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Graduating from LDC Status: A Focus on Small Island Developing States (SIDS)

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Abstract

The withdrawal of international support measures raises sustainability concerns among countries graduating from the category of least developed countries (LDCs). Despite care taken to ensure smooth transition, these concerns are rife, especially for small island developing states (SIDS). Of the 16 LDCs slated to graduate by 2024, 6 are SIDS. SIDS' calls for additional special and differential treatment tailored to their unique vulnerabilities have yielded few wins. At the World Trade Organization (WTO) level, SIDS are not formally recognised as a distinct category; hence, their claim for special treatment will remain contentious – even amid proposals for reform of WTO rules to better serve the neediest. This paper argues that it matters little whether or not graduating SIDS receive additional support beyond smooth transition – for various reasons, including the fact that several fall-back options for LDCs are available.

JEL Classification: F13, O11, O19

Keywords: WTO, Least Developed Country, small island developing states, LDC graduation

Contents

1. Introduction

Since the establishment of the least developed country (LDC) category in 1971, and of the concept of graduation in 1991, the list of LDCs has known little movement in the positive direction. More countries have joined the list than have left it over the past 47 years. Only five LDCs had graduated as at December 2018 Botswana (1994), Cape Verde (2007), Maldives (2011), Samoa (2014) and Equatorial Guinea (2017). However, the next five years will witness a flurry of activity, as no fewer than 16 LDCs are expected to graduate by 2024 (UNCTAD, 2016). While this development is welcome, it raises several questions about long-term sustainability as LDCs lose eligibility for a range of support measures following graduation.

Sustainability concerns are rife for the seven small island developing states (SIDS) that are currently on the LDC list: Comoros, Kiribati, São Tomé and Príncipe, Solomon Islands, Timor-Leste, Tuvalu and Vanuatu.[1] These concerns can perhaps be summarised in one word: vulnerability. Their vulnerability derives from their unique geographical features. SIDS are small in physical size, far away from centres of economic activity, and isolated. These characteristics result in SIDS being vulnerable to external economic shocks over which they have little control; lack of resources and remoteness also entail poverty and social vulnerability. Last, but certainly not least, SIDS are particularly exposed to climate change, and hence to environmental vulnerability.

All but one (Comoros) of the SIDS are expected to graduate by 2024. The experience of past SIDS graduates suggests that they have generally maintained their development momentum, and there has been no case of slipping back. This may bode well for the next cohort of graduates. Nevertheless, each small island developing state is unique in terms of its level of preparedness to face post-graduation challenges, so past experiences, however positive, cannot be generalised.

The onus to ensure sustainability rests on the graduates themselves. However, because the international community will be withdrawing the very support measures that contributed – in part, at least – to the SIDS' development while they were LDCs, it has a moral obligation to ensure that graduates do not become a victim of their success. In practice, care should be taken to ensure a smooth transition process when LDCs join the ranks of other developing countries. However, because of the specific vulnerabilities of SIDS, what applies to graduating LDCs may not be enough for SIDS graduates. UNCTAD (2016) talks of 'graduation with momentum', that is, graduation anchored in a long-term process of structural transformation. If graduation with momentum is required for newly graduated LDCs to reach the Sustainable Development Goals (SDGs), it will be particularly critical to the SIDS among them.

SIDS have led a relentless battle – on several platforms – for special and differential treatment (S&DT) consistent with their unique vulnerabilities. The seven SIDS that are also LDCs, and therefore eligible for an array of international support measures available to LDCs, have argued that these measures are inadequate to meet their development challenges as SIDS. They have advocated for additional and targeted S&DT. Their efforts have yielded few significant wins to date. However, even as their resolve remains undeterred, there has been a rising call for SIDS (and LDCs generally) to address their problems by their own will and effort rather than depending on preferential treatment, which is both uncertain and insufficient.

This paper goes in the same direction: it critically assesses the international support measures available to LDCs, with a focus on the graduating SIDS LDCs; makes a case for specific S&DT for SIDS; and urges graduates to invest in structural transformation of their economies to better absorb the shocks that graduation triggers.

2. SIDS LDCs' graduation prospects

Inclusion in the LDC list is based on the same criteria as graduating out of it, except that the threshold levels for graduation are higher than for inclusion. These criteria include per capita gross national income (GNI), human assets and economic vulnerability to shocks. The last two are measured by composite indices of structural weakness, namely the human assets index (HAI) and the economic vulnerability index (EVI).[2] The thresholds for these criteria are set and periodically reviewed by the Committee for Development Policy (CDP), a subsidiary of the UN Economic and Social Council.

To qualify for graduation, an LDC must have reached threshold levels for graduation for at least two of the three criteria, or its GNI per capita must be at least twice the graduation threshold (the 'income only' graduation rule).[3] Recent analysis by UNCTAD forecasts that 16 LDCs will graduate by 2024, of which 6 are SIDS (see UNCTAD, 2016). Table 1 summarises the criteria by which the latter will probably graduate.

Except for Timor-Leste, all future graduates will meet the same two graduation criteria, namely income and HAI; Timor-Leste is expected to graduate by the 'income only' rule. This pattern is broadly consistent with the experience to date: three of the past four graduates satisfied the income criterion and a precursor to the HAI.[4] Only Maldives met all three criteria, including an index of economic diversification meant to gauge vulnerability to economic shocks. It appears that SIDS graduate through a combination of limited diversification towards services, especially tourism, and investment in human capital (UNCTAD, 2016). In other words, SIDS tend to graduate with high levels of economic vulnerability: of the nine projected SIDS graduates as of 2021, only one – Maldives – is expected to have achieved a satisfactory degree of economic diversification.

3. SIDS vulnerability: a perennial issue

SIDS LDCs face a 'double structural handicap': they combine the structural challenges of LDCs with the vulnerabilities of SIDS (UNCTAD, 2016: 60). The Istanbul Programme of Action (IPoA) identifies eight priority areas calling for urgent action. These are areas where LDCs face the most daunting challenges to development. They include weak productive capacity; underinvestment in agriculture and rural development; marginalisation in global trade, due mainly to lack of competitiveness; overdependence on commodity exports and lack of diversification; low levels of investment in human and social capital; economic vulnerability to

Table 1. Graduation timeline for future SIDS LDC graduates

Country	Year of full statistical eligibility for graduation[a]	Criteria satisfied	Year of CDP recommendation for graduation	Expected year of graduation
Vanuatu	2009	Income, HAI	2012	2020[b]
Tuvalu	2009	Income, HAI	2012	2021
Kiribati	2015	Income, HAI	Decision deferred to 2018 review	
São Tomé and Príncipe	2015	Income, HAI	May be recommended for graduation if graduation criteria are (still) satisfied at the CDP triennial review in 2018	
Solomon Islands	2015	Income, HAI		
Timor-Leste	2015	Income only		

[a]Most recent year is shown in cases where eligibility criteria were satisfied earlier but graduation was deferred.
[b]As endorsed by the General Assembly.
Source: adapted from UNCTAD (2016).

external crises; weak resource mobilisation; and weak institutional capacities (UN, 2011). Smallness and insularity impose additional constraints on economic development. A small market precludes economies of scale and, along with a narrow resource base, forces undue specialisation and openness to trade, exposing SIDS to external shocks and accentuating their inherent vulnerability. Indivisible fixed costs and lack of economies of scale result in higher cost and a lower volume of public services; a generally uncompetitive private sector, characterised by monopolistic firms, high production costs and a lack of product diversification; and high transport costs, which raise the cost of imports and reduce the export competitiveness of remote and geographically isolated SIDS (IMF, 2013).

Inherent constraints to the development of the private sector mean that few employment opportunities exist, prompting the government to take a leading role in providing jobs. This often results in excessively large public sectors, which when compounded with weak domestic resource mobilisation capability, can lead to high, and often spiralling, national debts. SIDS tend to rely more heavily on international trade taxes as a source of government revenue than on other sources, making it difficult for them to commit to trade liberalisation. Although SIDS, by and large, understand that services are the way to go, poor information technology (IT) connectivity, especially on islands far off the path of major submarine fibre optic cables, impedes the development of IT-enabled services and affects other service sectors, such as education and health, as well.

SIDS also face severe challenges in social development arising from the generally higher cost of providing infrastructure and public services. While they have made significant strides in combating infant mortality and water-borne diseases, they are now confronted with a rising incidence of non-communicable diseases, treating which often stretches government finances. Smallness also makes it difficult to train people in a wide range of areas, resulting in a shortage of staff in critical sectors. A consequence of lack of human resource development, along with low financial capacity, is that SIDS have poor representation at the level of international organisations, which has a negative impact on their advocacy efforts.

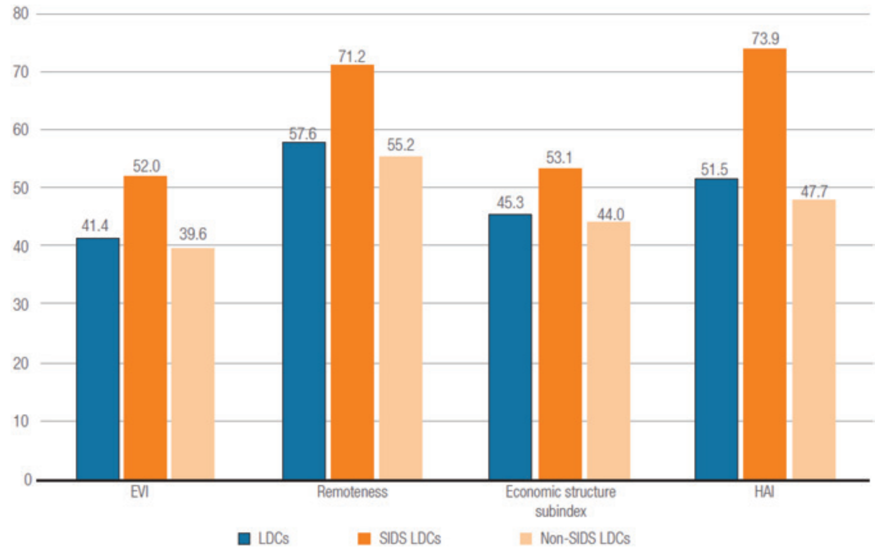
Perhaps the biggest challenge to sustainable development in SIDS arises from their extreme exposure to climate change and natural disasters. Sea-level rise can wipe out the supply of key resources as well as entire settlements in low-lying islands such as Maldives. Climate change-induced weather events, such as hurricanes, drought and flooding, cause significant economic damage and take a toll on the economies' natural capital, which is so critical to sectors such as tourism, and ultimately, therefore, on livelihoods. SIDS also find it hard to manage their rich biodiversity, and continue to face chronic food insecurity. The lack of space makes effective waste management a perennial challenge.

Vulnerability is a ubiquitous characteristic of SIDS: 'almost all of the states classified as 'most vulnerable' are small states, and about 2/3 of these are islands' (von Tigerstrom, 2005). SIDS LDCs are significantly more vulnerable than non-SIDS LDCs, with an average EVI score of 52.0 compared with 39.6 for the latter group. Moreover, 13 of the 20 countries with the highest EVI scores are SIDS, of which four are LDCs (UNCTAD, 2016). SIDS LDCs also exhibit higher levels of vulnerability on subindices such as remoteness or economic structure (a measure of economic concentration) (Figure 1).

However, SIDS within the LDC category show a clear advantage over other LDCs on the LDC criteria, i.e. per capita income and HAI. In 2016, while average GNI per capita for all LDCs (US$955) and for non-SIDS LDCs (US$942) was not markedly different, it stood at US$2,089 for SIDS LDCs, more than twice the level for LDCs. Similarly, SIDS LDCs featured an average HAI score of 73.9 as against 47.7 for non-SIDS LDCs. These indicators suggest that SIDS 'on average show no tendency towards underdevelopment' (Cordina and Vella, 2012). They have successfully overcome their geography-related disadvantages to achieve higher levels of openness, education and financial development (Alesina et al., 2005), which underpin their economic growth record.

Yet it seems that the economic performance of small states, and especially micro-states, has deteriorated in recent years relative to their larger peers. Lower growth has entailed slower progress in social indicators, with the HDI, for example, improving more for larger economies than for small states between 2000 and 2010 (IMF, 2013). While the causes of slow growth in SIDS require further investigation, the brain drain-induced decline in productivity

Figure 1. Selected structural indicators of SIDS LDCs



Source: UNCTAD (2016).

and generally weak competitiveness have been pointed out as key culprits (ibid.).

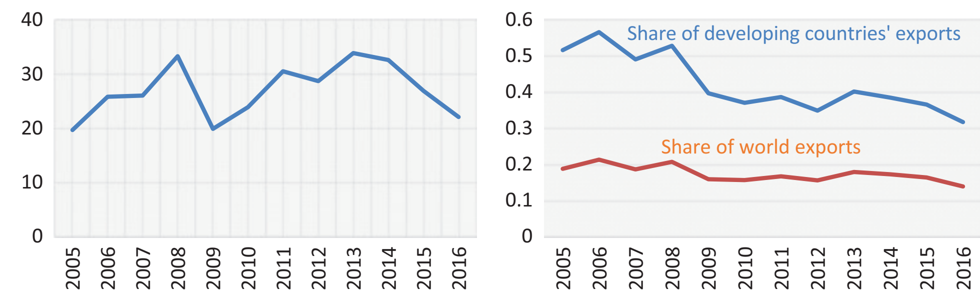
A key aspect of vulnerability affecting small states, and SIDS in particular, is economic volatility. The IMF (2013) has identified three elements of volatility common to SIDS: volatility of growth, external sector volatility and fiscal volatility. Although smallness per se is not associated with higher growth volatility, there is evidence that the recent slowdown of growth in SIDS has coincided with greater output volatility, which arises from variability in terms of trade, external demand and official development assistance. Conversely, small states have experienced greater current account and fiscal volatility relative to larger countries of similar income levels (ibid.).

4. SIDS LDCs' trade: a story of resilience

SIDS' merchandise exports have increased significantly since the 1990s, rising three-fold between 2002 and 2008 before dropping 40 per cent in 2009. Recovery from the financial crisis has proved difficult, and exports have been on a downward trend in recent years (Figure 2a). In 2016, SIDS accounted for 0.14 per cent of world merchandise exports (Figure 2b) – a share that is roughly comparable to their share of global gross domestic product (GDP) (0.12%) or of world population (0.17%).

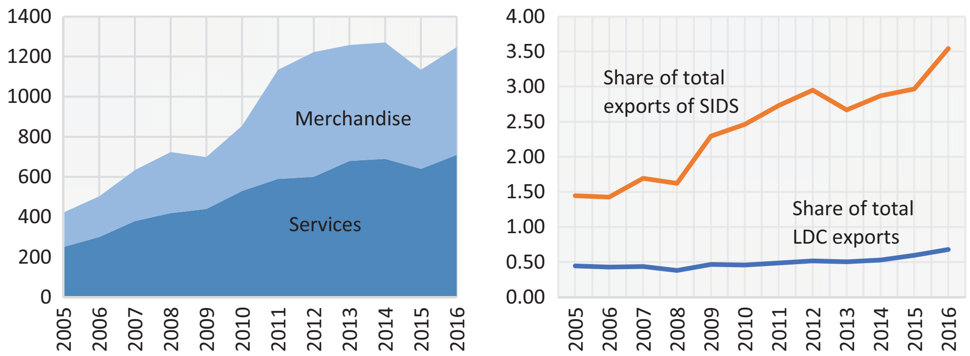
In relative terms, however, SIDS have been increasingly marginalised in world trade. Their shares of both global exports

Figure 2. (a) SIDS' merchandise exports (US$ billion); (b) SIDS' export shares (%)



Source: Author's calculations using data from UNCTADStat.

Figure 3 (a) SIDS LDCs' exports, 2005–2016; (b) SIDS LDCs' percentages of total exports



Source: Author's calculations using UNCTADStat.

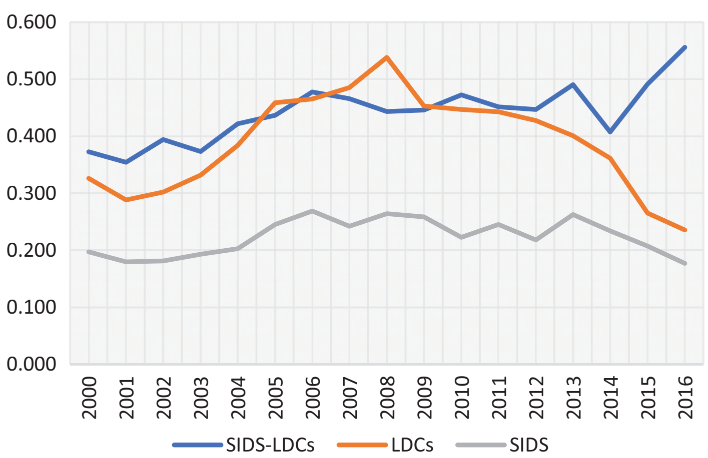
and developing-country exports have eroded steadily over the years, especially since 2008, with the decline being sharper for the latter. SIDS' share of developing-country exports has fallen from a peak of 0.57 per cent in 2006 to 0.32 per cent in 2016, and the downward trend is likely to continue.

Remarkably, for the seven LDCs among the SIDS, exports have been more robust. Their exports of both goods and services have increased, with services dominating total exports as well as being more resilient to economic crises (Figure 3). SIDS LDCs represented 3.5 per cent of SIDS' total exports, and 0.7 per cent of LDCs' total exports, in 2016. To put these figures in perspective, consider that these economies accounted for 8.4 per cent of SIDS' GDP and 0.85 per cent of LDCs' GDP in 2016. Thus, SIDS LDCs' exports appear to be well below their production potential, implying that these countries face particularly severe challenges to exports. On a more positive note, however, their share of exports has increased firmly over the past decade: it stood at 1.5 per cent of SIDS' exports and 0.4 per cent of LDCs' total exports in 2005 (Figure 4).

Understanding the forces underlying these trends can be revealing for policy-makers and the wider development community. Preliminary analysis suggests that the SIDS LDCs' exports of goods have increased slightly faster than their services exports, whereas the opposite trend is observed for both SIDS and LDCs' exports, generally. For example, SIDS LDCs' merchandise exports increased over three-fold between 2005 and 2016; for LDCs, exports nearly doubled whereas they barely increased for SIDS as a group.

A potential explanation for this mixed performance comes from export product diversification. Whereas export concentration has generally declined in both SIDS and LDCs, especially since 2008, there are indications that it has increased in the seven SIDS LDCs (Figure 4).

Figure 4 Export concentration index, 2000–2016



Source: Author's calculations using data from UNCTADStat.
Note: The index takes values between 0 and 1. The higher the value, the more concentrated the export structure.

5. International support measures (ISMs) specific to LDCs/SIDS

Special treatment for SIDS can be construed to mean three things:

a. special and differential treatment in trade;
b. common but differentiated responsibility in dealing with climate change; and
c. special consideration in the allocation of development assistance.

While SIDS have led a constant battle on all fronts over many years, their advocacy efforts have not yielded the desired results.

5.1 The international community's response to SIDS and their vulnerability

The international community's response to the plight of SIDS has a long history and an eventful path, yet few concrete results have emerged. Officially, the earliest attempt to recognise the specific vulnerabilities of small states is credited to the Rio Earth Summit of 1992. Notably, Agenda 21, a product of the summit, recognises the need 'to adopt and implement plans and programmes to support the sustainable development and utilization of their marine and coastal resources, including meeting essential human needs, maintaining biodiversity and improving the quality of life for island people' as well as the need for the adoption of 'measures which will enable small island developing States to cope effectively, creatively and sustainably with environmental change and to mitigate impacts and reduce the threats posed to marine and coastal resources' (UNCED, 1992).

The Barbados Programme of Action (1994) (BPA) went further and defined a number of measures across 14 key priorities to be undertaken by SIDS and their international partners, individually or jointly, with a view to promoting the sustainable development of SIDS. In particular, the programme calls for targeted intervention in the cross-sectoral areas of capacity building, institutional development, technology transfer and international cooperation to promote SIDS' trade. Similar commitments have been reiterated in subsequent meetings, leading up to the Third International Conference on Small Island Developing States in Samoa in 2014. In the Preamble to the Samoa Pathway, member States reaffirmed their 'commitment to take urgent and concrete action to address the vulnerability of small island developing States', and emphasised 'the urgency of finding additional solutions to the major challenges' facing SIDS (UN, 2014).

In the meantime, a series of high-level meetings to review implementation of the BPA, notably the Johannesburg Plan of Implementation (2002), the Mauritius Strategy of Implementation (MSI, 2005) and MSI+5 (2010), have highlighted several shortcomings in the institutional support for SIDS as well as other constraints on the full and effective implementation of the BPA. MSI+5, for example, called for coordinated action to 'more effectively address the unique and particular vulnerabilities and development needs' of SIDS (UN, 2010).

The statement in the Preamble to the BPA that SIDS were a 'special case for both environment and development' has become a blueprint for the international community's actions in support of SIDS (UN, 1994). SIDS themselves have emphasised that their unique challenges call for special support – that is, more favourable support than what is normally afforded to developing countries. A recent example is the unequivocal call by delegates at the High-Level Review Meeting of the MSI in New York (September 2010) to enhance international support for SIDS in several areas, including aid; adaptation to climate change and financing of green investments and renewable energy development; and WTO-compatible trade preference programmes that acknowledge and address SIDS' unique vulnerabilities (IISD, 2010).

5.2 SIDS and the multilateral trading system

Whether or not developing countries can be differentiated based on their characteristics, and SIDS can be singled out for special treatment in the WTO regime, remains a point of contention. Currently, the only subcategory of developing countries that is officially recognised for S&DT is the LDCs. This is in contrast to the practice of other international institutions, which differentiate among developing countries according to various criteria. The

World Bank, for example, classifies developing countries by per capita income level.

At the WTO, SIDS arguably fit into the subcategory of member countries called 'small and vulnerable economies' (SVEs). An SVE is defined as a developing country whose average share of world trade, for the period 1999–2004, in (a) merchandise does not exceed 0.16 per cent; (b) non-agricultural products does not exceed 0.1 per cent; and (c) agricultural products does not exceed 0.4 per cent. SVEs collectively account for less than 1 per cent of global trade (von Tigerstrom, 2005). The SVE group currently comprises 26 WTO members and 1 WTO observer (The Bahamas).[5] Fourteen of these SVEs are SIDS as defined and recognised by UNCTAD.

The WTO Work Programme on Small Economies, dedicated to this group, was established following a decision of the Doha Ministerial Conference in 2001 to 'frame responses to the trade-related issues identified for the fuller integration of SVEs into the multilateral trading system' (WTO, 2001: para. 35). However, the Doha Declaration never intended to create a subcategory of WTO members, so SVEs are not recognised formally as a category in their own right, even though certain decisions can be attributed directly to their existence (Soobramanien and Gosset, 2015). This means that SIDS' calls for amendments or exceptions to existing WTO rules as a form of additional S&DT will remain contentious (von Tigerstrom, 2005).

Small economies may see a ray of hope in a 2004 Appellate Body decision in a case brought by India against EU tariff preferences.[6] The WTO noted that treatment to 'developing countries' could be differentiated based on specific criteria, such as 'development, financial and trade needs which the treatment in question is intended to respond'. Although the decision was made in a specific dispute case, it creates a reasonable basis to consider if there are merits in singling out distinctive groups of countries for special treatment. To date, however, SIDS' insistence that their unique vulnerabilities deserve a differentiated approach has not made much headway, with the notable exception of the agricultural and non-agricultural market access negotiations.

Despite their frustration with the WTO, and despite the fact that awareness of their specific challenges by the international community has done little to improve their global trade performance, SIDS nevertheless find comfort in the protection that the rule-based multilateral trading system provides to the smallest and most vulnerable of its membership. This is especially true for SIDS, which lack both the leverage and the resources to engage in negotiations on their own, especially in the face of the proliferation of regional and mega-regional trading blocs and the rise of plurilateralism.

Small economies are participating actively in WTO processes with a view to concluding the long-standing Doha Development Agenda (DDA). They have managed to promote issues of key interest to them in the areas of agricultural and non-agricultural market access, and final outcomes in these areas will reflect specific flexibilities for SVEs. In agriculture, for example, in addition to the existing flexibilities for developing countries provided for in the Agreement on Agriculture, further flexibilities have been proposed in the tariff-reduction formula, in the areas of sensitive products and special products, in domestic support and export subsidies, in safeguards and in special provisions for LDCs, which should be of benefit to the seven SIDS LDCs (UNCTAD, 2010). The current draft negotiating texts contain explicit references to SVEs. Accordingly, the new flexibilities will apply not just to developing countries in general but to SVEs in particular, suggesting that small states' efforts are bearing fruit.

Other recent developments at the WTO are also encouraging for SIDS. The Trade Facilitation Agreement, even if it does not include specific provisions or flexibilities for SIDS, will probably have a disproportionately greater impact on them. This is because the agreement aims to reduce trade costs, a major problem for SIDS given their distance from major markets and their high trade costs. SIDS must therefore embrace the agreement and implement it as a self-interested measure. If properly sequenced, the agreement may incur low cost and, ultimately, pay for itself (Ancharaz, 2015).

5.3 S&DT – any chance for SIDS?

There are 145 provisions relating to S&DT in the WTO agreements, which the WTO has classified into six types (Yanai, 2013):

a. provisions designed to enhance developing countries' market access in developed countries;
b. provisions urging WTO Members to safeguard the interests of developing countries while implementing WTO agreements and applying trade policies;
c. provisions allowing developing countries greater flexibility in implementing their WTO commitments (e.g. exemptions, reduced levels of commitment, procedural flexibilities);
d. provisions for longer transitional periods for developing countries;
e. provisions regarding technical assistance and other support to developing countries;
f. specific provisions for LDCs.

In the DDA negotiations, developing countries (and SIDS) have called for the strengthening of S&DT through two key proposals, namely that:

1. S&DT be made an integral and inherent objective of the multilateral trading system rather than a privilege given by developed countries to developing countries; and
2. an S&DT regime be established with legally binding force (ibid.).

There have been some important achievements on S&DT in the DDA so far. Both the Bali and Nairobi packages contain specific and favourable provisions for developing countries, especially LDCs. However, although ministers at the Bali Conference, reiterating the Hong Kong Declaration, called on developing-country members 'that do not yet provide duty-free and quota-free access for at least 97 percent of products originating from LDCs' (WTO, 2013) to do so before the next ministerial conference, universal duty-free quota-free (DFQF) market access has remained rather elusive, largely because of the United States' reluctance to provide meaningful preferences to *all* LDCs. This situation is probably a boon for SIDS, most of which silently oppose the move, since DFQF market access for all LDCs would privilege some LDCs at the expense of smaller economies (Ancharaz, 2015). Simulations suggest that several SIDS (e.g. Comoros, Timor-Leste and Tuvalu) will be adversely affected, or will gain little from a comprehensive DFQF deal (Laird, 2012).

There are several reasons for the lack of progress of SIDS in having their proposals on S&DT given due consideration at the WTO level. First, as noted above, SIDS are not formally recognised as a group. The notion of 'small and vulnerable economies', which forms the basis of the WTO work programme on small economies, was always meant to exist as a reference group rather than a separate category attracting differentiated treatment. The problem goes even further: the very definition of developing countries, which determines eligibility for S&DT, remains ambiguous. While LDCs – a subset of developing countries – are clearly defined, this is not the case with the larger group of developing countries. The established practice is that a country confers on itself the status of a developing country through self-declaration. This has resulted in an awkward situation, with a diverse range of countries holding on to their 'developing country' status when they de facto present many features of developed economies. This is true of countries such as Chile, Korea, Singapore, etc.

Moreover, the legal basis of S&DT remains fuzzy. The evolution of S&DT within the WTO system suggests that its incorporation into WTO agreements 'was not the codification of an established legal norm but the result of political compromise between developed and developing countries' (Yanai, 2013: 5). Thus, while the Enabling Clause is regarded as a legal basis for the Generalised System of Preferences (GSP), the S&DT principle itself lacks any such foundation. This significantly complicates SIDS' advocacy efforts in respect of specific and enhanced S&DT for their members. It would be advisable that, in the first instance, SIDS join the developing countries' struggle for S&DT to be recognised as legally binding. They can then call for differentiated treatment for their group – hopefully on the back of an improved legal regime.

Several proposals have been made by academics and critics to make S&DT more effective. Many of these proposals hinge on differentiating among developing countries at a finer level, since the current 'one size fits all' approach is deemed to have failed the neediest. Hoekman et al. (2003), for example, suggest that S&DT 'should focus primarily on WTO rules and be limited to those countries that need it most – very small and poor economies'.

They argue that, instead of allowing developing countries to opt out of WTO rules that appear 'anti-development', the rules themselves need to be changed to make them more inclusive and development-friendly. This, in part, requires that criteria be adopted to differentiate between countries so that the most flexible rules apply specifically to the most vulnerable. Unfortunately, the authors offer no guidance on what form such criteria could take, other than expressing preference for a 'simple rule-of-thumb approach to determine eligibility', leaving the issue to be resolved by a high-level group to be established by WTO members.

Some development advocates insist that the S&DT principle must be recast as 'hard law' so that it is 'legally enforceable, predictable, and therefore more beneficial' (Kaushik and Mukiibi, 2011) while others have called for implementation of the 'right to development' in international law as it relates to S&DT at the WTO (Chimni, 2011). Meléndez-Ortiz and Biswas (2011) have proposed an 'a la carte' S&DT that would be needs-based and tailor-made for specific country subgroups, such as SIDS.

5.4 S&DT and common but differentiated responsibility

More recently, some researchers have drawn a parallel between the concept of S&DT in trade and development and the notion of common but differentiated responsibility (CBDR) in international environmental law, and asked if the latter could apply to S&DT (Yanai, 2013). The principle of CBDR states that all countries have a common responsibility to protect the environment; however, the level of commitment should be in line with each country's historical contribution to climate change and commensurate with its capacity to prevent, reduce and control such damage (ibid.). Thus, CBDR admits the possibility that a country's responsibility to address climate change can vary according to its specific social, economic and ecological circumstances. Multilateral environmental agreements specify differentiation not only between developed and developing countries, but also among developing countries.

While the principles of S&DT and CBDR have functioned in their respective areas of international law, there appears to be some movement at the level of the WTO to consider the particular local conditions of developing countries when adopting environmental measures. The tone is set by the WTO dispute settlement panel, which, in its ruling in the famous shrimp case (see WTO, n.d.), invoked the principle of CBDR, urging that the specific needs and situations of developing countries be considered in trade where such trade has environmental implications. The complementarity between S&DT and CBDR can be exploited by SIDS to advocate enhanced S&DT given their unique vulnerabilities with respect to both trade and climate change.

5.5 Preferential schemes: an avenue for enhanced S&DT?

A number of developed countries have traditionally provided differentiated treatment to various groups of developing countries through unilateral, non-reciprocal trade preference schemes. The best known are the GSP schemes of Canada, the EU, Japan and the United States. At the Hong Kong Ministerial Conference of 2005, Members agreed that 'Developed country Members shall, and Developing-country Members declaring themselves in a position to do so should, provide duty-free and quota-free market access on a lasting basis, for all products originating from all LDCs by 2008' (WTO, 2005: Annex F, para. 36). India became the first among emerging economies (i.e. excluding Korea, which launched a DFQF scheme in 2000) to propose a preferential trade scheme for LDCs. China followed in 2010.

The Bali Declaration of 2013 reiterated the call for developed countries 'that do not yet provide [DFQF] market access for at least 97 percent of products originating from LDCs … to improve their existing [DFQF] coverage for such products, so as to provide increasingly greater market access to LDCs, prior to the next Ministerial Conference' (WTO, 2013). The country that is implicitly targeted by this declaration is the United States, which, unlike its peers, lacks a comprehensive DFQF scheme for the world's poorest economies. DFQF market access was high on the agenda at the Nairobi Ministerial Conference in 2015, and, in the weeks leading up to the event, researchers had speculated about what it would take for the USA to finally come up with such an offer.[7]

That did not happen – much to the relief of SIDS. While the USA does not have a DFQF scheme like the EU's Everything But Arms (EBA) initiative, its existing preferential initiatives, such as the African Growth and Opportunity Act (AGOA) and the Caribbean Basin Initiative (CBI), cater for the entire spectrum of SIDS. In practice, however, these schemes could be enhanced – and this is where SIDS' efforts should be directed. AGOA, for example, excludes several products in which African countries are known to be competitive. Agricultural products are subject to tariff-rate quotas, with products such as sugar, peanuts and tobacco facing exorbitant tariffs. Furthermore, restrictions on sugar and dairy content limit eligible exports to raw materials and primary products, effectively robbing SIDS of opportunities for higher value-added agro-processing (Ancharaz, 2015). SIDS that qualify for preferential market access to the USA under AGOA or the CBI should ask for DFQF treatment and enhanced rules of origin, and those that are not eligible for such treatment (including the Pacific SIDS, several of which are among the poorest of the world) should lobby for inclusion – most likely through a scheme specific to their region.

The EU GSP Regulation hints at what a preferential scheme for SIDS could look like if it embraced the notion of differentiation. The regulation provides for a sliding scale of preferences within three schemes according to the different needs of developing countries (European Commission, 2018):

a. a standard GSP for low- and lower middle-income countries;
b. a GSP+ for vulnerable low- and lower middle-income countries; and
c. EBA for LDCs.

The GSP+ might be the most suitable scheme for SIDS. However, it still leaves out a number of higher middle-income countries (such as The Bahamas, Barbados, Cape Verde, Mauritius and Seychelles) that do not qualify for any of the above schemes. In practice, this may not matter, since all of these SIDS have signed economic partnership agreements (EPAs) with the EU, which offer them the privilege of exporting 100 per cent duty-free and quota-free to the EU. While the EPAs came at substantial cost to many SIDS, obliging them to open up their markets substantially to EU goods (and services), they nevertheless have the advantage of being a WTO-compatible agreement grounded in Article XXIV of the General Agreement on Tariffs and Trade (GATT) rather than a unilateral preference scheme that lacked legal basis.

A recent proposal by Yanai (2013) – that the codification of a preferential scheme as a multilateral agreement could allow more effective and meaningful trade preferences for specific groups of countries – deserves further consideration. The EPAs are a prime example of this logic. Although one could dispute whether or not the EPAs have yielded any benefit over and above the Cotonou Agreement, the fact remains that the EPAs are irrevocable agreements that cement trade ties between the EU and its former colonies. Complete with a development chapter, and a 'rendez-vous' clause that allows both parties to revisit certain provisions or to open negotiations with a view to enlarging the scope of the agreements, the EPAs are a clear step in the direction of differentiated treatment for developing countries that takes into account their specific situation. This logic can be extended to other arrangements, such as AGOA, and serve as a platform for developed countries to design SIDS-specific deals providing greater flexibility than is currently available.

But is the conversion of a unilateral preference scheme into an EPA-type agreement consistent with enhanced preferences for SIDS? On the face of it, such a move appears economically detrimental to SIDS, and this was highlighted by a number of simulation studies, which concluded that the EPAs would entail significant welfare losses to African, Caribbean and Pacific (ACP) countries following liberalisation of trade with their EU partners. In theory, Article XXIV of the GATT provides for greater flexibility towards developing countries in North–South trade arrangements – both in the transition period (exceeding 10 years 'only in exceptional cases') and in product coverage (deviation from the requirement that liberalisation covers 'substantially all the trade'). In practice, however, S&DT in RTAs has been interpreted by the WTO's Committee on Regional Trade Agreements to apply only to the transition period. This resulted in much confusion and disappointment in the EPA negotiations regarding the amount of trade liberalisation that developing countries needed to undertake given that the EU's imports were almost 100 per cent duty-free.

In conclusion, S&DT for developing countries will always remain contentious – more so as the issue has become highly political, with some of the largest and most competitive economies (such as China) still eligible for S&DT under WTO rules. However, SIDS have a legitimate basis to vie for enhanced S&DT. Their resolve should be bolstered by the continuous erosion of preferences, as non-SIDS LDCs and other developing countries benefit from improved preferences and reformed rules of origin – much at the expense of SIDS.

6. S&DT: much ado about nothing?

Critics have argued, and the evidence shows, that the current way in which S&DT is implemented is inaccurate, inequitable and inefficient (Jean, 2013). Inaccurate because the 'developing countries' category at the WTO has remained static when in fact several countries have advanced to the 'industrialised countries' league. Inequitable because S&DT offers the same treatment to countries with widely different levels of development. This one-size-fits-all approach does not fit current reality. And inefficient because selective flexibilities and exemptions have not promoted economic development. They have encouraged 'muddling through' with bad policies and delayed reform. Moreover, S&DT represents a barrier to reform in the WTO, since it has become a justification for path-dependent disciplines that are difficult to change (ibid.). For example, so long as developing countries' domestic support of agriculture remains anchored in S&DT, wider reforms of agriculture will remain elusive.

SIDS, and the seven LDCs among them, should not depend excessively on an S&DT regime that is fundamentally flawed, nor should they pin their hope on an enhanced S&DT regime that has been too long in the making. While intended to help poor countries, in practice S&DT has been biased against them. There is no overwhelming support for S&DT as a growth-promoting strategy (Ornelas, 2016).

Moreover, the effectiveness of trade preferences remains debatable. Brenton (2003), for example, finds that stringent rules of origin (RoO) resulted in poor utilisation of the EBA preferences by LDC exporters in 2001, while Candau and Jean (2005) show that this was the case mainly for non-African LDCs, for which preference utilisation was around 50 per cent. Similarly, Mattoo et al. (2003) estimate that the benefits of AGOA would be multiplied five-fold if there were no RoO. More recent studies (e.g. Nilsson and Matsson, 2009), however, provide a rather positive assessment of trade preferences, partly because EU rules of origin have improved.

Poor utilisation of trade preferences is also, and perhaps to a large extent, the result of weak capacity in developing countries, and in particular among LDCs. For example, in a study of developing-country agri-food exports to the EU and the USA, Bureau et al. (2007) find that, while only a small proportion of exports occurred outside the preferential regimes – suggesting a high rate of preference utilisation – exports from the poorest countries remained very low, leading the authors to cast doubt on the real effectiveness of these trade preferences. Their study, however, does not investigate the issue further and, more generally, there is a dearth of *empirical* evidence on domestic capacity as a determinant of preference utilisation. Indirect evidence comes from research that reveals a tendency for utilisation rates to decline with the degree of processing (e.g. Hakobyan, 2012). While tariff escalation may be to blame, it is also a fact that processing capacity is the weakest in the poorest countries.

Building developing countries' productive capacity for better utilisation of trade preferences, and to support their integration into the world trading system more generally, is a key focus of the aid for trade initiative. Where such aid has built quality or compliance infrastructure, it has succeeded in boosting exports, especially of higher value-added agricultural products, as demonstrated, for example, by the case stories showcased by the United Nations Industrial Development Organization (UNIDO, 2011) at the WTO Aid for Trade Global Review 2011. A study by Gradeva and Martinez-Zarzoso (2015) confirms the positive impact of the EBA initiative on ACP exports when trade preferences are combined with aid.

7. Smooth transition and fall-back options

There are several mechanisms built into the international trade system and the global aid architecture to ensure that graduation does not disrupt the very economic progress that led up to that event. In the absence of these mechanisms, graduation would create a perverse dynamic in which graduates would be victims of their own success.

7.1 Smooth transition

In a series of resolutions, the United Nations has called upon development and trading partners to show greater flexibility towards graduated LDCs, given their continued structural vulnerability. Coming in the aftermath of the Istanbul Programme of Action for LDCs, in which Member States committed to assisting LDCs so that half of them could meet the criteria for graduation by 2020, the latest resolution, A/RES/67/221,[8] reiterated the calls for action made in earlier resolutions, starting with the seminal 2005 resolution,[9] which laid out the founding principles of a smooth transition strategy. Specifically, in relation to trade preferences, A/RES/67/221 invited the WTO 'to consider extending to graduated countries the existing special and differential treatment measures and exemptions available to least developed countries for a period appropriate to the development situation of the country'.

The resolution also reiterated 'its call upon development and trading partners of graduating countries to make efforts so that their bilateral and multilateral strategies and aid programmes support the national transition strategy of the respective country'. New to the resolution is a plea to 'development partners to consider [LDC] indicators, gross national income per capita, the human assets index and the economic vulnerability index as part of their criteria for allocating official development assistance' to newly graduated LDCs.

The concept of smooth transition allows for a grace period of three years before graduation takes effect and, after this date, up to nine years during which international support measures in favour of LDCs are to be phased in gradually and predictably to avoid any disruption to graduates' development progress (UNCTAD, 2016). Moreover, it calls on UN agencies to provide 'targeted technical assistance' and to help graduating LDCs in preparing their smooth transition strategy. These arrangements are particularly important for the SIDS among the graduating LDCs, given their greater openness to international trade and, hence, exposure to external shocks, as well as their increased vulnerability to climate change (ibid.).

Taking the UN resolutions in support of smooth transition seriously, the EU has extended EBA preferences for LDCs by three years after graduation. Six other OECD countries have also applied some measures of flexibility towards LDC graduates. To a lesser extent, so has the United States. However, smooth transition has not been universally adopted by development and trading partners and institutions, including the WTO. At the WTO, LDC graduates benefit from extended access to the Enhanced Integrated Framework; S&DT provisions, conversely, have remained insensitive to graduating LDCs.

The lack of consensus on smooth transition entails considerable uncertainty as LDCs prepare their smooth transition strategy. It means that future graduates cannot rely on the UN's good intentions for the extra support they will need to fare in a situation where the usual preferential treatment in trade and aid will be no more. Graduates will be left to their own devices to optimise use of S&DT provisions and to leverage their diplomacy, expertise and resources to secure critical aid. Unfortunately, when it comes to capacity, LDCs, and especially the SIDS among them, face the most binding constraints.

7.2 Fall-back options

In a worst-case scenario, it is useful to ponder the fall-back options that graduating LDCs have. These options, it turns out, are not too bad.

In the case of trade, LDC graduates may lose eligibility for preferential treatment in several key markets in both developed and emerging economies. Table 2 summarises some of the most relevant duty-free schemes available to LDCs. The most generous of these is, without doubt, the EBA, with its near-universal coverage. Most of the other schemes offer duty-free

Table 2. Trade preference schemes for LDCs in selected markets

Country	Scheme	Coverage
Canada	GSP–LDC Tariff Programme, 2003–	98.8 per cent (excluding dairy, eggs, poultry)
EU	GSP EBA initiative, 2001–	99.8 per cent (excluding arms and ammunition)
Japan	Enhanced DFQF market access, 2007–2021	98.2 per cent of tariff lines (excluding rice, sugar, fishery products, articles of leather)
Korea	Presidential Decree on Preferential Tariff for LDCs, 2000–	95 per cent of tariff lines
USA	GSP Least Developed Beneficiary Developing Countries (LDBDC), 2011–	5,000 products available for duty-free treatment under GSP, of which about 1,500 reserved for LDBDCs
	AGOA – available to 40 designated African countries, of which 26 LDCs, 2000–2025	1,835 products available for duty-free treatment in addition to GSP preferences
	Caribbean Basin Trade Partnership Act – available to 17 beneficiary countries in Central American and the Caribbean, including one LDC, Haiti, 2000–2020	Most products, including textiles and apparel. Haiti enjoys additional trade preferences under special programmes
China	Duty-free treatment for LDCs, 2010–	Between 60 per cent and 97 per cent of tariff lines
India	Duty-free Tariff Preference Scheme, 2008– (revised August 2014)	98 per cent of tariff lines

Source: Laird (2012), author's computation.

coverage on more than 90 per cent of tariff lines. With pervasive exclusion, the USA remains a notable exception. However, even in schemes that claim to provide extensive duty-free coverage, a number of products of export interest to LDCs continue to be excluded. Evidence suggests that excluding only 3 per cent of tariff lines could exclude virtually all of LDC exports (Laborde, 2008).

Of the above-listed countries, as noted earlier, only the EU has extended EBA preferences for three years after graduation, while Canada and the USA provide less flexibility. Unless the other preference-giving countries clarify their position in the next two years, and unless the USA improves its offer, graduating LDCs may be facing the spectre of severe loss of preferences in some of their key markets by 2021. The case of Japan, which imposed most-favoured-nation (MFN) tariffs on the Maldives just six months after the country's graduation in 2011 (CDP, 2012), is a stark reminder of how fast the rules-based system could kick in to hurt newly graduated LDCs in the absence of negotiated smooth transition strategies with major partners.

As regards the EU, while the three-year transition period is welcome, it may not be sufficient. However, the EU offers a few alternatives that could be second-best fall-back options for graduates. Of particular interest is the GSP+ scheme, which offers duty-free treatment on 66 per cent of EU tariff lines and is available for vulnerable low- and lower middle-income countries after they sign and ratify 27 core international conventions related to labour standards, good governance and environmental protection.

The next accessible option for the graduates is the EPAs that the EU has concluded, or is negotiating, with a number of ACP countries, including LDCs and SIDS. The EPAs provide duty-free access to the EU in return for reciprocal trade liberalisation in partner countries. In recently concluded EPAs, the magnitude of tariff cuts has averaged 70 per cent, phased over a fairly long period. For some graduates, this may be a small price to pay to preserve access to the EU market.

Of the six SIDS LDCs that are slated to graduate by 2021, the EU is currently negotiating an EPA with Togo and seven member-states of the Economic Community of Central African States, including a recently graduated LDC (Equatorial Guinea) and a future graduate (São Tomé and Príncipe). In the Pacific, the EU has concluded an EPA with Papua New Guinea and Fiji Islands, to which Samoa (graduated in 2014) and Solomon Islands are negotiating membership. This still leaves out Timor-Leste, Tuvalu and Vanuatu. The last two should consider joining their peer-SIDS in the EU-Pacific EPA negotiations. Timor-Leste, which is not an ACP country, should pursue GSP+ as the only option left under current rules. Whether or not this option is a feasible one, though, is a different question. As a recently graduated LDC, will Timor-Leste have the institutional and diplomatic capability to sign the 27 required conventions – and all that within three years before its graduation becomes effective?

7.3 Other support measures

Smooth transition procedures for other international support measures, such as aid, concessional financing and technical assistance, are also unclear (UNCTAD, 2016). If donors use the LDC criterion in their aid allocation, then graduation could have adverse impacts on aid flows to LDCs. Fortunately, the evidence does not suggest that this is the case: there is no 'LDC effect' in aid allocation (ibid.), meaning that, other things equal, the amount of aid received by an LDC is not significantly different from the amount received by a non-LDC. This corroborates with the evidence that bilateral donors consider a range of factors, including political and strategic ones in addition to the recipient's needs and institutional capacity, in their aid allocation decisions (Alesina and Dollar, 2000).

As regards multilateral donors, all six future SIDS LDC graduates currently enjoy different degrees of access to the concessional financing windows of the World Bank (the International Development Association, IDA) or of their regional development bank: the African Development Bank in the case of São Tomé and Príncipe, and the Asian Development Bank in the case of Kiribati, Solomon Islands, Timor-Leste, Tuvalu and Vanuatu. The last two, as well as Kiribati, and São Tomé and Príncipe, qualify for IDA assistance under the 'small-island exception'; hence, their status will not be affected by graduation. For the other SIDS LDCs, it appears that the relevant criterion is GNI per capita rather than LDC status per se. Since GNI per capita at the time of graduation is unlikely to be much higher than when the country was an LDC, there is no reason to believe that SIDS graduates will face any reduced access to development finance (UNCTAD, 2016).

8. Conclusion

The IPoA target of half of all LDCs meeting the criteria for graduation by 2020 will be missed by a wide margin; nevertheless, 16 LDCs are expected to graduate by 2024. All of them had satisfied the graduation criteria by 2015, many even earlier. Of the 16 LDCs, six are SIDS, which are subject to far greater vulnerability than other LDCs by virtue of their geographical characteristics. Graduation means that LDCs will no longer be eligible for special and differential treatment in trade, and in the allocation of aid and climate finance. To ensure that this does not disrupt graduates' development progress, the UN has proposed, and many development and trade partners have adopted, a smooth transition period during which preferences are phased out gradually, and graduates are assisted to develop coping strategies. Since SIDS LDCs will continue to be SIDS even after they graduate from LDC status, they are in need of greater support.

SIDS have advocated specific S&DT provisions given their unique vulnerabilities. However, they have not been successful on this front, and it is unlikely that existing S&DT provisions will distinguish SIDS from LDCs with a view to according the former additional preferential treatment specific to their particular circumstances. This leads one to ask how SIDS graduates will adapt when they lose the preferences they have long been accustomed to. This paper critically assesses the flexibility afforded by smooth transition and the fall-back options available to graduates, with a focus on SIDS.

Although many trade and development partners have adopted smooth transition measures, these vary markedly among preference-granting countries, creating significant uncertainty for graduates. In the area of trade preferences, the EU has shown the greatest flexibility, offering graduates a grace period of three years during which they continue to benefit from duty-free access to the EU under the EBA. Beyond this period, perhaps the best option for the SIDS is to enter into an Economic Partnership Agreement with the EU. São Tomé and Príncipe, and Solomon Islands are already pursuing this path. Kiribati, Tuvalu and Vanuatu should also consider it. Timor-Leste, the only non-ACP country among the SIDS graduands, is not eligible for an EPA; its best option is to qualify for the GSP+ scheme, which offers duty-free treatment on 66 per cent of EU tariff lines. For trade partners other than the EU, however, the uncertainty remains. LDCs should use their common voice to urge greater predictability in the application of smooth transition procedures.

As regards S&DT in aid allocation, there is little evidence to suggest that graduates will be worse off. The EIF has embraced smooth transition and is currently supporting three graduated LDCs. There is no reason to believe that this practice will change. What may change, however, is the focus of aid-for-trade interventions once graduates lose EIF eligibility. Such aid may be directed to sectors in which they are most needed rather than being limited to institutional support and productive capacity building under the EIF. This may be a welcome development.

The above analysis assumes no action by graduating SIDS and, therefore, represents a worst-case scenario. In practice, these countries are already aware that they will be graduating by 2024. This knowledge, along with the three-year grace period recommended by the UN, and adhered to by several trade and development partners (albeit to varying degrees) give the LDCs significant headroom in planning for their graduation. Future graduates should use this time to invest in productive and institutional capacity building to ready themselves to face competition in global markets without the cover of preferences. The international community stands ready to help in this endeavour.

Notes

1 There is no consistent definition of what a small island developing state is. Even within the United Nations (UN) system, definitions vary. For example, the United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and the Small Island Developing States (UN-OHRLLS) recognises 51 SIDS, the United Nations Conference on Trade and Development (UNCTAD) counts 28, and 41 SIDS are party to the United Nations Framework Convention on Climate Change (UNFCCC). Other international organisations, such as the World Bank, have their own definitions. This paper uses UNCTAD's unofficial list (UNCTAD, n.d.).

2 See UN-OHRLLS (n.d.) for further details on the composition of the indices.

3 The GNI graduation threshold was fixed at US$2,484 at the 2015 triennial review of the CDP.

4 In 2002, the HAI replaced the Augmented Physical Quality of Life Index, which was introduced in 1991 as an indicator of human development.

5 The WTO members are **Antigua and Barbuda**, **Barbados**, Belize, Bolivia, Cuba, Dominica, the Dominican Republic, El Salvador, Ecuador, **Fiji Islands**, **Grenada**, Guatemala, Honduras, **Jamaica**, **Mauritius**, Nicaragua, Panama, **Papua New Guinea**, **St Kitts and Nevis**, **St Lucia**, **St Vincent and the Grenadines**, **Samoa**, **Seychelles**, Sri Lanka, **Tonga**, and **Trinidad and Tobago**. The countries in bold are UNCTAD-recognised SIDS.

6 See WT/DS246/AB/R.2004 – EC Conditions for the Granting of Tariff Preferences to Developing Countries.

7 See, for example, Ancharaz (2015).

8 See http://unctad.org/meetings/en/SessionalDocuments/ares67d221_en.pdf

9 Resolution A/RES/59/209. See http://unohrlls.org/custom-content/uploads/2017/03/ares59_209.pdf

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