
SMALL STATES AND THE WORLD TRADE ORGANISATION

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Abstract. The economic constraints and vulnerabilities of small states are well documented. Yet, so far, these states have not managed to persuade the World Trade Organisation (WTO) that they merit special treatment in view of the disproportionate burden that they carry in taking on board the WTO rules. However in 2001, the Ministerial Declaration issued at the Doha WTO made specific reference to small economies, referring, in paragraph 35, to the need “to frame responses to the trade-related issues, identified for the fuller integration of small, vulnerable economies into the multilateral trading system, and not to create a sub-category of WTO members”. This chapter will discuss the main issues underlying the claim for special and differential treatment for small states, and assesses the prospects that such a claim be accepted by the WTO.

1. Introduction

A good deal of work has been done on small economies¹ over the past 40 years. Kuznets (1960), Scitovsky (1960) and de Vries (1973) were among the early authors of studies in this area. Subsequently work on vulnerability indices have been undertaken by UNCTAD and the United Nations Committee for Development Policy (New York) and the Commonwealth Secretariat. A very important contribution was made by Briguglio (1992; 1995), which was followed by Crowards (1999), Encontre (1999), Grynberg (1998), Atkins et al. (2000) Davenport (2001) and others.

In the light of their experience with the implementation of the WTO rules since its inception in 1994, small states, members of the WTO,

¹ The terms “small economies”, “small states” and “small island developing states” will be used interchangeably in this chapter. Under the Doha Development Agenda, all these appellations are subsumed under the concept of “small economies”.

attempted to make a case for special and differential treatment, in view of the constraints and disproportional burden that these states face in taking on board the WTO rules. With the process of globalisation, there has been a greater marginalisation of these economies as they found it increasingly difficult to integrate into the multilateral trading system. Their shares of trade have either decreased or stagnated. As a result of intense diplomatic activity undertaken by small economies in and outside the WTO, the Ministerial Declaration issued at the Doha WTO 2001 Conference, made more specific reference to small economies in paragraph 35. This chapter will discuss the main issues underlying the claim for special and differential treatment, and assess the prospects that the WTO accepts this claim.

The rest of this chapter is organised as follows. Section 2 gives some background information regarding small economies and the WTO. Section 3 shows that in the past, GATT, which was the predecessor of the WTO, did allow special and differential treatment for member countries on the basis of certain criteria, while section 4 argues that specific tailor-made differential treatment should be accorded to small states. Section 5 deals with technical assistance to enable SIDS to participate more effectively within the WTO. Section 6 concludes the chapter with a recommendation that small economies should urgently undertake measures to strengthen their case in international negotiations through, inter alia, empirical evidence, with a view to providing a timely input for the completion of the Doha Mandate on framing responses to the trade-related issues of small economies.

2. Small Economies and the WTO

In recent years, the substantive research and the discussions within the WTO and other fora, have contributed to a large extent to creating greater awareness of the problems and concerns of small economies, even among the sceptics. Not long ago, discussing differentiated treatment for small economies was practically a non-starter. It was considered as tantamount to an obstruction to liberalisation and an argument against globalisation, favouring the perpetuation of protectionism.

Many of the WTO members that found it difficult to accept the concept of differentiation for small economies have themselves been the beneficiaries of differentiated treatment and thus benefited from transitional and substantive exceptions and safeguards, in their early stages of development. Australia and New Zealand for example, had

for long years enjoyed preferences from the UK. Preferential arrangements also existed for other developed countries and for some of the resource-rich developing countries.

As a result of the long and systematic work of advocacy by small economies within the WTO and elsewhere, and the literature and related discussions² on the characteristics of small economies, there is now a greater awareness of the inherent characteristics associated with small size, insularity and geographical remoteness, which bring with them unique weaknesses and disadvantages. These include limited ability to enjoy economies of scale, limited diversification possibilities, indivisibility of infrastructural costs and relatively high transport costs.

It is now widely recognised that the cost of doing business in small remote island economies is not the same as doing it in metropolitan and cosmopolitan areas which benefit from greater clustering, proximity to commercial centres, and more frequent transport connections (see Winters and Martins, forthcoming). The concept of just-in-time and zero-stock can be a common feature of business practices in the developed world and a number of developing countries. These virtuous concepts of modern business management certainly do not apply in many small economies which do not have proximate sourcing facilities. Small economies are also at a disadvantage in attracting foreign investment. Even when they have good policies and other attractive characteristics they are rated to be significantly more risky (Collier and Dollar, 1999). These problems and others have been sufficiently detailed in the literature and during discussions within WTO and other fora.

The new WTO rules that will arise as a result of the Doha Round will very likely impact on small economies much more than on larger jurisdictions, due to, amongst other things, the fact that the former rely very heavily on import tariffs for government revenue and that the survival of the local manufacturing sectors calls for special fiscal incentives (including subsidies) to compensate for the high cost of doing business in these economies (see Bhuglah, 2004).

The problems of small economies have been compounded by the fact that they have now to face globalisation more as a challenge than an opportunity. The pressures arising from the dismantling of preferential arrangements in their traditional markets have continued to mount,

² A bibliography has been prepared by the WTO and is available in WTO Document WT/COMTD/SE/W/4 (searchable at <http://docsonline.wto.org>). A number of other substantive papers have been tabled at the WTO by WTO members and the WTO Secretariat.

thus eroding a safety valve which used to compensate somewhat for their disadvantageous characteristics. In the case of preferential arrangements for bananas, there has been a cascade of challenges in the WTO coming from a number of larger countries including Australia, Brazil, Thailand and Philippines. The sugar preferential regime has also been seriously challenged, again by larger countries.

Small economies are conscious that globalisation is an irreversible process and that they have to adjust. The Right Honourable Owen Arthur, Prime Minister of Barbados, in a 1996 lecture on “The New Realities of Caribbean International Economic Relations” made the following observations regarding the globalisation process:

“The long run has arrived for the Caribbean because the economic policies and postures deriving from our passive incorporation in the international economy as the recipients of the preferences and concessional financial flows, have now been overtaken by powerful and irreversible international developments, and it would be fatal for the region not to take cognisance and to accommodate the new realities in its contemporary international relations. The long run has arrived because it would be fatal for us to recoil from making the economic adjustment nationally and regionally which can no longer be postponed if the region is to respond appropriately to irreversible and fundamental changes at the core of the international economy.”³

Appropriate Responses

Given that small economies have inherent disadvantages and vulnerabilities, what type of responses would be appropriate for these economies to adjust to the globalisation challenge? Undoubtedly, small economies themselves must recognise that national and regional efforts are necessary for designing and implementing appropriate economic, fiscal and trade policies, regulatory and governance arrangements and incentive schemes to attract investment.

If globalisation is about interdependence, the efforts at the multilateral level within the WTO, which is the main theatre for action on trade issues, are of paramount importance. Small economies, members of the WTO, are not in favour of a system without rules and disciplines, but they want unequal rules for unequal partners, with a reasonable transition period which will give small economies time to adapt. In other words, they are calling for greater flexibility

³ Distinguished Lecturer Series, 1996, Institute of International Relations, UWI.

and differentiated treatment within the overall framework of the rules-based WTO system, taking into account their inherent constraints and providing appropriate responses. Such an approach within a rules-based system could still be in line with the WTO's cardinal principles of transparency, certainty, and predictability, with the added advantage that the Organisation would be supporting adjustments and transitions to enable small economies to make a more healthy contribution to the multilateral trading system.

3. Precedents of Differentiated Treatment

GATT and Developing Countries

A flashback on the evolution of the WTO shows that the system has, in the past, been dynamic and has responded to different concerns and problems of different members at different times, within its rules-based system. Making different rules for some weaker members is not incompatible with a rules-based system. It does not hamper discipline but simply emphasises the point that the pace of liberalisation for some countries could be tempered in a well-organised, predictable and transparent manner.

When the text of the GATT was negotiated in 1947, it was assumed among developed countries that, as a general rule, the Agreement should apply equally to countries, no matter their stage of development. However, the strong position taken by developing countries regarding full reciprocity in trade liberalisation and preferential access to developed-country markets led to an attempt to carve out a differentiated arrangement. Thus, in 1955, GATT revised Article XVIII, and sections A, B and C were added, broadly with the aim of facilitating the progressive development of developing country economies, especially those that could only support low standards of living and those that were in the early stages of development.

An interpretative note added to the GATT explained that the phrase "low standard of living" was to be taken to refer to normal economic circumstances and not exceptionally favourable and temporary conditions resulting from good export markets for primary commodities. The phrase "in the early stages of economic development" was applied also to countries which were undergoing a process of industrialisation to correct excessive dependence on primary production.

In 1979 the Enabling Clause was introduced. Differential and favourable treatment accorded under this clause was "designed to

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facilitate and promote the trade of developing countries". Furthermore, it enjoined that such treatment when "provided by developed contracting parties to developing countries" should be "if necessary, modified, to respond positively to the development of financial and trade needs of developing countries." For example, in the Agreement on Agriculture following the Uruguay Round, some specific provisions were devised to fit the specific needs of even some more resource-rich countries. But also these included the special provision for net food-importing countries. Article 6.2 on the other hand, provided for special attention to support the producers in developing countries in order to encourage diversification from growing illicit narcotic crops.

Other cases where such precedents have been created without the need of having to introduce a special category of countries are:

- Article 3 and Annex VII of the Agreement on Subsidies and Countervailing Measures (SCM);
- Article 27.6 of the SCM Agreement;
- Article 27.4 of the SCM (Doha Decision);
- Article 5.8 and Article 6 of the Agreement on Implementation of Articles VI of GATT, 1994;
- Article 9 of the Agreement on Safeguards;
- Article 2 and Articles 6.6(a) and 6.6(b) of the Agreement on Textiles and Clothing.

The underlying tool that has been used for introducing the measures of relief and differentiated treatment is a tailor-made threshold for application for a particular sector, product or agreement. An important example is Annex VII of the SCM Agreement which caters for those developing countries which are not Least Developed Countries (LDCs) but which have a GNP per capita not exceeding \$1000. The exemptions and benefits which are available to the LDCs have been extended to this group of "Annex VII" countries. Many of the SIDS which are neither LDCs nor "Annex VII" countries are not entitled to the differentiated treatment and therefore do not benefit from this measure. All these above examples show that differentiation provisions can be carved out within the rules-based system of the WTO itself without creating any new category of countries. They also show that differentiated treatment is not incompatible with and within a rules-based WTO system.

4. Special and Differential Treatment for Small Economies

In 2001, by agreeing on a work programme on small economies within the overall framework of the Doha Development Agenda, WTO members are expressly mandated "to frame responses to the trade-

related issues, identified for the fuller integration of small, vulnerable economies into the multilateral trading system, and not to create a sub-category of WTO members” (WTO, Doha Declaration, Para. 35).

The Doha Ministerial Declaration may be considered as initiating a process for rule-making leading to ensure differentiated treatment for small economies. However, a part of Paragraph 35 of the Doha Ministerial Declaration is rather peculiar and renders differentiation prospects quite complex, since it specifically proscribed that a sub-category of WTO Members should not be created. It must, however, be noted that a good deal of progress has so far been achieved, considering the extensive sensitisation work that has been carried out as a result of the voluminous documents and detailed discussions within the WTO. These have helped to identify trade-related issues peculiar to small economies.

The obligation imposed by paragraph 35 of the Doha declaration not to create a new sub-category of members in the WTO makes it imperative to devise creative and robust solutions in favour of small economies. It would appear that the obvious route to take would be to look at precedents within the WTO whereby differentiations have been created and exceptions made to the basic principles of MFN and non-discrimination (see Tulloch, 2001), astutely avoiding the creation of a new category of members while, at the same time, addressing the specific areas of concern.

The difficulties posed by the condition of not creating a sub-category of members should however be addressed seriously if a meaningful differential treatment is to be accorded to small economies. A number of objective criteria have been worked out in trying to identify the inherent characteristics, disadvantages and vulnerabilities of small economies. Various indices have also been produced, notably with regard to the vulnerabilities of small economies. However, it has so far not been possible to obtain unanimity on what can be regarded as a robust index which can be safely used in the WTO.

This task is made even more complicated in a WTO system which is still based on self-selection, except for the countries classified by the UN as LDCs. This is why it is not surprising that some countries have chosen to be recognised as developing countries even if their economies are relatively developed. Some “developing” countries, according to the OECD, should be regarded as fully-fledged developed countries (OECD, 2004).

The Doha decision on Article 27.4 illustrates this reality very clearly. Before looking into this issue, let us consider the background to this

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decision. While WTO provisions recognise that subsidies may play an important role in economic development programs of developing country members and allow for some flexibility for developing countries in the application of subsidies, the Agreement does not provide the flexibility that small economies need in order to address these inherent cost disadvantages.

As explained earlier, a number of developing countries have been put at par with the LDCs and are thus exempted from disciplines relating to subsidies in the industrial sector merely by virtue of an amendment of the Agreement with the inclusion of the Annex VII list of countries. Until the Doha Ministerial Conference, small economies—seriously hampered in their industrialisation due to their inherent vulnerabilities and handicaps—were not so exempted. However, following a Ministerial Decision taken in Doha, small economies along with other developing countries have been given this exemption for a transitional period ending in 2008, subject to an annual review.

Small economies may therefore maintain measures in order to compensate for their inherent costs disadvantages and to attract investment. In this context, there are two elements which need to be noted:

- First, the case for this exemption was initiated by the small island developing states (SIDS) which are working within the framework of the Small Economies Programme and which are located in the Indian Ocean, Caribbean and the Pacific. Other developing countries that opposed this initiative and claimed that this was a “protectionist move”, were finally convinced that the exemption was fundamental for industrial development and therefore joined in the fray and also laid claim to the benefits arising from the decision which was taken in Doha.
- The single criterion of GNI not exceeding 20 billion dollars was used. As a result, 120 countries had to be accommodated, even though it was SIDS that prodded in favour of this initiative, in view of their crucial need for promoting industrial development of their respective countries. The benefits deriving from the exception to the rules (following the Doha Decision) have become available, and are now enjoyed, even by those countries which neither demanded them nor fought for them. In fact, some of them actually opposed the initiative when it was launched by SIDS.

In the wake of this “extended demand”, opening a floodgate of this nature is bound to undermine the essence and the value of differentiated treatment which the original promoters—in this case

SIDS—had been looking for. It also lends support to the sceptics who feared free-riding tendencies that could undermine the credibility of the initiative in that this would not really work in favour of genuinely most vulnerable countries. Small economies themselves are wary that an unduly large number of beneficiaries comprising more resilient economies can undermine and defeat the very purpose for which the measure was genuinely initiated. The lesson learnt in this case is that the differentiated treatment that is sought should be more carefully targeted to those who merit such treatment for the good of those who deserve it as well as for that of the system.

This, however, does not mean that all is lost and that there are no possible solutions for small economies. The abundance of literature and statistics now available on the subject matter should be usefully harnessed. Different variables have been used to classify countries according to size, including GDP, population, land area, and share in global trade. But there has also been a number of indices that have been developed such as economic vulnerability, competitiveness, openness to world trade, export concentration, industrialisation, human development and others. This is a big resource base which has to be usefully exploited.

Some composite indices already exist and are based on a measurable set of variables. So far these studies have not helped small economies to make a solid case for differentiated treatment and policy space to them within the WTO. It is therefore necessary to carry out further statistical exercises to make a stronger case for differentiation that can be accepted by consensus within the WTO.

5. The Need for Technical Assistance

Small economies need to strengthen their technical capacity to formulate trade policies and related negotiating positions and to implement WTO obligations. This is not costless, and the burden on small economies is proportionately much higher than it is for larger territories, given the problem of indivisibility of overhead expenditures.

One important priority is to strengthen representation in Geneva so that the small states which have no Mission in Geneva can establish an appropriate presence where the negotiations take place. Alliance building is a crucial feature of modern commercial diplomacy. For the small economies, this activity is of even greater significance as it strengthens their ability to cope with the rigours and realities of the

negotiating world as well as to interact confidently and meaningfully with players in the multilateral negotiations.

In this regard technical assistance is called for in line with the WTO technical assistance programme⁴ in order to:

- Assist in the process of integration of beneficiaries into the multilateral trading system and contribute to the expansion of their trade;
- Strengthen and enhance institutional and human capacities in the public sector for appropriate participation in the multilateral trading system.

Technical assistance for trade capacity-building should be designed and provided to help the small vulnerable economies to take the highest possible advantage of the benefits from the multilateral trading system and also to enable them to participate effectively in the ongoing work of the WTO. This work has to be a fundamental feature not only of activities with the WTO but also in the bilateral cooperation programmes of the trading partners.

While it is acknowledged that certain commitments by the WTO and trading partners for providing technical assistance already exist, future efforts should build on such commitments in mobilising and directing resources to help small economies prepare for and participate in the negotiations as well as implement WTO commitments. Specifically, the focus should be on overall business development, exports of goods and services, trade facilitation, sanitary and phytosanitary standards for agricultural trade and information exchange and outreach.

Since services are bound to play an increasingly important role in the development of small economies, assistance should also be provided for the establishment and efficient functioning of the “one-stop shop” clearing house of information for potential investors and for industrial and services development. In this regard, training capacities of officials in various Ministries working with trade and investment promotion agencies should be strengthened.

Assistance for institutional capacity building should also be extended to include the establishment of national or regional law institutes and think-tanks which would, inter alia, bring together trade policy experts and researchers from international and multilateral organisations such

⁴ See *Manual on Technical Cooperation and Training*, WTO Document WT/COMTD/14 (available at http://www.wto.org/english/tratop_e/devel_e/teccop_e/ctd14_e.htm).

as the World Bank, UNDP, WTO, UNCTAD as well as regional universities and other relevant institutions. These efforts should also be supported in terms of logistics, infrastructure, technology transfer and information and communications development.

6. Conclusion

In a member-driven organisation like the WTO, small economies have tried to make a case for differentiation, but they have not been successful so far. There is considerable material that could strengthen the case of small economies in this regard, but this needs to be consolidated and used more effectively. The difficulties of small economies to address the problems posed by their inherent and permanent vulnerabilities and by the exigencies of a rules-based system call for additional technical work.

This chapter has suggested that small economies can strengthen their case for targeted special and differential treatment by drawing on the lessons learnt from GATT/WTO precedents in this regard, as well as undertaking further technical work to strengthen the evidence of their economic vulnerability and to explain the special difficulties that will arise as a result of taking on board all WTO in view of their particular circumstances.

Small economies, working on their own initiative, and supported by appropriate technical assistance, should attempt to consolidate the large amount of research and analytical work carried out so far to further their case for the much-needed special and differential treatment. This task should be undertaken urgently, inter alia, through a timely input for the completion of the Doha Mandate on framing responses to the trade-related issues of small economies.

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