

# **The Pacific Island States and the WTO Towards a post-Seattle Agenda for the Small Vulnerable States**

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## **I) Introduction**

The purpose of this paper is to up-date participants on recent developments in the WTO as they pertain to some of the world's smallest, least developed and most vulnerable economies in the Western and Central Pacific. At present three Forum island countries (FICs) of the fourteen independent island states of the Pacific are members of the WTO<sup>1</sup>. These countries Papua New Guinea, Solomon Islands and Fiji were either GATT *de facto* members or acceded immediately prior to the completion of the Uruguay Round and are WTO founder members. Three more countries Vanuatu, Samoa and Tonga are currently in the process of accession with Vanuatu simultaneously the closest to accession and possibly the first country trying to accede to the WTO that will withdraw its application. Three countries of these six ie Samoa, Vanuatu and Solomon Islands are classified by ECOSOC as least developed though if more sophisticated modalities were employed for graduation and reclassification of countries arguably most of the fourteen FICs would be classified as LDCs.

The experience of FICs with the WTO has in large measure been based upon the management of the challenges that the birth of the organisation and the completion of the Uruguay Round has created. While few dispute that the WTO has created opportunities for trade these are not opportunities that have, in any evident way, benefited the island states of the Pacific. This is in large measure not because the states of the region are inward looking but rather because their economies have, by and large, not reached a stage of development or are so disadvantaged by the combined economic effects of smallness isolation and dispersion that they are not in a position to take advantage of them.

The paper will focus first upon the various policy and administrative challenges created by the WTO for FICs and attempts by the small vulnerable states (SVS) to develop a global alliance of small states at the WTO. The second part of the paper will focus upon appropriate modalities to turn the liberalisation process into one where SVS can also benefit from the opportunities created by global trade liberalisation. This section will by necessity refocus on the WTO work program for SVS and the thorny issue of definition and graduation. Without an appropriate and widely accepted definition of small vulnerable economies then the attempts to either obtain Special and Differential Treatment or access to special facilities will face even

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\* These are the views of the author and not necessarily the views of the Forum Secretariat or any of its member governments.

<sup>1</sup> Australia and New Zealand are members of the Forum and the WTO.

greater challenges when it becomes an issue in the WTO or other multilateral agencies.

## **II) Challenges created by the WTO**

The WTO is the single most significant manifestation of the post-cold war globalisation process. Globalisation and the end of the cold war have led to the obvious fear of marginalisation among developing countries. Decreases in aid levels both in real per capita terms and as percentage of developed country GDP together with the loss of trade preference have undermined the economies of developing and least developed countries. This process of loss of aid and diminution in the commercial value of trade preference due to trade liberalisation is undermining the economic foundations of the small island states of the Western Pacific. The section below considers the experience with panel reports and the liberalisation process as well as FIC experience with the trade policy review mechanism and the accession process.

### **Panel Reports and Liberalisation**

In this section the reports of various panels and the evolving trade liberalisation agenda are considered in terms of their impact upon regional economies and regional trade agreements.

#### *- The Banana Panel Reports and the Suva Convention*

The three Banana Panel reports and the dispute between the USA and the EU last year have meant that any of the countries reliant upon commodity protocols have felt increasingly vulnerable to changes in trade policy. This has been particularly the case in Fiji which has experienced a substantial decline in investment as a percentage of GDP in the last few years. While this has been in large measure caused by endogenous factors, such as land law insecurity, there can be little doubt that insecurity over the Sugar Protocol and sugar prices has served to compound the problems of Fiji in stimulating domestic investment. Similarly, concerns over WTO compatibility of tuna preferences going into the EU market has also adversely impacted development of tuna processing facilities throughout the Pacific region.

The inconsistency of the Lomé Convention with the WTO provisions has necessitated the creation of Pacific regional integration frameworks to prepare for a possible Regional Economic Partnership Arrangement (REPA) with Europe. This inducement to regional integration among the FICs can be seen as one of the few beneficial side effects of the Banana Panel reports. However, there remains a very justified fear that the need to bring the post-Lome trade regime into conformity with Article XXIV of the GATT through reciprocal liberalisation towards the EU beginning after 2008 may well be premature. Given the complex web of de jure and de facto MFN obligations with Pacific rim countries this will induce an equivalent liberalisation with USA, Australia and New Zealand. Such a process may actually serve to retard or even destabilise the development process of the region much, in the same way as premature financial liberalisation in SE Asia served to destabilise that region in 1997.

#### *- TRIMs, ATC and Spartecca*

The Spartecca treaty between Australia and New Zealand and the fourteen FICs which grants the latter free market access for originating exports to the Australian and New Zealand market. Spartecca, when read together with the provisions of Australian sectoral policy towards motor vehicles and textiles, clothing and footwear (TCF) industries, has been of substantial benefit to Samoa and Fiji. The Australian Motor Vehicle Plan which is a transitional arrangement for that sector specifies that in order to meet the definition of 'Australian-produced' there are obligations for domestic producers to meet certain domestic processing requirements. It was the change in the definition of domestic content in the early 1990's to include FIC content that induced Yazaki (Australia) to shift its highly labour intensive production of electronic belts from Australia to Samoa. Last year there were 3,000 people employed at the facility but employment has now fallen sharply to around 1,700. As Australia moves to further liberalise its motor vehicle industry the domestic processing requirements may not continue in order to assure full compliance with the TRIMs agreement.

Similar concerns exist in Fiji over Australian liberalisation of the TCF sector. Approximately 17,000 jobs have been created in the Fiji garment industry as New Zealand and then Australian manufacturers moved off-shore to capitalise on the benefits of the liberalisation of the sector and its full inclusion under Spartecca from 1988. Australia, using an export subsidy regime for its textile sector, subsidised the exports of textiles which were then processed in Fiji, and other countries, and re-exported as garments to Australia. However, as Australia moves to bring into effect the terms of the WTO's *Agreement on Textiles and Clothing* the Fiji garment industry will lose the benefit of subsidies provided to exported Australian textiles. Furthermore this will also compound their difficulties of complying with the 50% ex-factory cost rules of origin provisions of Spartecca<sup>2</sup>. Thus changes in the trade regime in Australia which will assure WTO compliance could adversely effect both Samoa and Fiji.

- *Fisheries Subsidies*

The highly sensitive question of the environmental impact of WTO incompatible subsidies to the fisheries sector, while not yet a WTO dispute, may have very adverse effects upon revenue from fisheries access agreements in the island states of the Western Pacific. In the case of some of the smallest FICs, fisheries access fees make up one third of government revenue. The environmental movement together with the USA and New Zealand have argued that subsidies to the fisheries sector are responsible for much of the environmentally unsustainable fisheries, especially in the North Atlantic and off the coast of West Africa. The EU and to some degree Japan, both of which offer subsidies to their own fleets are seen as the principle violators of the WTO *Agreement on Subsidies and Countervailing Measures*. Strictly speaking there is no need for new WTO disciplines in this sector. There is every reason to believe that existing disciplines would be adequate to cover fisheries subsidies but because the sector is sensitive, sector specific subsidy reduction agreements may be necessary to deal with the problems of the sector, much as in the case of agriculture during the Uruguay Round.

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<sup>2</sup> At present Fiji garments are exported under a temporary derogation from the 50% rule for a range of products. This derogation is reviewed on an annual basis.

One of the most important sources of revenue for the smallest island states are payments made by the USA under the terms of the US multilateral fisheries access arrangement with the members of the Forum Fisheries Agency. This access agreement is without doubt the most generous of any signed by the countries of the Western Pacific resulting in government revenues of approximately 10-11% of the value of the catch. However, approximately 80% of the disbursements by the USA are made from funds (ie subsidies) provided by USAID. It is precisely this type of fisheries access agreements between the EU and West African states that has been the subject of attack by the environmental NGOs such as WWF and Greenpeace. If new or existing disciplines are applied globally to regions like the Western Pacific where there are generally no real issues of unsustainable harvests of tuna, then the victims of this dispute may be some of the world's poorest and most vulnerable economies.

### **The Accession Process**

If the experience of FICs with panels and the liberalisation may be seen as indirect and via its effects on more powerful trading partners then the impact of the accession process is very clear, direct and transparent. At present three FICs Vanuatu and Samoa which are also LLDCs and Tonga are in the process of accession. Of the nine LLDCs awaiting accession to the WTO Vanuatu is the most advanced. The negative experience of Vanuatu with WTO accession has been such that some of the other FICs that had been considering making an application are now reconsidering.

Vanuatu has now been trying to accede to the WTO for five years. It has expended approximately USD 300,000-400,000 in its efforts at accession thus far. It has now reached the point where it has completed almost all protocol negotiations. Vanuatu also has completed bilateral negotiations with all its major trading partners including the EU, Japan, Australia, New Zealand and Canada. **The only outstanding problem that Vanuatu currently has in terms of its bilateral negotiations is with the USA, a country with which it does not trade ( total bilateral trade is less than USD1 million)**

Vanuatu is ranked, depending upon which index one uses, amongst the world's most vulnerable economies. Vanuatu has no income tax and the government depends largely upon import duties and a recently introduced value added tax for revenue. Vanuatu has agreed to bind its tariff at an arithmetic average of approximately 45%. It has also agreed to make specific commitments in sixteen service sectors, which is four times the average of LLDC members of the WTO. Vanuatu has agreed to zero-for-zero commitments in over 160 tariff lines and is in full conformity with zero-for-zero initiatives in information technology.

This does not appear to be sufficient for the USA which has demanded that Vanuatu lower its bound tariff to around 15-25% and open the telecommunications sector. In Vanuatu this is not legally possible as France Telecom has an ironclad gateway monopoly until 2012. The USA has demanded that Vanuatu make commitments to open the telecommunications sector in 2012. Vanuatu has replied that opening the telecom sector would result in France Telecom, quite rationally deciding not to invest in the improvement of telecommunications infrastructure. In twelve years Vanuatu

would find itself far behind the rest of the world in telecommunications, which is vital to a small vulnerable country highly dependent upon tourism and the service sector.

More importantly the US demands for a reduction of the bound rate of import duty to 25% would result in a complete loss of flexibility in the taxation system. In the event there were any natural disaster, a relatively common cause of decreased revenue and increased expenditure, the government would not be in a position to raise import duties. Vanuatu has only requested transitional arrangements in the application of the *Agreement on Customs Valuation* and the TRIPs for two years which is permitted to LDC WTO members for much longer. The US has not agreed to even these moderate requests for transition. Unless there is a moderation of US demands Vanuatu has indicated that it will this year withdraw its application for WTO membership.

The USA has no trading interest in Vanuatu. Its demands are systemic rather than country specific. These demands being placed on a LLDC are being done because of the precedent that it would create with other applicants to the WTO. Thus Vanuatu is simply 'collateral damage'. WTO officials are fond of saying that the multilateral trading system is a rules based system but the accession process has no rules and is the very antithesis of what the members publicly state to be the intention of the organisation. Accession, because the applicant is not a WTO member and has no rights, is power based and more importantly the applicant cannot inflict any marginal cost on the WTO members when they demand progressively more trade concessions. It is this latter factor that makes the accession process inherently flawed and not just because it is between LLDCs and small vulnerable states like Vanuatu and large WTO members such as the USA, EU and Japan.

One of the most famous clichés repeated at WTO ministerial conferences is the desire of members, 'to integrate the least developed countries into the multilateral trading system'. Yet the experience of Vanuatu is the exact opposite. Once ministers have finished their diplomatic speeches the job of trade officials is 'business as usual' ie extracting the maximum concessions possible irrespective of the development needs or status of the applicant.

It is not until the WTO lives by its promises and creates a genuinely rules based system will least developed and highly vulnerable countries be able to take their proper place at the WTO. At present accession is power based where the applicant, even the most powerful such as China has no real power to inflict any marginal cost on a demandeur. **The negotiation of WTO accession is fundamentally flawed and lawless, and as a result in desperate need of reform for it undermines the credibility of the rule based multilateral trading system.**

### **Trade Policy Review**

One of the most positive experiences that small vulnerable states experience at the WTO is the process of trade policy review (TPR). This WTO review of the trading system is intended, by and large, to be a transparency exercise. The TPR mechanism was intended to be more- something akin to IMF Article VIII consultations. However, during the Uruguay Round members were unwilling to grant the WTO that level of authority.

Thus far all three FIC WTO members have undergone at least one TPR. All have commented positively upon TPR as a transparency exercise. The information that is brought together by the WTO allows local officials to better understand the reality of the domestic trading environment. Ironically hard pressed local trade officials often do not themselves know the details of the domestic trading environment. The Trade Policy Review document is thus an important contribution to the understanding of the business environment in SVS.

However, there is another side to the TPR which is somewhat more problematic as it has a normative message that there exists an ideal 'best practice' model of trade policy against which WTO members are judged. This best practice model, is implicit and never stated, because for political reasons it would be quite unacceptable to WTO members. However, there is no doubt that it exists and it is not surprisingly a free market, laissez faire model. This is despite the fact that the WTO Secretariat repeats, as mantra, that it is there to support gradual and negotiated liberalisation and not free trade at any cost. When WTO members have confronted the WTO Secretariat seeking an explicit statement of what this best practice model is, as was the case late last year when PNG went through TPR, there is only a denial that it exists. However, the text of the TPR document, both in the case of PNG and Solomon Islands indicates a policy response that is based on a laissez faire, free trade model. That some countries, eg Korea and Taiwan, have dramatically departed from the laissez-faire approach and experienced rapid and prolonged economic growth while others, eg Hong Kong, have not departed from such a model while also experiencing rapid growth does not appear to be cause for any measure of circumspection.

One issue in the TPR, perhaps the most sensitive of all trade issues in the region, indicates in a most poignant manner the direction of WTO thinking in terms of trade and development policy. Both PNG and Solomon Islands have, with very limited vigour, pursued a policy of down stream processing of raw materials such as timber, marine products and agricultural products. Both countries have also pursued a policy of agricultural diversification. In the case of PNG some of the attempts have been very successful, such as palm oil which was a government led attempt at diversification. In the Solomon Islands diversification of exports towards tuna canning was also a government lead initiative. Other *dirigiste* attempts at diversification such as sugar in PNG and rice on Guadalcanal were somewhat less than successful.

The policy objective of moving away from being the exporters of a narrow range of unprocessed raw materials is a deeply held, and in large measure bipartisan policy objective in both countries. The downstream processing that does occur in Melanesia has rarely gone beyond the export of some sawn timber and canned tuna. The WTO, argued that 'down stream processing is an undesirable economic objective' because it would mean a departure from production of unprocessed products where Melanesian countries are seen as having a comparative advantage. The view of the WTO is that resource rich islands should remain the optimal resource rent seekers and export unprocessed forest and marine products, leaving production and processing to those countries with a comparative advantage. It is difficult to imagine a policy prescription that is more odious to Pacific island policy makers. Rather than advising on the need to put limits on the costs imposed on society by down-stream processing the WTO

position is doctrinaire and is widely seen as perpetuating the region's comparative advantage inherited from the colonial period.

The WTO trade policy review reports, both in the case of Solomon Islands and PNG, took particular exception to the policy practice of exempting processed timber from export taxes that are normally imposed on logs. This, it is argued, created market inefficiencies and distorted optimal behaviour by loggers. Yet there is almost no evidence that loggers process significant quantities of timber in either country. This is despite very large incentives to do so. The reason that no processing occurs despite substantial incentives is that the massive rents they earn from various forms of trade malpractice in the industry which remains ripe despite efforts by both governments to stamp this out.

The WTO advocated the elimination of export taxes and their replacement with an auctioning system. However to offer such policy advice based on the assumption of the existence of a competitive market for logs in Melanesia is at variance with the available evidence. One firm in PNG controls over 50% of exports and hence an auctioning system would be impractical. There is a need in the case of TPR for a more balanced and less doctrinaire approach to trade and development policy

Ironically the World Bank, which presented its report on PNG in Port Moresby in the same week as the WTO's TPR, argued for the reintroduction of export taxes on logs which had been temporarily suspended. There is clearly a need for a greater measure of policy coherence between the Bretton Woods institutions and greater measure of understanding of its members by the WTO Secretariat.

### **Seattle and the SIDS Alliance**

Prior to the Seattle Ministerial conference the small states of the Pacific, Caribbean and Indian Ocean attempted to form a strategic alliance for the purpose of the WTO Ministerial conference. Despite concerted efforts, as well as clear ministerial mandates in both the Pacific and the Caribbean, this strategic alliance has not yet materialised. This is not to suggest that there have not been actions taken by small states as a group at Seattle to assure their position.

At Seattle, Fiji working together with the Forum Secretariat and Caricom produced a petition demanding an improvement in language regarding the small states from the Committee of the Whole. The result of the petition signed by Heads of Delegation of 15 SIDS from the Pacific, Indian Ocean and Caribbean was that there was vastly improved language in the draft ministerial communiqué which, had it been approved, would have seen the beginning of a work program on small states at the WTO. This is the stage prior to the establishment of a working group and the first step towards some form of recognition for SVS. The draft ministerial text was not agreed to in Seattle and the meeting failed. However, once the US presidential elections are completed there is a reasonable expectation that a second attempt will probably be made to relaunch the Millennium round and small states will need to be prepared for this meeting.

The effort to re-establish the global alliance of island states is now all the more vital. Not only is there a need for political alliance but there is a need for a work programme that:

1. Defines the scope of, and empirically demonstrates that the trade and investment difficulties that confront SVS are of an order not significantly different from LLDCs.
2. Consider appropriate options for the definition of small states and a system of graduation of those small states no longer requiring any form of special and differential treatment at the WTO or access to special facilities
3. Defines appropriate measures whether in the WTO or other multilateral fora to assist small states in full integration in the global economy.

Perhaps most importantly the creation of a global alliance of small states will help deal with the most difficult of WTO issues since the Seattle meeting, the democratisation of decision making. For many small states the Seattle meeting was the first they attended where there were concrete preparations for a new round of multilateral trade negotiations. The now infamous 'Green Room' process where only a few large WTO members are invited to unscheduled meetings of the WTO to make major decisions on policy was viewed by many WTO members as an affirmation of their worst expectations of how the organisation functions. However, the demands for transparency and democratic decision making have clearly to be balanced against the obvious demands of organisational efficiency. Making decisions with 135 members present will render the organisation dysfunctional. The creation of a formal global alliance of small states may be the best way to assure that a representative is at those small group meetings that are necessary to make the WTO an efficient functioning organisation simultaneously allowing for transparent and accountable representation.

### **III) The WTO Work Program for SVS**

#### *Trade and Investment Constraints faced by the SVS*

Few small island states in the Pacific now believe that they will benefit from liberalisation of trade in any substantial way without going through a very long and difficult transition period. Moreover, many of the FICs feel they are not sufficiently strong or stable to weather the severe political or economic consequences of these transitions. The position of multilateral agencies remains that there is no reason for further intervention in SVS and economic adjustment is both a necessary and sufficient condition to assure economic growth. What is not accepted is that some island states may be so small isolated and vulnerable that it is difficult to imagine what combination of internal adjustment policies would induce substantial domestic or foreign investment. Many SVS suffer from very high operating costs stemming not from policy induced measures but from the inherent nature of small, isolated and physically dispersed economies.

It is not until the global community is willing to recognise that a substantial portion of these cost disadvantages are inherent and not just related to endogenous policy measures that appropriate modalities will be developed to assist SVS take advantage of opportunities being created by trade liberalisation. Herein lies the policy tension for

SVS in dealing with globalisation and the WTO. While the WTO may be creating a globalised economy, it is not the WTO that is in any position to deal with the problems created by globalisation for SVS. Globalisation leads investors to look for locations for investment that minimise costs. Small isolated economies rarely fit this description. **Thus globalisation may for, sound economic reasons, lead to a decrease in investment in small vulnerable states.**

Regrettably, for political reasons multilateral agencies may be willing, at least nominally if not in terms of resource flows, to treat SVS as a particular and special category of disadvantaged states but at a technical level there is little or no support for the recognition of the SVS because there is a widespread belief that smallness imposes no significant disadvantage on a country. The paper presented by Mr Easterly last year in St Lucia entitled 'Small Countries, Small Problems' remains very much the mainstream view of the impact of smallness on development. While at a political level there has been a reaction to this paper, there has, to the best of the author's knowledge, been no systematic attempt to refute its conclusions.

Unless SVS are willing to address this issue in their work program, any attempts to seek special and differential treatment or any other form of recognition beyond *de minimis* provisions will fail in the much more hostile political environment of the WTO.

#### *Appropriate Options for the Definition of Small States*

There exist numerous possible definitions of SVS. In the past definitions have been based upon:

- Demographics (Comsec)
- Size of GDP
- Share of world trade (WTO)

While all three can be used to gauge smallness they do not address the question of economic and environmental vulnerability which at present is the one quality of small state economies that has received relatively wide acceptance by the international community. Apart from vulnerability there are at present no other economic qualities that are accepted internationally as hampering the development of SVS. As a result, if the SVS are to make rapid progress towards recognition at the WTO and multilateral fora then the vulnerability index will constitute an important component in that process. Forum leaders have endorsed the vulnerability index and have called for its acceptance by the global community in assessing the development status of SVS.

However the question of definition, and the even more difficult question of an appropriate modality for the graduation countries that have, through economic development, become less vulnerable, must remain political rather than technical. It is because any definition that is chosen will have border cases that will exclude countries that are widely perceived to be worthy cases for special and differential treatment. Many of the political problems associated with graduation can be dealt with by the use of appropriate lag periods for those countries at what are politically defined as being critical thresholds in the vulnerability index for SVS. However, all the technocrat can do is offer several reasoned options for those thresholds and in the final analysis it is a political choice as to which point or range on the vulnerability index the international community sets. In light of the experience of the WTO and the

refusal of members to define 'developing' countries, leaving the question to self-election, one should not assume that any discussion of graduation at an organisation based on consensus will be easy.

The SVS have time to find appropriate options for defining themselves on the vulnerability index along with other widely accepted measures of disadvantage. There is a political consensus emerging that many SVS face problems that are not dissimilar to those countries that are now defined as LDCs. However, this political consensus will be undermined unless the SVS demonstrate that the technocratic consensus around works similar to that of Mr Easterly has failed to grasp the depth of trade and investment problems confronted by small states.

### *Modalities for Assisting Small States*

The first part of the work program of the SVS must address the problem of empirically demonstrating that SVS have a case for some special assistance that is beyond their development status. Then the focus must be upon which institutions are best able to assure that SVS become fully integrated into the multilateral trading system. In this regard the range of solutions to this problem may well lie with the World Bank/IFC rather than with the WTO. Indeed the development of catastrophe insurance programs constitutes one constructive way that multilateral agencies can assist in dealing with vulnerability. However vulnerability to natural disaster is not the only trade problem confronting SVS.

As argued above, many of the trade and investment problems confronted by the SVS stem from measures towards globalisation taken at the WTO however, it is not evident that their resolution is necessarily in the purview of the WTO. The calls for more special and differential treatment, while certainly useful and necessary, solve nothing in terms of attracting more investment to SVS which remains the only way the SVS will benefit from globalisation. Just as nations and regions have special funds to provide appropriate market friendly incentives for investors to locate in disadvantaged areas as exist in the EU, Canada and the USA there is a need for the development of similar facilities by the global community.

The experience after the Uruguay Round with the Ministerial Declaration of impact on net food importing countries is a case at hand. Here is a situation where the global community recognised that the outcome of the agriculture negotiations would have adverse effects on developing countries. Moreover, the negotiations that commence this year on agriculture will only serve to compound these difficulties. Yet the international community never operationalised its concern because the issue was relegated to a ministerial declaration rather than becoming part of the agreements of the Uruguay Round or taking the matter to a more appropriate for a such as the World Food Program or the World Bank.

The need for SVS, working together with LDCs, to develop an appropriate modality that will assure full integration in the trading system are clear. However the most appropriate institution for this remains the IFC and not the WTO. If the focus of the SVS and the LDCs remain obtaining further special and differential treatment, while valuable will do little to lift the standard of living of citizens in SVS and will expend scarce political capital into a process that yields low economic returns.

## **Conclusion**

The experience of FICs with the WTO has been one of marginalisation resulting from a political process over which they have little say. It is a process that is increasingly seen as undermining the foundations of the regional economy which are based on trade preferences. Institutionally, to assure the voice of the SVS is heard, a global alliance is essential and global institutions such as the Commonwealth and UNCTAD are vital in facilitating this alliance. The hiatus between the Seattle Ministerial Conference and the next affords the SVS an opportunity to forge a lasting grouping of over 30 WTO members. In light of the recent experience, it is imperative that this grouping begin its work program at the earliest possible date to demonstrate to the international community that there exists a strong and empirically valid case for special and differential treatment. Regrettably there is as yet no such consensus and less so a view as to precisely what measures are needed to assure the full and complete integration of SVS in the global trading system.