protocol into formal bilateral concessional aid.

However, in the case of Fiji concessional aid may be a less efficient means of transferring income when it is compared to trade. Yassin (1982) makes the point that in assessing the relative merits of trade and aid it is important to consider what Thirwall (1976: 40) called 'secondary repercussions'. The main secondary repercussions that should be considered are in terms of the impact of trade in comparison to aid on savings and on productivity. The argument that aid cuts domestic savings was originally made by Griffin (1970). Subsequent work has dismissed the argument on both theoretical and empirical grounds (White 1992). As regards the comparative impact of trade and aid on productivity, little work has been done. However, there may be reasons to believe that for Fiji the productivity implications of exports may exceed those of concessional aid. The basis for such an argument is that even though Fiji's exports remain dominated by a primary commodity such exports nonetheless still bring dynamic benefits that concessional aid does not.

In terms of the dynamic efficiency gains brought about by trade, these include the possibility of the country benefiting from economies of scale as the total market available to producers increases; this is certainly true in the sugar industry. Moreover, economies of scale have in the past facilitated growth-enhancing investment. Other dynamic gains from trade include the recognition that Fiji must produce internationally-competitive goods. This acts as a competitive discipline on domestic producers to seek to improve efficiency. It is certainly true that the Fiji sugar industry is aware of the importance of the international market for its growth and development. Another dynamic gain is the acquisition and dissemination of technical knowledge that permits efficiency improvements to flow out of investment. Those in the Fiji sugar industry recognize that efficiency improvements necessitate the modernization of the industry, and that this in turn requires accessing productivity-enhancing international knowledge. Finally, trade-oriented economies demonstrate greater adaptability to changes in economic circumstances. The enhanced ability to be flexible is an important

benefit of international trade. Thus, in terms of its respective merits, trade may enhance productivity, investment and growth in Fiji in a manner which exceeds that which would be obtained if Fiji's comparatively low levels of concessional aid were to be increased.

In order to reap the gains that trade has the capacity to produce Fiji requires market access. However, while many developed market economies seek to foster free trade in developing economies they concurrently maintain restrictions on market access. Thus, free trade as such does not exist. Rather, arrangements for the movements of goods exist. Such arrangements can enhance the vulnerability of countries such as Fiji, which produce primary commodities. Countries such as Fiji may be unable to freely sell their products and garner the resources necessary to fund diversification into more valuable processed goods. This constraint is compounded in the case of the European Union by the fact that the Union is the world's largest sugar exporter. While not as important as it once was, the export of European sugar on the world market has had an impact on the world market price of sugar in the past and in so doing has acted to constrain the ability of farmers in Fiji to compete. This has weakened the capacity of Fiji to diversify.

Fiji needs to reduce its dependence on sugar by expanding into new agricultural products, new sugar by-products, and by diversifying its manufacturing base. Granted, it could be argued that the impact of the Sugar Protocol in Fiji has been to block diversification by fostering a variant of 'Dutch disease'. Dutch disease occurs when increased inflows of external resources results in the price of non-tradeables rising in relation to the price of tradeables. The effect would be to generate a rise in the real effective exchange rate, a decline in export competitiveness, and the possible onset of stagnation. It might be argued that the income transfers from the Sugar Protocol might result in the operation of similar mechanisms. However, it is not clear whether Dutch disease is an appropriate analysis for Fiji. Theoretically, models of the impact of Dutch disease requires full employment of resources (Karshenas 1990). Such an assumption does not hold in the case of Fiji, where there is a large degree of slack in the labour market, particular outside the sugarcane harvesting season. Moreover, the key variable in managing the transition process arising out of the inflow of external resources in circumstances of a lack of full employment is that of the quality and timing of policy interventions. Policy interventions should seek to avoid the possibility of crowding out arising as a result of the inflow of external resources. While not done for this particular reason, the devaluation of the nominal exchange rate in the late 1980s served to reduce the real effective exchange rate by almost 46 per cent (Akram-Lodhi 1996). The upward drift in the real effective exchange rate during the 1990s has been modest and has not obviated the initial devaluation. This has served to limit the potential of the Sugar Protocol to foster Dutch disease during the 1990s. Indeed, there appears to be little pressure

for further devaluation in those sectors which might benefit, particularly garments and tourism. Thus, Dutch disease is something of a non-issue; what is an issue is the continuing need of Fiji's farmers to generate the resources to diversify. Fiji's farmers must be able to sell their products and governments must assist in the diversification process. What is required is market access which gives Fiji's producers the resources capable of funding diversification and efficiency improvements and the time necessary to adjust by restricting third party competition. This is precisely what the Sugar Protocol currently accomplishes for Fiji. The Sugar Protocol is a form of trade-based official development assistance linked to a commercial agreement. In a sense, the Sugar Protocol could be considered as a model of 'fair trade' arrangements (see van Halsema and Papma 1997). In order for the Sugar Protocol to be able to continue to perform this role, there is a need to maintain preferential access to the European market.

7. THE FUTURE OF THE SUGAR SECTOR IN FIJI

The Sugar Protocol has been an important source of price stability and sales security for Fiji. However, in Fiji it is being argued by some that the benefits of the Sugar Protocol for Fiji are likely to erode. Five reasons are commonly given. Scarce budgetary resources within the EU has led to pressures upon the sugar subsidy of the CAP. Moreover, some have argued that the Union's internal sugar price will start to fall in the wake of the Uruguay Round Agreement. In addition, it is possible that additional US pressure will be exerted on the EU to further cut subsidies. Concurrently, special market access arrangements such as the Sugar Protocol are now vulnerable to third-party complaints under the WTO. Finally, short-term expectations are that world sugar prices will fall by between 5 and 10 per cent over the next 10 years. The Fiji sugar industry is therefore facing a period of significant challenges. The strategic challenges confronting the industry from outside Fiji operate in two time frames: the medium term and the long term.

i. The medium term

In Fiji it is becoming widely accepted that over the remainder of the decade there will be a reduction in national welfare originating in changes in the sugar industry. It is believed that the main source of the reduction in national welfare will be from the loss of the transfers received from the Sugar Protocol. Under the terms of the Uruguay Round Agreement the European Union has agreed to reduce both the tariff protection received by European farmers and the volume of export subsidies European farmers receive. The value of subsidized exports must fall by 36 per cent by the year 2000, using 1986-90 as a reference period for the value of subsidized exports. The quantity of subsidized exports must also fall by 21 per cent by the year 2000. As a result, some have argued that the EU's internal sugar price will fall, leading to a fall in the price paid for Fiji's quota exports to Europe. A widely-quoted

figure is that the price paid to Fiji's sugar farmers exporting to the EU will fall by as much as 15 per cent by the year 2000 (Akram-Lodhi 1996). It has been estimated that were such a scenario to happen the impact of agricultural trade liberalization under the Uruguay Round Agreement would be a net welfare loss to Fiji equivalent to some 2.52 per cent of gross domestic product (MacDonald 1994).

This scenario is unlikely to occur. Barring an unforeseen shock, the EU should be able to meet its Uruguay Round commitments to reduce both the tariff protection and the volume of export subsidies received by European sugar farmers while simultaneously maintaining the level of internal support prices. Moreover, the EU can cut internal sugar quotas in an effort to sustain the internal support price. Thus, it is probable that over the remainder of the decade the internal support price will remain broadly stable. This means that Fiji will continue to receive a comparable level of transfers from the Sugar Protocol over the remainder of the decade.

As for the world sugar price, it is likely that the world market is entering a period of reduced volatility. It is true that some price erosion is likely to occur. However, the Uruguay Round Agreement will have only a limited effect on the world sugar price. The impact of the fall in the EU's export subsidy on the world sugar price is speculative. It is worth stressing though that the EU now has a less important role in determining the world sugar price than was previously the case because Brazil, India and Indonesia have become more important in determining the global sugar price. While World Bank estimates of a gradual fall in world sugar prices of between 5 and 10 per cent to the year 2005 appear to us to be optimistic, such an estimate does seem appropriate to the early years of the next decade.

ii. The long term

The long term position of Fiji's sugar industry is affected by two factors. First, the current Lomé Convention expires in 2000. It is highly likely that a follow-up convention will be negotiated between the EU and the ACP countries. Granted, for the Fiji sugar sector a follow-up convention may appear unimportant. The Sugar Protocol is formally independent of the Lomé Convention. However, both the possibility of a follow-up convention and the Fiji sugar industry itself will be directly effected by the second factor: that as a consequence of the Uruguay Round Agreement agriculture now falls within the purview of the WTO.

It is not widely recognized that the Uruguay Round Agreement has already been highly significant for Fiji. Under the Agreement on Agriculture tariff quota access to the EU for sugar was locked into tariff schedules inspected and agreed by all signatories to the Agreement and subsequently all members of the WTO. Moreover, the amount of tariff quota

access agreed was identical to that contained within the Sugar Protocol. The beneficiaries of tariff quota access to the EU sugar market are explicitly recognized as being the ACP countries. Thus, the Uruguay Round Agreement established WTO-consistent access to the EU sugar market for ACP sugar exporters. The locking in of market access under agreed tariff schedules means that under no circumstances will that access be reduced; it can only be enlarged. Thus, ACP market access to the EU sugar market is now independent of the Sugar Protocol itself. However, it is important to stress two caveats. First, the locking in of tariff quota access applies to the ACP states as a whole and not Fiji in particular. There is no provision concerning the allocation of the tariff quota access to specific countries. Second, it is possible that ACP market access to the EU sugar market could be subjected to a legal challenge.

That having been stated, the inclusion of agriculture within the WTO now poses two significant challenges for the Fiji sugar industry. Under the Agreement on Agriculture, the next round of WTO-initiated multilateral trade negotiations in agricultural products will begin in 1999. These negotiations 'will set in train a more powerful impetus to change than may at first sight seem obvious' (Roberts 1996: 6). Negotiations

can be expected to broadly follow the lines of the Uruguay Round: further reductions of support, increases in market access (eg. through further reduction of tariffs and tariff equivalents) and further reduction in export subsidies and subsidized export quantities (Roberts 1996: 5).

Moreover, it is likely that the EU will face some pressure to make commodity-specific agreements. These could have a major impact on the EU sugar regime as negotiations pursue cuts in tariffs, in export subsidies and in the support directed towards European sugar production. At the same time, pressures on the EU sugar regime are likely to be intensified by those industries within Europe that use sugar as an input in the production of higher value-added commodities. Producers of such commodities, which form an increasingly important share of EU exports to non-EU members, may become reticent about paying the comparatively high internal sugar price; they are likely to prefer procuring sugar at the world price. In sum, there is likely to be sustained internal and external pressure upon the EU's internal sugar price. Indeed, it is quite possible that the EU will begin a process of shifting towards world market prices in the sugar sector. This would substantially erode if not eliminate the benefits Fiji receives from preferential access to the EU sugar market.

Pressure on the sugar price may be accentuated by difficulties involved in negotiating a follow-up convention to Lomé IV. Despite the fact that non-discriminatory non-reciprocal trading arrangements such as Lomé are permissible under the WTO the WTO has already expressed doubts about the general benefits of non-reciprocal trading arrangements, arguing

that they provide limited economic gains and foster protectionism (World Trade Organization 1995). Formally, the WTO will only support regional trading arrangements if they are consistent with Article 24 of the General Agreement on Tariffs and Trade. In order to be consistent, regional trading arrangements must have as an explicit objective a movement towards reciprocal free trade between the contracting parties over a 10 year transition period, with free trade being defined as trade subject to zero import duty. In some exceptional cases, the transition period may be extended to 12 years. Moreover, regional trading arrangements which violate the rules of the WTO can be subject to legal action. Admittedly, the application of Article 24 has been haphazard in the past. However, following the Uruguay Round Agreement the EU and the ACP did feel it necessary to obtain a temporary waiver of Article 24 in order to prevent third party complaints about its special market access arrangements.

It is possible that doubts over the benefits of non-reciprocal regional trading arrangements may lead to attempts to more strictly apply the rules of the WTO, and Article 24 in particular. At the same time, it appears increasingly unlikely that the EU would agree to seek another waiver for a subsequent convention. If such is the case, participants in a post-Lomé agreement would not only have to act on behalf of their own producers and consumers. They would also have to consider the impact of the agreement on the freedom of world trading relationships. As a consequence, a follow-up convention would have to be a reciprocal agreement which encompassed a dismantling of trade barriers in an effort to move towards free trade between the contracting parties over a 10 year period. It could be argued that the European Commission's Green Paper on future relations between the EU and the ACP is an attempt to facilitate the negotiation of a post-Lomé agreement which is WTO-consistent. In addition, support from the WTO for regional trading arrangements requires that they exclude no significant economic sector. If Article 24 were to be rigorously enforced, the inability of a post-Lomé agreement to exclude significant sectors means that the Sugar Protocol would have to at the very least be made consistent with a follow-up convention. This implies significant movement towards a re-formulation of the Sugar Protocol. A re-formulated Sugar Protocol would have to make significant progress towards free trade in sugar between the contracting parties by 2010. This implies an end to quotas for specific countries. However, such a move is unlikely to occur: the locking in of tariff quota access for ACP sugar exporters to the European market means that market access now has a life independent of both the Lomé Convention and the Sugar Protocol. In a sense, the market access provisions of the Sugar Protocol are now redundant. Therefore, a more realistic scenario would be the termination of the Sugar Protocol.

If Article 24 were to be more rigorously enforced, freer trade in sugar would mean that

European sugar producers would face competition from ACP countries not at the internal support price but at the much lower world market price. This would reinforce any trends within the EU towards a reduction in the internal support price arising out of post-1999 multilateral agricultural trade liberalization negotiations.

Therefore, in the long term the outlook for the Sugar Protocol to continue to provide benefits to Fiji is problematic. The market access arrangements of the Protocol now exist independently of the Protocol but make no specific provision in favour of Fiji. This means that the main continued benefit of the Protocol lies in the price it offers for Fiji's sugar. However, it is likely that after 1999 there will be major downward pressure on the EU's internal sugar price, and thus the price received by all ACP sugar producers. This pressure will only be reinforced if Article 24 comes to be more strictly interpreted, as in order for a Protocol to survive would imply it becoming consistent with the free trade objectives of a follow-up convention subject to the approval of the WTO.

Fiji faces the possibility of losing both sizeable transfers from the EU and its clearly specified preferential access to the EU market. Clearly, in the long term the sugar industry in Fiji faces a major challenge. It has been recently estimated that full trade liberalization will result in a loss to Fiji of US\$41 million a year at 1985 prices (MacDonald 1994). Such a loss would represent a major shock to such a small economy. Fiji will have to adjust.

8. TRADE-LED RESTRUCTURING IN FIJI'S SUGAR SECTOR

Sugar has been a source of social stability in Fiji. However, it would appear that the Sugar Protocol is unlikely to survive in its present form beyond 2010. Indeed, it is likely that Fiji faces the need to undergo restructuring in the sugar sector, in order to be able to become competitive at the world market price. A transition to an environment ruled by free market prices could result in severe dislocations. Moreover, production, harvesting and transportation costs in the sugar sector are already rising, reducing the returns to growers and millers. At a time when Fiji's economic system is challenged by so many other problems, including the impending cessation of preferential market access for its non-sugar manufacturing sectors, a highly uncertain future awaits the sugar sector and indeed the country (Akram-Lodhi 1996). Much will therefore depend on how well Fiji's sugar sector is able to respond to these challenges.

In Fiji, policy makers have long recognised that in the longer term the country will have to develop an internationally competitive sugar industry. However, attempts at restructuring have been burdened by the problems of distance from markets, a complex system of land ownership and distribution, and by the escalating freight and insurance costs. A rapid

transition to free trade will not solve these problems. Moreover, a rapid transition to free trade will severely undermine social equity. It is therefore imperative that Fiji manage the transition in its sugar sector. A longer term approach will be essential if the structural reforms needed in the sugar sector are to take account of the potentially serious social costs involved in the reform process.

Already, at the industry level preferential prices have created an environment in which major initiatives aimed at efficiency improvements in both the milling and farming sectors have been undertaken. These efforts need time and support to translate into productivity improvements. In this light, preferential trading arrangements have an important part to play in managing the transition that must occur in Fiji's sugar sector. Over its remaining life it is important that the preferential arrangements embodied in the Sugar Protocol are used to prepare Fiji's sugar industry for open competition in world markets. The challenge is a major one: we estimate that the farming and milling sectors have to seek to boost productivity by at least 25 percent.

Experience elsewhere demonstrates that restructuring at the farm level is likely to result in a gradual concentration of farm enterprises into larger units of operation as they seek to generate productivity gains. Experience elsewhere also demonstrates that further productivity improvements on farms with a larger scale of operations may be secured through a transition to semi-mechanised harvesting. However, these processes would have major social consequences. The 65 per cent of growers producing less than 350 tonnes per year are likely to be seriously exposed to poverty as price supports are reduced to world market levels. Moreover, rural cane cutters would also face deepening economic hardship.

We do not welcome this outcome. It is therefore necessary to formulate policies which can assist in maintaining the security of those threatened by the transition to free market prices. For smallholder farmers, five policies might assist in enhancing their productivity and thus their security during uncertain times. First, a lasting settlement of land lease questions could make a major contribution to stabilizing the transition process. Secondly, renewed efforts at encouraging crop diversification are going to be needed. Third, decades of built up experience in plant breeding and improved husbandry measures should be reinvigorated in order to seek to boost productivity. Fourth, substantial infrastructural investments targeted at improving transport and increasing the efficiency of cane crushing and milling could assist in fostering productivity improvements. Fifth, there must be some movement towards a system of payments based upon the quality of cane rather than its quantity. All five issues however cannot be solved overnight; a medium to long term time frame is required.

While the need for productivity gains have been stressed, Fiji also needs to use preferential trade to begin to develop a range of sugar by-products which have a higher value-added component and which can be produced locally. Moreover, it will be necessary to try to develop niche export markets for such products. The development of such products will be an important means by which the economy can seek to deal with the employment issues created by the transition to a more open sugar trading environment. Such policies will be of major importance to both those farmers who lose their livelihoods and to those rural cane cutters displaced by trends towards mechanization.

These policies have resource costs. The challenge will be to target some portion of the preferential price currently received under the Sugar Protocol towards sustaining efforts designed to foster productivity improvements in the farming, harvesting and milling sectors. An increase in export taxes may be inevitable. Resources will also be required to accommodate the social equity implications of restructuring. If social disruption is to be avoided, research, industry level support and central coordination will be required. Moreover, it is vital that the European Union is engaged in this process and that future ACP/EU trade agreements sustain a preferential trade-based institutional framework during the transition period. Inevitably, successor trade-based institutional arrangements to the Lomé Convention and the Sugar Protocol will need to accept that these frameworks have worked for Fiji's economy in the past. The last thing that Fiji needs is a replacement of trade-based institutional arrangements with new concessional aid regimes.

9. CONCLUSION

The Sugar Protocol has contributed enormously to Fiji's social and economic development. By providing price stability and market access, it has helped sustain productivity improvements in the sugar industry and provided the main source of income for almost a quarter of the country's economically active population. While the EU's international commitments over the next five years will not seriously affect the industry, any further price falls in the following decade arising from multilateral negotiations will expose the industry to global competition without the prerequisite competitive strength. International competitiveness in the sugar industry must be the long term goal. However, in order to move towards international competitiveness it is vital that the market security and price stability provided by the Protocol be retained as long as possible so as to sustain the conditions necessary for productivity improvements and agricultural and non-agricultural diversification. In the absence of an orderly process of change social stability and Fiji's economic well-being are likely to be seriously harmed.

10. TABLES

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Table 1: Fiji agrarian indicators, 1965-1992

Year	GNP per capita Year	GDP growth per year	Trade deficit (%)	Agri- culture (%)	Agrarian labour (%)	Sugar in force (%)	Sugar in GDP (%)	Sugar exports (%)
1965	290	--	--	30	55	--	71	
1970	400	13	--	25	52	--	66	
1975	1030	1	--	23	49	--	83	
1980	1750	-2	15	20	46	--	81	
1985	1650	-3	20	16	--	12	59	
1986	1740	8	14	19	--	16	55	
1987	1620	-7	4	21	--	13	56	
1988	1620	1	9	18	--	12	44	
1989	1780	14	12	17	--	13	41	
1990	1860	5	21	--	--	11	37	
1991	1920	1	15	--	--	11	40	
1992	2010	3	14	--	--	11	41	

Notes: -- indicates not accessible;

GDP growth per year is in constant prices;

1991 and 1992 figures are estimates.

Source: World Bank 1994;

Fiji Bureau of Statistics various issues;

Reserve Bank of Fiji various issues.

Table 2: Fiji sugar industry production and prices, 1975-1994

Year	Contracts	Area harvested (000ha)	Production (000t)	Cane input				Exports (000t)	Exports (\$000)	Exports (\$t)			
				Production (t/ha)	Price paid of sugar (\$/t)	Sugar production (000t)	Molasses production (000t)						
1975	16994	45	2160	48	32.12	8.1	264	73	246	94718			
1976	17197	47	2283	48.6	24.57	8	286	79	246	67704			
1977	18005	52	2674	51.4	26.74	7.4	362	105	324	93576			
1978	18383	54	2833	52.8	25	8.2	347	106	294	83273			
1979	19233	62	4063	65.5	23.35	8.6	473	163	428	116962			
1980	19567	66	3360	50.9	35.19	8.5	396	129	441	174175			
1981	20936	66	3931	59.6	26.24	8.4	470	152	408	131561			
1982	21558	69	4075	59.1	26.75	8.4	487	150	411	125076			
1983	21671	59	2203	37.3	29.55	8	276	84	343	111935			
1984	22130	69	4290	62.2	22.26	8.9	480	188	379	109955			
1985	22154	71	3043	43.4	24.61	8.9	341	108	410	111828			
1986	22182	69	4109	59.6	36.55	8.2	502	159	324	133716			
1987	22255	71	2960	44.8	52.37	7.4	401	130	429	186158			
1988	22127	64	3185	49.9	43.95	8.8	363	130	409	198347			
1989	21771	64	4099	57.7	46.48	8.9	461	151	398	228285			
1990	21334	70	4016	57.6	41.3	9.8	408	164	394	223669			
1991	22479	72	3380	46.5	50.89	8.7	389	138	357	220400			
1992	23334	73	3533	48.6	54.99	8.3	426	129	365	221281			
1993	23454	74	3704	50.1	49.16	8.4	442	136	439	230688			
1994	22808	74	4064	53.4	50	7.9	517	155	471	252183			

Source: Fiji Bureau of Statistics Current Economic Statistics Table 4.7.

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