Preferential trade or strong institutions
promoting sustainable development in Fiji

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Abstract

Many developing nations rely on preferential trade access to developed nations' markets to stimulate economic growth. Developed nations see this dispensation as an important form of developmental aid. However, preferential access contravenes World Trade Organization rules, which require Most Favoured Nation status to be granted all member nations without regard to membership in regional or other preferential agreements. This paper analyses the impact on the economy of Fiji of preferential access to the European Union through rules set forth under the Lomé Convention. Results indicate that Fiji government expenditures directed toward enabling domestic institutional capacity are as important in contributing to GDP growth as is preferential trade access.

Keywords

Sustainable development; institution building; Fiji; preferential trade agreements; sugarcane production.

pricing scheme for sugar imported into the EU from certain countries. Fiji's sugar producers, by virtue of their country's membership of the Africa, Caribbean and Pacific (ACP) group of nations, benefit from receiving prices for sugar at up to three times the world price, while European consumers lose in two ways: paying higher prices for purchased sugar and paying higher taxes to finance continued EU 'aid through trade' spending.

World Trade Organization (WTO) regulations stipulate that preferential trade agreements (PTA) contravene the notion of granting Most Favoured Nation (MFN) status for every member nation of the WTO. And, in any case, the economic burden on the citizens of the EU of this type of arrangement makes change inevitable. The question becomes how best to manage change, strengthen institutional capacity, and assure sustainable growth in a world in which the links between institution building and growth are not as clearly defined as are those connecting trade and growth.

The paper is developed as follows: after a brief literature review that traces the evolution of the institutional emphasis on growth, a description of the Fiji economy and its reliance on sugar export follows in the third section. The fourth section contains a description of the regression model used to analyse factors affecting GDP growth in Fiji over the past eighteen years, including preferential trade access and governmental expenditures devoted to strengthening institutional capacity. Results and discussion follow in the fifth section. Concluding remarks provide a summary of the paper's highlights.

Preferential trade and other factors affecting development

The degree to which trade, and in particular, preferential trade arrangements contribute to growth has interested the economic community since the Classical writings of Ricardo, Torrens and James Mill (see Hutchison 1953) and more recently since the establishment of the General Agreement on Tariffs and Trade during the Bretton Woods meetings at the close of World War II. Much of the early work of Viner (1950), Meade (1955) and Lipsey (1960) focused on the implications of European integration and the benefits versus the costs of establishing an economic zone free of trade restrictions in Western Europe.

- allowing greater competition in financial markets through removal of interest rate controls and moving away from a fixed exchange rate to a currency board.

Our focus here is the sugar industry, which has been an important component of the social and economic fabric of Fiji society and as such constitutes a critical national institution.

Fiji and the Sugar Protocol

Sugar accounts for 40 per cent of Fiji's exports and directly or indirectly affects the employment of up to 200,000 people of a total population of 830,000. Sugarcane farming and processing together form the most important sector of the Fiji economy. Farming is typically smallholder with the average farm size being about 10 acres of land leased from native Fijian land owning tribal groups (see Szmedra 1999). Approximately 75 per cent of sugar farmers are Indo-Fijian, the descendants of indentured labourers brought to Fiji by the British colonial regime to avoid the use of native labour and consequent disruption of traditional Fijian village life. The cultural mix has led to racial and political turmoil, resulting in overthrown governments in 1987 and again in May 2000 (see Szmedra 2001). Though the country is rich in natural resources and situated at a Pacific crossroads, the economic growth and development it has experienced since independence in 1970 can fairly be described as disappointing for both its citizens and the donor community (Williams & Morling 2000).

One way in which the UK as the former colonial power has attempted to assist economic development in Fiji has been through preferential access—under the Commonwealth Sugar Agreement and more recently under the Sugar Protocol of the Lomé Convention—of Fiji sugar into the UK at up to three times the world price (Barrack & May 1997). The Sugar Protocol guides trade relations between the EU and the ACP group of nations comprised of former European colonial states in Africa, the Caribbean and the Pacific.

The Sugar Protocol came into effect in 1975 when the European Community, as the EU was then called, was a net importer of sugar. Since then, European beet sugar production has increased to the point where the EU is now a net exporter of sugar. However, the Sugar Protocol has been maintained as a method of assisting ACP development.

controlling preferential access into the EU for sugar producers, but at prices to be negotiated yearly. What is sure is that the level of preferential pricing will be scaled back considerably to economise EU agricultural subsidy expenditures in light of the EU enlargement to twenty-five nations in May 2004. The resource needs within the EU for the effective integration of up to ten new members will make it difficult to maintain external aid directed toward ACP sugar producers at historical levels. Reliance by Fiji and other ACP sugar producing nations on the EU to maintain support at present levels seems a pipe dream though many in Fiji have difficulty envisioning an economy without sugar as its enabling agent.[2]

In spite of the importance of the preferential access and pricing regimes that Lomé had afforded, change is the current operational idiom. Change entails an emphasis on alternative growth mechanisms and away from primary-export led growth embodied in reliance on sugar. The inevitable move by the EU toward assistance policies more in line with world market prices implies that nations that continue to rely on a single commodity as their principal foreign exchange earner will experience deteriorating terms of trade. Diversification away from primary commodity dependence requires strong institutions both to equip and support the emigration of resources from the primary commodity sector.

In the next section we develop a model that attempts to determine whether contemporaneous directing of governmental expenditures toward building institutional capacity contributes to GDP growth or whether those expenditures are overshadowed by the benefits of preferential access to the EU market.

The model

The basic premise of the paper, and therefore the hypothetical structure of the regression model, is to distinguish the differential impacts on development and sustainable growth of openness to trade versus investment in building institutional capacity. It can be argued that engagement in one is required to have the resources to apply to the other; i.e. a country must engage in trade in order to have the means to build institutional capacity. But in the developing nation context, that is not always the case. Donor nations and agencies are, many times, anxious to provide financial and human resources to build are included to describe the importance of trade overall to GDP growth, as Australia represents trade under both preferential access under the SPARTECA[4] regime of trade preferences, and free trade with no preferential access given. Australia is Fiji's most important trading partner in terms of overall dollar value of exports and has held that position since 1993 when the dollar value of exports to the UK was relegated to second position. Since then exports to the US have surpassed those to the UK, reflecting the growing importance of regional trading regimes.[5]

The variables used to model institutional capacity building measure government expenditures on four different aspects of institutional structure: general public services, education, health, and social security and welfare. Expenditures on general public services include maintaining government and the legal system as well as infrastructure appropriate to the needs of both an expanding population and a developing economy. Expenditures on education would arguably be the most critical for a developing nation attempting to maximise growth potential in an increasingly integrated global market and facing the high probability of diminished preferential pricing of exported sugar. Education expenditures would necessarily have a lagged relationship with GDP growth, the extent of the lag a subjective determination depending upon the quality of the nation's educational system and objectively on expenditures per pupil. Lacking data describing each of these conditions, education expenditures are lagged two-years in the model specification. This recognises the missing data problem but also preserves a workable number of degrees of freedom, an important consideration when working with a relatively limited time series data set.

Government expenditures on health care provision are a logical addition to the factors that contribute to building institutional capacity. Productivity gains can be expected from a population that has access to modern health technologies and the current pharmacopoeia. One would expect these expenditures to have a positive impact on GDP growth. However, much of the healthcare system in Fiji provides health services at less than cost, with the government subsidising the difference between cost and patient outlay. When government expenditures on health are evaluated in this way, it becomes a proxy for the general overall health of the population. In other words, as

Results

Table 2 reports the results of the linear regression on the hypothetical model.

Table 2 Linear regression results
Dependent Variable*: GDP at current market prices*

	Unstandardised Coefficients		**Standardised Coefficients**	**t**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	-523.152	105.989		-4.936	0.001
expaus	4.925	0.650	0.422***	7.583	0.000
expUK	2.135	1.418	0.051	1.505	0.163
genpubse	10.469	1.139	0.587***	9.192	0.000
education	47.327	7.407	1.571***	6.389	0.000
health	-58.489	11.634	-1.222***	-5.027	0.001
socsecwe	-549.844	103.316	-0.522***	-5.322	0.000
coups 1987 and 2000	-49.866	56.680	-0.020	-0.880	0.400

*** = Significance at the >0.01 level
Adjusted R^2 = 0.994

All the variables have the hypothesised sign and all are significant at the >0.01 level save exports to the UK and the dummy representing years in which a coup took place. Though every school child in Fiji can recite the 'sugar is the backbone of Fiji' anthem, these results suggest other trade and investment factors contribute more to GDP growth than does preferential trade access of Fiji sugar to the EU market. In particular, exports to Australia under SPARTECA have sparked the rapid growth of the Fiji garment industry, which essentially did not exist fifteen years ago. Employment in the industry now approaches 20,000 workers and is not subject to disruptions caused by the vagaries of climate or technical breakdowns that plague the farming, milling and transport of sugarcane. Besides preferential access of garments to the Australian market, other commodities and goods enter Australia from Fiji under MFN status. Gold, silver, manufactured food items, traditional Pacific Islander foodstuffs such as taro and cassava, and traditional herbs including kava are also exported.

Finally, the dummy descriptor signifying years in which coups took place has the correct negative sign but is not statistically significant. This is a surprising result. Coups, military insurrections, popular revolutions and other forms of political instability freeze economic activity during the period of the unrest and then diminish foreign interest in the nation as a potential site for business investment, tourism or other mercantile activity as the violence unwinds. Both coups in Fiji occurred during the month of May, which is sufficiently early in the year for the aforementioned effects to be reflected in GDP statistics. The negative sign does indicate a slowdown or reversal of growth in those years but not to the degree expected. The events of May 2000 were especially enduring, involving as they did a takeover of Parliament House and the holding hostage of the entire sitting parliamentary membership for 57 days. The entire central business district of Suva, the nation's capital, was looted and many places of business burned. So although the coup was geographically localised, it paralysed the nation's capital city for an extended period. However, the fact that the economy of Fiji is sufficiently diverse, with much of the resource exploitation and tourism industries concentrated outside the capital region, may help to explain this unintuitive result. Though economic activity diminished during the initial stages of each of the coups, as the drama played out the people and businesses of Fiji resumed their normal pursuits. So though the coups did have a negative impact, Fiji Islanders proved resilient in recovering quickly to minimise any enduring material damage. The social strains, however, remain.

Summary and concluding remarks

Many economists and social scientists believe that differences in institutions and state policies are the causes of large differences in developmental trends across countries. With the emergence of global markets, the GATT and WTO, others have emphasised the quick integration of developing nations into preferential and regional trade agreements and WTO membership provides the quickest route to sustained growth. In this paper we have argued that investing in building institutional capacity overrides the exigencies of trade engagement and offers the most effective way toward sustainable development. Our argument rests on the following premises: (1) preferential trade access contravenes the rules set forth by the WTO and will disappear when rules and

Notes

1 The Cotonou Agreement, signed in Cotonou, Benin, June 2000, replaces the Lomé Convention in stipulating the structure and extent of aid extended to the ACP nations by the EU.

2 Barrack and May (1997) provide the sugar industry view of what benefits preferential access has provided to the economy of Fiji and hopes of what future preferential agreements should include.

3 www.adb.org/Documents/Books/Key_Indicators/2001/fij.pdf

4 South Pacific Area Regional Trade and Economic Cooperation Agreement.

5 SPARTECA has been the engine propelling the growth of the garment industry in Fiji. Under the preferential access scheme resources have been attracted to garment production. Current estimates place the number of garment workers in Fiji at approximately 20,000 (Government of Australia 2003). But preferential access in many instances encourages bad trade and bad development policy decisions. Resources have been drawn to garments due to preferences rather than true comparative advantage. This bodes ill for long-term sustainable development. The garment industry in Fiji has recently contracted due to competition from East Asian nations. The industry's very existence is dubious if and when SPARTECA's rules of origin change or the agreement expires.

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