Working Smart and Small

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Commonwealth Secretariat

Commonwealth Secretariat
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Contents

List of abbreviations

AGOA	African Growth and Opportunity Act
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BoP	Balance of Payments
BAC	Botswana Accountancy College
BEDIA	Botswana Export Development and Investment Authority
BTA	Botswana Telecommunications Authority
BPO	Business processing outsourcing
CARICOM	Caribbean Community and Common Market
COMESA	Common Market for Eastern and Southern Africa
CI	Concentration index
DIFC	Dubai International Financial Center
ECCB	Eastern Caribbean Central Bank
EPAs	Economic Partnership Agreements
EPZs	Export Processing Zones
EU	European Union
FATS	Foreign affiliate trade in services
FDI	Foreign direct investment
FTAs	Free Trade Agreements
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
ICT	Information and communications technology
IT	Information technology
IAS	International Accounting Standards
IFSC	International Financial Services Center
IMF	International Monetary Fund

ISA	International Standards on Auditing
IRS	Integrated Resort Scheme
JEC	Joint Economic Council
LDC	Least-developed country
MCCI	Mauritian Chamber of Commerce and Industry
MDGs	Millennium Development Goals
MFN	Most favoured nation
OFC	Offshore financial centre
OECD	Organisation for Economic Co-operation and Development
OECS	Organisation of Eastern Caribbean States
PIF	Pacific Islands Forum
PPP	Purchasing power parity
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAPES	Scheme to Attract Professionals for Emerging Sectors
SMEs	Small and medium enterprises
SSA	Sub-Saharan Africa
TLC	Telecommunications
UAE	United Arab Emirates
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
WTO	World Trade Organization
WTTC	World Tourism and Travel Council

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Introduction

This book examines the promotion of knowledge-based and service industries in small states. It was commissioned by the Small States section of the Economic Affairs Division of the Commonwealth Secretariat. This request followed the Small States Agenda proposed in the Commonwealth/World Bank Joint Task Force Report of April 2000. The review of this agenda, entitled 'Toward an outward-oriented development strategy for small states: issues, opportunities and resilience building', was prepared in August 2006. Both reports identify serious challenges for development in small states due to their small size, remoteness and vulnerability. The review suggests that over the past few years, the prospects for small states have deteriorated further due to (future) preference erosion and the emergence of new, large competitors. It proposes that small states need to reposition themselves in the global economy and move into knowledge-based and service industries. Growth strategies in the new competitive environment will also increasingly rely on the promotion of knowledge-based and service industries. The study highlighted in this book suggests how this might be done.

Part I of the book provides an overview of general factors stimulating or constraining the development of services and trade in services in an outward-oriented development strategy in small states. It also identifies key trends in the services sectors of these states. The analysis reveals that for many small states, trade in services, especially tourism-related services, is an important foreign exchange earner. Tourism is highly important for low- and middle-income small states due to their relatively less diversified services as compared to those of the high-income states. Generally, the more developed a country, the more it is engaged in knowledge-based services.

Part II discusses how some small states have promoted knowledge-based and service industries in their economies on the basis of six case studies of countries from different geographical locations and income groups: Botswana, Mauritius, Singapore, St Lucia, United Arab Emirates and Vanuatu. The studies covered the performance and supporting factors in five promising services sectors: financial services; information and communications technology (ICT); educational services; professional business services; and tourism.

The authors pay specific attention to St Lucia. This is a particularly interesting case study as, on the one hand, it offers a successful example compared to the rest of the Organisation of Eastern Caribbean States (OECS). For instance, it has successful event tourism such as carnivals, musical and sports events, and important marina services, information technology (IT) call centres, offshore schools, a cultural foundation and a services coalition. On the other hand, St Lucia also has the potential to benefit by learning from the experience of other successful countries in terms of, for example, developing appropriate human resources for service industries. Developing its services further is particularly important considering that the country faces the constraints listed in the small states report review, including a rapid erosion of preferences (in agriculture).

Part III of the book concludes and provides policy implications, emphasising that it makes economic sense for small states to concentrate on the development of knowledge-intensive services. In order to create a vision for the development of a country's services sector, strong leadership is required. This in turn may cause a change in mind-set throughout the economy towards one that is more competitive and service-dependent. Key factors could also be consistent support from government for knowledge-based services over a number of years or decades, at the same time as maintaining an economy that is flexible to meet new challenges.

Changes in policy might also be required at all levels: in trade negotiations, the development of supply capacity, and building an appropriate domestic regulatory framework. Relationships between the public and private sectors need to be strengthened so that the businesses benefit further from initiatives undertaken by the government. At the same time, engagement with the international economy is crucial, so that lessons can be learnt from other countries – particularly from the experiences of successful small states. In addition, the international community can help by supporting such initiatives and assisting small states technically as well as financially to build the domestic capacity necessary to support the services sectors.

The views presented in this book are those of the authors and do not necessarily represent the views of the Commonwealth Secretariat. The authors are grateful to Constance Vigilance for her support and Maura Felix for organising the consultations. They also appreciate the comments made by officials during consultations in June 2007, as well as the suggestions provided during a Commonwealth Secretariat meeting of High Commissioners in July 2007 and those of an anonymous reviewer.

PART I

The Importance of Services for Small States

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Being small: old and new challenges

Traditional challenges

This chapter reviews the general developmental challenges faced by small states, which relate to their size and location. Earlier literature identifies private sector development, especially in the manufacturing sector, as one of the primary concerns in these states (Winters and Martins, 2005; Briguglio et al., 2006; Pollard, 2007). Due to their small populations, the domestic market size is also small in these countries. As a result, most of the firms in small states are small and medium enterprises with limited opportunities for reaping the benefits of economies of scale and investing in research and development. Hence, unit costs of production are higher as compared to those in larger economies. Also, most small states have a poor investment climate, weak institutions, are remote and lack skilled labour or adequate human capital, which limits access to external capital and constrains industrial development.

Small states are also characterised by lack of competition in product markets. This leads to a misallocation of resources, inefficiencies in production and lack of incentives for innovation. All these factors contribute to high unit production costs for firms in these countries. The high production costs are compounded by high transportation costs due to the remoteness and insularity of many small states. This implies that firms in small states need to charge higher prices to stay in business or else accept lower returns on some part of their costs as compared to those in larger economies.

Winters and Martins (2005) support this view and find that business costs, particularly transport and labour, are significantly higher in small states. Table 2.1 presents their estimated cost disadvantages in transport and labour when compared with a hypothetical median economy with a total population between 10 and 50 million inhabitants. On average, micro (and very small) states face considerably higher size effects, ranging from 22 to 222 per cent. The authors argue that small consignment size, poor infrastructure, lack of competition and weak institutions inflate the costs of trade, and create strong economic disadvantages for these countries.

Table 2.2 presents survey data on business costs according to region, population size and GDP as used by Winters and Martins. The costs of electricity, water and telephone services are higher in micro (population less that 0.4 million) and very small (population between 0.4 and 2 million) states as compared to other countries. Since many countries in the Pacific, Caribbean and sub-Saharan Africa (SSA) are small, these costs are higher there as well.[1] Small states appear to have a greater cost disadvantage in shipping as compared to air transportation. However, the manufacturing labour cost per hour in micro and very small countries is lower as compared to larger countries.

Table 2.1: Estimated cost disadvantages for small economies (%)

Area of cost	*Micro*	*Very small*	*Small*
Airfreight average	31.8	4.1	–1.7
Seafreight average	221.6	71.7	9.4
Unskilled wages average	60.1	31.6	6.6
Semi-skilled wages average	22.4	12.1	2.6
Skilled wages average	38.0	20.3	4.3

Notes: Statistics represent percentage deviation of costs in micro (population<0.4mn), very small (0.4mn<population<2mn) and small economies (2mn<population<10mn) from those in a hypothetical median economy (10mn<population<50mn) based on the econometric analysis conducted by Winters and Martins (2005).

Source: Winters and Martins (2005)

Table 2.2: Survey data on business costs

	Costs of electricity (standard commercial line) in $	*Costs of water (standard commercial line) in $*	*Telephone line rental fee (standard commercial line) in $*	*Telephone rate per min local calls (peak hr.) in $*	*Airfreight cost to London in $*	*Shipping cost to New York in $*	*Manufacturing labour cost per hour in $*
By region*							
Pacific	0.21	3.56	9.3	0.09	798	3,248	1.80
Caribbean	0.16	3.41	20.2	0.06	598	2,977	2.75
SSA	0.37	1.92	6.4	0.12	462	2,706	2.06
LA	0.08	0.62	12.7	0.03	696	1,581	2.86
S. Asia	0.08	0.16	3.7	0.04	387	2,333	0.47
Rest Asia	0.07	0.45	7.4	0.04	709	2,742	2.81
OECD	0.15	1.33	20.0	0.05	446	2,013	13.22
By population							
< 0.4 mn.	0.19	3.86	15.6	0.08	715	3,431	2.61
0.4–2 mn	0.37	0.85	8.20	0.12	517	2,584	0.77
2–10 mn.	0.16	1.94	15.4	0.05	382	1,982	13.6
10–50 mn.	0.13	1.05	11.6	0.06	508	2,240	6.35
> 50 mn.	0.31	1.75	13.0	0.06	867	3,191	12.1
By GDP							
< 0.4 bn.	0.19	4.02	11.0	0.10	818	3,570	2.44
0.4–2 bn	0.17	1.66	11.8	0.03	523	2,687	2.01
2–10 bn.	0.30	2.42	11.2	0.13	433	2,795	0.57
10–50 bn.	0.28	1.14	10.6	0.04	539	1,951	3.57
> 50 bn.	0.09	1.06	16.4	0.05	540	2,186	11.0

Notes: * SSA=sub-Saharan Africa, LA=Latin America, S. Asia=South Asia, bn=billion, mn=million

Source: Winters and Martins (2005)

Industries of small states are price-takers in international markets, and the price they take may be below their average costs (because they cannot exploit economies of scale). A small state's vulnerability to fluctuations in input and output prices is aggravated by its undiversified economic base, which itself is in many cases an outcome of its limited size and the scarcity of human capital.

Table 2.3 provides examples of the high concentration of exports of commodities and services in the Pacific and Caribbean regions. For most economies, the combined share of the first and second commodity/service is over 50 per cent in the total exports of goods and services. Many other small states in different regions exhibit a similar pattern, which indicates the higher vulnerability of these states to internal and external shocks.

Table 2.4 provides a more comprehensive picture of the limited diversification of small economies. Columns (1) and (2) provide information on the number of commodities exported and the concentration index (CI) of small states.[2] The average number of commodities exported by small states in 2003 was 83.79 and the average export concentration index was 0.46. Out of the 51 countries listed below, more than half of the countries exported 50 or less products and 19 had a CI greater than 0.50, which indicates high concentration of the export sector.

Table 2.3: Concentration of export commodities and services (% of total exports, 1997)

Countries	*First commodity or service*	*Second commodity or service*
Pacific		
Fiji	26.3 (tourism)	11.9 (sugar)
Kiribati	34.5 (copra)	18.2 (tourism)
Marshall Islands	38.0 (chilled fish)	7.3 (tourism)
Micronesia, Federal States	40.1 (fish)	9.8 (tourism)
Papua New Guinea	28.3 (gold)	18.7 (crude oil)
Samoa	50.6 (tourism)	4.1 (copra)
Solomon Islands	33.9 (logs)	8.3 (palm oil)
Tonga	28.4 (tourism)	11.9 (squash)
Vanuatu	41.6 (tourism)	14.4 (copra)
Caribbean		
Antigua and Barbuda	61.0 (tourism)	4.6 (re-export of petroleum)
Barbados	54.9 (tourism)	2.8 (sugar)
Belize	27.8 (tourism)	14.2 (sugar)
Guyana	17.9 (sugar)	11.3 (rice)
St Kitts	50.7 (tourism)	12.1 (sugar)
St Lucia	75.6 (tourism)	8.6 (bananas)
St Vincent	43.7 (tourism)	10.5 (bananas)

Source: Commonwealth Secretariat/World Bank Joint Task Force Report (2000)

Table 2.4: Export concentration of small states (2003)

Countries	*Commodities*	*CI*	*Countries*	*Commodities*	*CI*
Antigua & Barbuda	10	0.83	Lesotho	36	0.35
Bahamas	87	0.31	Liberia	13	0.67
Bahrain	127	0.70	Luxembourg	199	0.12
Barbados	96	0.23	Malta	122	0.46
Belize	30	0.39	Maldives	11	0.47
Bhutan	37	0.31	Mauritania	39	0.52
Botswana	121	0.83	Mauritius	157	0.28
Brunei	37	0.30	Namibia	171	0.25
Cape Verde	12	0.48	New Zealand	216	0.16
Central African Rep.	8	0.52	Norway	215	0.42
Comoros	5	0.87	Oman	162	0.67
Congo, Rep.	50	0.72	Panama	76	0.39
Costa Rica	179	0.21	Papua New Guinea	80	0.37
Cyprus	153	0.20	Qatar	119	0.59
Djibouti	31	0.34	Samoa	24	0.68
Dominica	15	0.41	Sao Tome & Principe	8	0.93
Equatorial Guinea	17	0.89			
Seychelles	18	0.72			
Estonia	210	0.12	Singapore	222	0.25
Fiji	96	0.27	Solomon Islands	20	0.65
Gabon	57	0.40	St Kitts & Nevis	17	0.51
Gambia, The	33	0.25	St Lucia	48	0.30
Grenada	22	0.30	St Vincent & the Grenadines	36	0.35
Guinea-Bissau	15	0.76	Suriname	59	0.61
Guyana	76	0.32	Swaziland	144	0.45
Iceland	102	0.37	Tonga	13	0.40
Ireland	221	0.21	Trinidad & Tobago	144	0.36
Jamaica	101	0.63	United Arab Emirates	223	0.49
Kiribati	13	0.85	Uruguay	155	0.20
Kuwait	138	0.64	Vanuatu	14	0.53

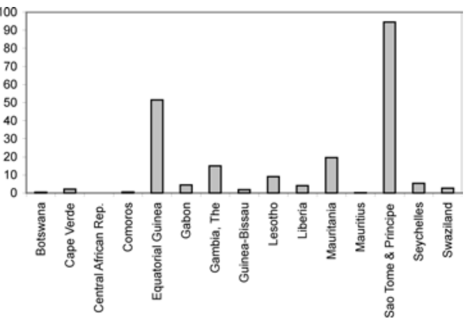
Source: Commonwealth Secretariat (2007)

A weak investment climate, remoteness and excessive exposure to external shocks all act as primary obstacles to attracting investment in these economies. Lack of foreign investment further limits their industrial development and diversification prospects, and creates a vicious circle of declining private sector investment and low diversification. Chart 2.1 presents net foreign direct investment (FDI) flows (as a percentage of GDP) in 2004 to small states in SSA, East Asia and the Pacific, South Asia, the Middle East and North Africa, and Latin America and the Caribbean. Most of the countries in

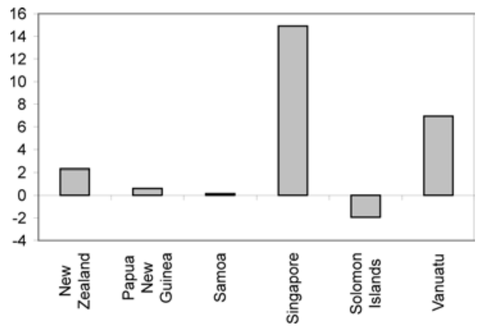
Latin America and the Caribbean have done well in attracting FDI. The average net FDI inflow to small states in the region as a percentage of GDP was 8.2 per cent. However, a majority of countries in other regions appear to have lagged behind significantly.

Limited institutional capacity is another important concern for small states. Small populations and limited economic activity reduce government revenue and constrain the amount governments can spend on public services, human capital, research and development, and strengthening institutions.[3] In addition, a vast majority of small states are remote and located in regions that are prone to natural calamities such as hurricanes and volcanoes (Srinivasan, 1986). These factors hamper economic activity and adversely affect the socio-economic development of these economies.

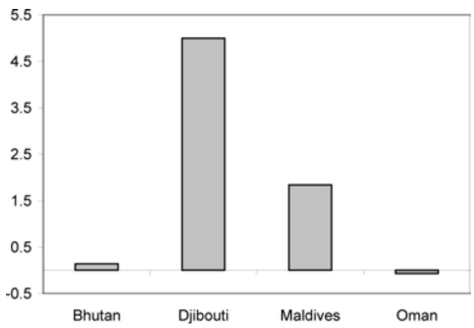
In the context of wider integration, Mattoo and Subramania (2004) argue that small states face systematic problems within the multilateral trading system, despite acquiring significant influence in the system since the Uruguay Round. This is because of



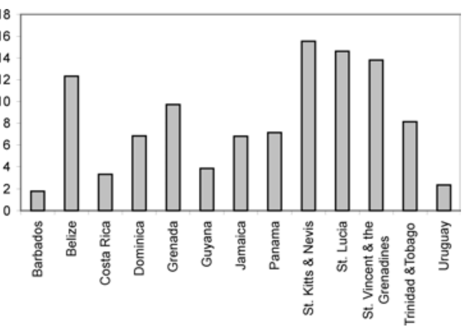
(a) Sub-Saharan Africa



(b) East Asia and the Pacific



(c) South Asia, Middle East & North Africa



(d) Latin America & the Caribbean

Chart 2.1: Net foreign direct investment flows to small states (as a % of GDP) in 2004
Source: Based on World Bank (2006)

their limited bargaining power in trade negotiations and misalignment of their interests with those of the broader trade liberalisation agenda.

New challenges

The Commonwealth Secretariat/World Bank Joint Task Force Report highlighted eight major characteristics of small states. These include remoteness and insularity, a high degree of openness, susceptibility to natural disasters, limited institutional capacity, limited diversification, limited access to external capital, high levels of poverty and inequality, and income volatility. The report focused on four main areas: volatility, vulnerability and natural disasters; strengthening capacity; adapting to changes in the global trading regime; and confronting challenges/availing opportunities from globalisation. It proposed a range of relevant common policy options to tackle these concerns.

The suggested policy options include a combination of correct domestic policy actions, new approaches to regional co-operation, continued external support and assistance from multilateral and bilateral development institutions, and achievable improvements in the external environment. For example, to tackle volatility and economic and environmental vulnerability, it suggests technical and financial donor support. It also highlights the importance of good trade policies, a reduction in regulatory uncertainty and lowering of barriers to exports to increase trade and attract new investment.

The report emphasises that the international community needs to give special consideration to small countries as trade integration continues. To strengthen institutional capacity, both regional and national approaches should be developed. These include providing information to facilitate business decision-making, training, capacity building, strengthening state-business relations and developing competition and regulatory policies. Finally, the report recommends two specific areas for small states to reap the benefits of globalisation and to reposition their economies: (i) strengthening the services sector, and (ii) developing information technology (IT) and electronic commerce. Both these initiatives require appropriate public sector infrastructure and external support from donor countries and multilateral institutions.

The 2006 review of the report finds that in addition to the developmental challenges identified in the initial report, such as remoteness and insularity, vulnerability to natural disasters, limited institutional capacity, a narrow economic base and a high degree of openness, **new** challenges have emerged for small states in recent years. These new challenges are:

- preference erosion for traditional exports;
- international competitive pressures from bigger countries such as China, India and Brazil;
- a rapid increase in the debt burden for various small states;
- increased environmental vulnerabilities;

- youth unemployment;
- security and crime; and
- the HIV/AIDS pandemic.

The review points out that although some small states have implemented aggressive economic reforms, improved the investment climate and governance systems and have strengthened co-operation in regulation and provision of various services, little has been achieved in terms of building resilience to environmental vulnerabilities and introducing natural disaster mitigation and insurance measures. In addition, in many small states progress in economic reforms has been slow and governance and institutions are still weak. However, this is not always the case, as is suggested by the experience of small African countries such as Botswana and Mauritius.

The review suggests that small states need to confront the developmental challenges they face by repositioning themselves in the global economy and creating a comparative advantage in knowledge-based and service industries such as tourism, finance, insurance, health, education and information and communications technology services. This is because some services are less sensitive to high transport and infrastructure costs and provide long-term market prospects. In addition, since these economies tend to have more small and medium-sized firms and no advantages of economies of scale, investing in sectors where demand is relatively price inelastic, such as tourism, will be a good strategy to increase employment, national income and government revenue.

For small countries with high levels of human capital, developing services will help them exploit their comparative advantage based on their skilled labour force. However, in states where the supply of human capital is scarce and educational infrastructure is weak, the review suggests upgrading the education system and increasing the capacity of educational institutions, and replicating the successes of countries such as the Bahamas, Barbados, Malta, Mauritius and Singapore.

The services sector covers a wide range of activities. A well-functioning services sector strengthens employment, productivity and innovation and is key to the overall economic performance of countries (OECD, 2005). It reduces reliance on the agriculture and manufacturing sectors and provides an additional source of growth and employment. Services are even more important for small states given their preference dependence on commodity exports and sensitivity to exogenous shocks, since it helps cushion terms of trade or other macroeconomic shocks. For example, in Singapore the services sector helped to counter the sharp drop in manufacturing output during the recessions of 1981–85, 1996–98 and 2001.[4]

Notes

1. In general, there is high a collinearity between country size, region and insularity (see Winters and Martins, 2005).

2. CI is defined as the sum of the squares of the export shares of each sector and lies between 0 (no concentration) and 1 (maximum concentration).
3. Some small states also experience emigration of skilled workers as skilled labour moves to countries with greater opportunities and higher returns to labour. According to various studies, a significant number of people emigrating from Africa and the Caribbean have tertiary education. However, there are many positive effects of migration including through remittances.
4. Source: Department of Statistics, Singapore, 2001.

3

Opportunities for small states

Despite the obvious disadvantages, some studies suggest reasons for optimism for small states. For example, Spolaore (2004) argues that previous studies like Winters and Martins (2005), might be overestimating the costs of being small. He observes that high costs associated with small size may in reality be due to physical isolation or remoteness and/or other political characteristics rather than actual size.[1] This view is supported by Armstrong et al. (1998) who do not find evidence that growth is determined by population size once initial income and regional effects are taken into account.

The findings of Easterly and Kraay (1999) suggest that small states engaging in international trade do not necessarily have lower incomes and productivity than larger countries. This could be because of the ability of small states to charge above median prices in niche markets, for example, tourism in tropical islands, or because of income transfers/preferential treatment from other countries (see unique products, below). Their analysis further shows that although the per capita GDP growth rates of small states is very volatile, the average growth rate is no lower than that of larger countries.[2] Easterly and Kraay argue that this is because the disadvantages of volatility are outweighed by the advantages of trade openness reaped by these countries, and also because the correlation of their economic fluctuations with world business cycles is low.

Small states have certain advantages because of their size. For example, small initiatives in the right direction and reasonable levels of investment can have a large and quick impact on the social and economic structures of the economy. The competitiveness approach (as in Winters and Martins) focuses on micro foundations of firm performance, and particularly on operating costs. However, there is more to development than firm-level costs. Different market and co-ordination failures exist at aggregate levels that need to be solved, and require effective and flexible action from the public side. This can, at least in theory, be done more effectively in smaller economies (although political systems also matter).

At the same time many small countries have cohesive populations, which allow them to adapt better to change (Kuznet, 1960). Hence, while there are many challenges that small, particularly low-income, states face, there are optimistic arguments about prospects in very small economies. The authors suggest that small states can overcome their inherent cost-based disadvantages (emphasised in the Winters and Martins study) by ensuring to benefit from the following:

Unique products: In the analytical discussions on disadvantages of small states, countries are assumed to produce identical products, that they will never specialise in unique products and that everybody consumes the same products. Clearly products are **not** identical and can be associated with certain brand names (for example, Jamaican rum, St Lucia hotels, Trinidad and Tobago tar and organic bananas from the Organisation of Eastern Caribbean States, OECS). These products are distinct and the price a country charges depends on the distinctiveness or uniqueness of the product (that is, the elasticity of substitution) compared to its competitors as well as on consumer preferences. If consumer preferences are sufficiently rigid, higher prices can offset higher (operating) costs for differentiated products.

Human capital development: Governments need to stimulate human capital development, which is important to increase productivity and innovation and also helps in creating brand names or other 'firm-specific assets'. As is known from the literature, firm-specific assets are amongst the major determinants of outward foreign direct investment (FDI). By using outward FDI, small islands can own the brand name/firm-specific assets while relocating physical production elsewhere, and in this way earn a large return in the form of profits/dividends/interest payments from abroad. The question is how to create relevant firm-specific assets? St Lucia shows that there is no lack of talent in very small economies (for example, Nobel prize winners Sir Arthur Lewis and Derek Walcot make St Lucia the country with the highest density of Nobel prize winners). An alternative is to attract owners of firm-specific assets/brand names to their economies by improving infrastructure and providing various types of incentives.

Improved communications and learning effects: Firms are locked into transactions not only based on cost-efficiency but also on trust and credibility. Seemingly inefficient exports may occur if the involved parties have a good working relationship and/or the costs of switching from a trading partner are high. Thus, firms in small states need to develop good communications and credibility with international firms, and pursue active marketing of their products. Also, over time, clusters of specific industries may form in small economies becoming competitive through learning effects (offsetting other operating cost disadvantages) – but they would not seem efficient on the basis of operating costs alone.

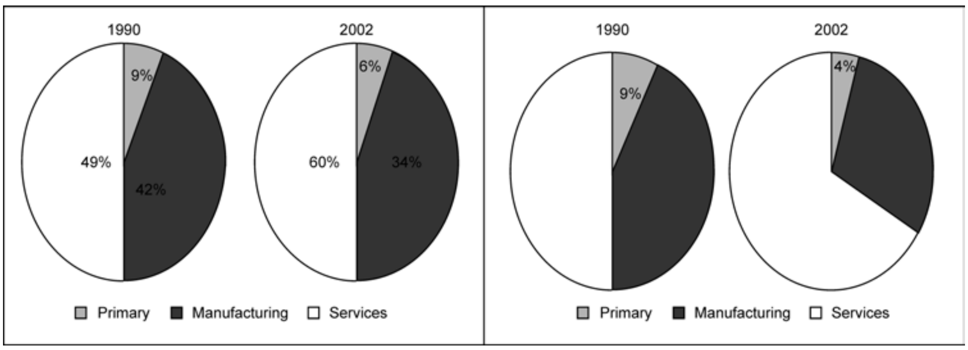
Migration and remittances: People can migrate (in some African, Caribbean and Pacific countries they have done so in great numbers over the past 50 years; such migration is even greater in smaller economies), benefiting the source country in terms of additional exports and inward finance. For instance, workers can migrate, work for more efficient firms abroad and then send back remittances. In fact, such diasporas abroad are linked to the expansion in exports of services, for example, exports of cultural services.

Promoting services: As mentioned earlier, manufacturing is likely to be less competitive in very small economies, because this type of industry is associated with decreasing costs curves (in addition to decreasing cost curves in industries producing manufacturing inputs). However, there are certain activities, for example, education and tourism, where costs are likely to be offset by consumer preferences. Thus, developing a strong services sector can help to counter some of the problems associated with a weak manufacturing sector, spurring employment and income growth.

In fact, considering the buoyant growth in many large economies, especially those in Asia, vast opportunities exist for small states to develop their potential in services. Global demand for knowledge-based business services, that is, services that provide knowledge-intensive inputs to the business processes of other organisations and firms, is growing very quickly as organisations all over the world undertake efforts to adapt to changing technological, economic and social conditions to enhance productivity and competitiveness.[3] Growth in the cross-border outsourcing of knowledge-based business services is estimated to have been increasing at more than 20 per cent in recent years (Conrad, 2007).

Similarly, the demand for quality healthcare, education and tourism is also increasing rapidly. For example, around 25,000 students from China go abroad annually for higher education and this number is expected to rise in the future as the Chinese economy continues to expand. Further, with sustained economic growth, China is predicted to become the fourth largest source of tourists in the world by the World Tourism Organization, with almost 100 million tourists travelling abroad each year by 2020.[4]

Foreign investment in services is also on the rise (see Chart 3.1). The contribution of the services sector to inward and outward world FDI stock increased from 49 per cent to 60 per cent and 47 per cent to 67 per cent, respectively, from 1990 to 2002. In contrast, the shares of both the primary and manufacturing sectors to world FDI stock decreased during the same time period. The United Nations Conference on Trade and Development (UNCTAD) (2004) reports that whereas FDI in manufacturing is increasing in the capital- and technology-intensive sectors, FDI in services is growing in the capital as well as the labour or human resource-intensive sectors. The prospects for a further increase in FDI in services appear to be bright according to the Global Investment Prospects survey conducted by UNCTAD. Most of the respondents to the



(a) Inward FDI stock (b) Outward FDI stock

Chart 3.1: Sectoral distribution of FDI stock in the world, 1990 and 2002
Source: UNCTAD (2004)

survey expected future FDI to be geared more towards services, particularly, transport, banking, and insurance and management.

Small states need to seize new opportunities arising in the services sector, but must also enhance productivity levels in existing services sectors by adopting appropriate policies and reforms relevant to their economies. Since international competition in services is growing, small states should focus on developing those services in which they have a competitive edge, for example, tourism, financial and legal services, education etc.

Notes

1. Winters and Martins (2005) acknowledge in their paper their inability to separate size effects from those of geographical remoteness due to their limited dataset.
2. Easterly and Kraay's definition of small states, which they call as 'microstates', is countries with a total population of one million people or less.
3. Source: *Knowledge-intensive business services – what future?* European Foundation for the improvement of Living and Working Conditions, Ireland. Available online at: http://www.eurofound.europa.eu/emcc/content/source/eu05011a.html [accessed 23 May 2008]
4. Source: *Making Singapore Asia's Leading Provider of World Class Services* (2002) Report of the Economic Review Committee Sub-Committee on Service Industries, Ministry of Trade and Industry, Singapore. Available online at: http://app.mti.gov.sg/data/pages/507/doc/ERC_SVS_Part1.pdf [accessed 23 May 2008]

4

Performance and trends of services and knowledge-based industries in small states

This chapter presents an analysis of the importance of the services sector for small states using typologies according to income (low, middle and high) and geographic location (landlocked, island and others) of small states.

There are various definitions of small states. Total population, GDP and the land size of economies are often used as measures to determine small states. Kuznet (1960), for example, defined small states to be those with a population of less than 10 million. Recently, the Commonwealth Advisory Group (1997) used the limit of 1.5 million people while defining small states.[1] This definition has been used in the Commonwealth Secretariat/World Bank Joint Task Force Report (2000) and in its review.[2] In its latest economic review of small states, *Small States: Economic Review and Basic Statistics*, Volume 11, the Commonwealth Secretariat classified all countries that had a total population of less than 5 million as small states. For consistency purposes, the authors follow the same definition in this document. This gives us 17 more economies as compared to the World Bank's group of small states.[3]

Income levels

To group small states according to their income, the authors use the World Bank's classification of income groups.[4] Table 4.1 presents real GDP per capita (purchasing power parity adjusted) and the annual GDP growth of the three income groups from 1990 to 2005. The average real GDP per capita for all small states increased from US$7,505 in 1990 to US$9,816 in 2005. However, the variation in the real per capita incomes also increased substantially. The average real per capita GDP for low-income states increased from US$387 in 1990 to US$392 in 2005. The increase was much higher for middle-income and high-income small states and their average real per capita GDP rose from US$5,319 to US$7,023 and from US$17,519 to US$29,711, respectively.

There appear to be noticeable differences in the growth rates of small states. The annual GDP growth during 1990–2005 was on average higher for high-income countries as compared to low- and middle-income small states. The overall average growth rate in 1995–2005 was 3.5 per cent, which when compared to the world average of 3.3

Table 4.1: Selected indicators for small states (1990–2005)

	*GDP per capita (constant 2000 US$)**				*GDP growth (annual %)*		
	1990	*1995*	*2000*	*2005*	*1990–94*	*1995–99*	*2000–05*
Low income states							
Bhutan	464	478	555	694	2.9	6.2	7.4
Central African Republic	270	249	252	227	–0.8	3.4	–0.7
Comoros	416	386	377	380	1.2	2.0	2.3
Gambia, The	325	303	320	335	2.6	3.6	3.9
Guinea-Bissau	183	183	158	135	3.5	0.4	–0.1
Liberia	203	57	183	135	–31.0	33.3	–3.4
Mauritania	338	372	409	447	3.2	4.5	4.9
Papua New Guinea	520	689	645	613	8.9	0.9	1.1
Sao Tome and Principe	330	328	332	356	1.6	1.9	3.8
Solomon Islands	820	820	715	647	4.4	2.1	0.8
Timor-Leste	N/A	N/A	404	338	N/A	N/A	N/A
Average of low-income small states	**387**	**386**	**395**	**392**	**–0.4**	**5.8**	**2.0**
Average of low-income group	**1,428**	**1,574**	**1,832**	**2,253**	**3.7**	**5.4**	**5.7**
Middle-income states							
Barbados	13,241	13,047	N/A	N/A	–1.5	3.3	N/A
Belize	4,137	4,912	5,869	6,780	8.1	3.6	6.4
Botswana	5,489	5,792	7,702	9,652	4.5	5.7	5.5
Cape Verde	3,416	3,962	4,859	5,835	3.9	6.6	5.2
Congo, Rep.	968	1,218	958	931	–0.1	1.9	5.0
Costa Rica	6,396	7,200	8,621	8,931	5.4	5.4	3.4
Djibouti	N/A	2,217	1,882	1,805	–1.7	–0.8	2.5
Dominica	4,442	4,898	5,932	5,377	2.2	2.4	–0.5
Equatorial Guinea	1,277	1,584	15,190	N/A	4.8	35.6	9.0
Estonia	8,905	6,829	9,763	14,515	–8.7	5.0	7.6
Fiji	N/A	4,862	4,676	5,329	3.8	2.6	2.2
Gabon	6,171	6,437	6,119	5,839	2.8	2.8	1.8
Grenada	5,542	5,497	7,537	7,354	1.5	5.6	1.0
Guyana	3,443	3,672	4,072	4,041	5.5	4.1	0.0
Jamaica	3,737	3,830	3,651	3,934	2.7	0.3	1.4
Kiribati	N/A	N/A	N/A	N/A	3.5	6.5	0.1
Lesotho	1,288	1,724	2,122	2,472	4.4	3.6	2.6
Mauritius	6,516	7,853	9,672	11,141	5.5	5.4	4.1
Namibia	5,409	5,651	6,058	6,980	4.6	3.6	4.2
Panama	4,587	5,392	6,164	7,052	6.8	4.5	3.9
Samoa	2,854	4,377	4,861	5,917	–1.1	3.9	4.9
Seychelles	12,835	13,769	17,964	14,866	4.5	5.3	–1.1

	GDP per capita (constant 2000 US$)*				GDP growth (annual %)		
St Kitts and Nevis	7,373	9,282	11,225	12,929	3.5	4.4	3.7
St Lucia	5,076	5,528	5,621	5,702	7.4	2.6	1.3
St Vincent and the Grenadines	4,614	4,684	5,334	6,126	2.1	2.7	3.1
Suriname	N/A	N/A	N/A	N/A	–0.3	1.8	4.3
Swaziland	4,223	4,195	4,394	4,595	3.8	3.7	2.2
Tonga	5,159	6,084	6,570	7,197	2.7	1.6	2.7
Trinidad and Tobago	6,949	7,259	8,961	12,306	0.9	4.6	7.4
Uruguay	7,180	8,228	8,781	9,087	4.3	2.2	0.8
Vanuatu	2,396	3,248	3,173	2,930	6.7	1.0	1.2
Average of middle-income small states	**5,319**	**5,629**	**6,705**	**7,023**	**3.0**	**4.5**	**3.2**
Average of middle-income group	**3,972**	**4,318**	**5,134**	**6,535**	**2.6**	**3.8**	**5.1**
High-income states							
Antigua and Barbuda	9,318	8,662	10,022	11,035	3.4	3.2	3.3
Bahamas, The	17,032	14,751	16,962	N/A	–0.3	3.3	1.2
Bahrain	14,691	14,564	15,928	N/A	7.0	4.0	5.8
Cyprus	14,479	16,899	20,318	20,959	4.8	4.0	3.4
Iceland	24,585	23,613	28,929	31,749	0.6	4.0	3.5
Ireland	15,587	19,346	30,532	36,621	4.4	9.7	5.9
Kuwait	N/A	18,225	16,505	N/A	21.2	2.0	6.4
Luxembourg	30,074	37,458	57,792	66,703	4.8	5.6	4.1
Malta	10,859	14,363	18,115	17,479	5.5	4.5	1.1
New Zealand	16,161	18,180	19,615	20,135	2.3	3.0	3.4
Norway	25,641	29,620	34,208	35,956	3.4	3.9	2.0
Oman	10,611	11,979	12,730	N/A	4.9	3.3	3.8
Singapore	14,755	19,512	23,744	26,764	9.1	6.0	5.0
United Arab Emirates	23,950	21,147	20,604	N/A	5.4	5.8	7.4
Average of high-income small states	**17,519**	**19,166**	**23,286**	**29,711**	**5.5**	**4.5**	**4.0**
Average of high-income group	**22,459**	**24,075**	**26,903**	**29,041**	**2.3**	**3.0**	**2.4**

Notes: * = purchasing power parity (PPP) adjusted; N/A= not available

Source: World Bank (2006)

per cent during the same period, suggests that small states performed reasonably well. However, when compared to 1995–2000, the growth rates of low, middle and high-income small states declined in 2000–2005.

Services

Overall, services present a significant part of small state economies, contributing on average over 50 per cent to the GDP during 1990–2004 (see Chart 4.1). In terms of income groups, the share of services in GDP is the highest for high-income small states, followed by middle- and low-income small states. In recent years, there appears to have been a decline in the contribution of services to GDP in high-income states, and a gradual increase in that of low-income states.

Charts 4.2, 4.3 and 4.4 present a detailed comparison between the average shares of the industry and services sectors in GDP for low-, middle-, and high-income small

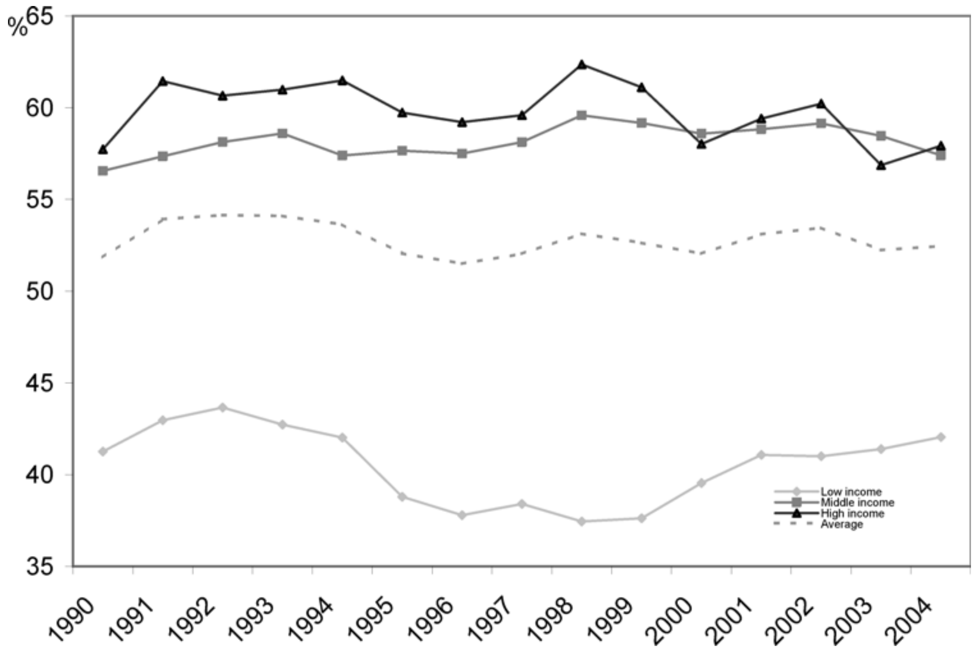


Chart 4.1: Share of services in GDP for small states (1990–2004)

Notes: Low income = Bhutan, Central African Rep., Comoros, Gambia, Guinea-Bissau, Liberia, Mauritania, Papua New Guinea, Sao Tome & Principe, Solomon Islands and Timor-Leste; Middle income = Barbados, Belize, Botswana, Cape Verde, Congo, Djibouti, Dominica, Equatorial Guinea, Estonia, Fiji, Gabon, Grenada, Guyana, Jamaica, Kiribati, Lesotho, Maldives, Mauritius, Namibia, Panama, St Kitts & Nevis, St Lucia, St Vincent & the Grenadines, Samoa, Seychelles, Suriname, Swaziland, Tonga, Trinidad & Tobago, Uruguay, Vanuatu; High income = Antigua & Barbuda, Bahamas, Bahrain, Cyprus, Iceland, Ireland, Kuwait, Luxembourg, Malta, New Zealand, Norway, Oman, Singapore and United Arab Emirates.

Source: Based on World Bank (2006)

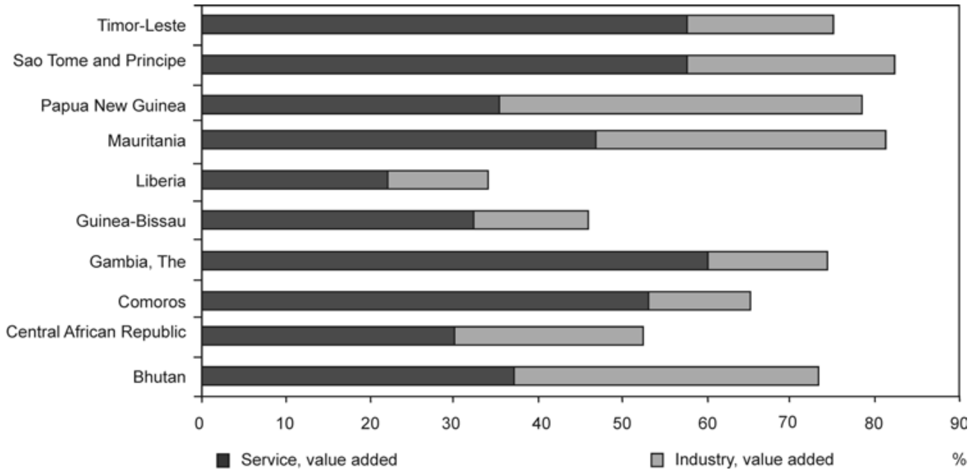


Chart 4.2: Share of GDP for low-income small states, by sector (1990–2004)
Source: Based on World Bank (2006)

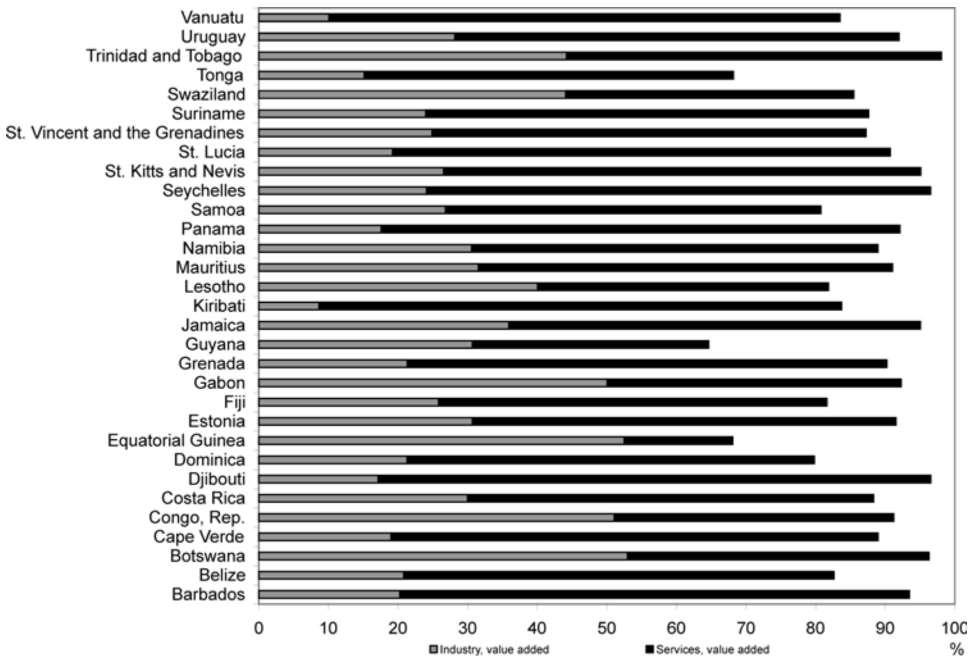


Chart 4.3: Share of GDP for middle-income small states, by sector (1990–2004)
Source: Based on World Bank (2006)

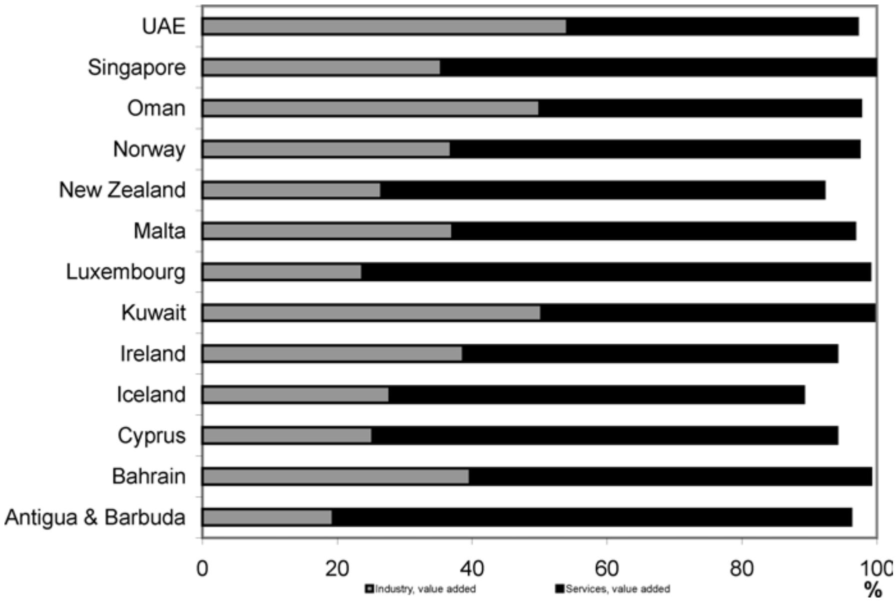


Chart 4.4: Share of GDP for high-income small states, by sector (1990–2004)
Source: Based on World Bank (2006)

states, respectively, during 1990–2004. The overall average share of services to GDP in 1990–2004 for low-, middle- and high-income states was 41, 58 and 61 per cent, respectively. Among the low-income states, only four countries – Sao Tome and Principe, The Gambia, Timor-Leste and Comoros – have a services-to-GDP ratio of about 50 per

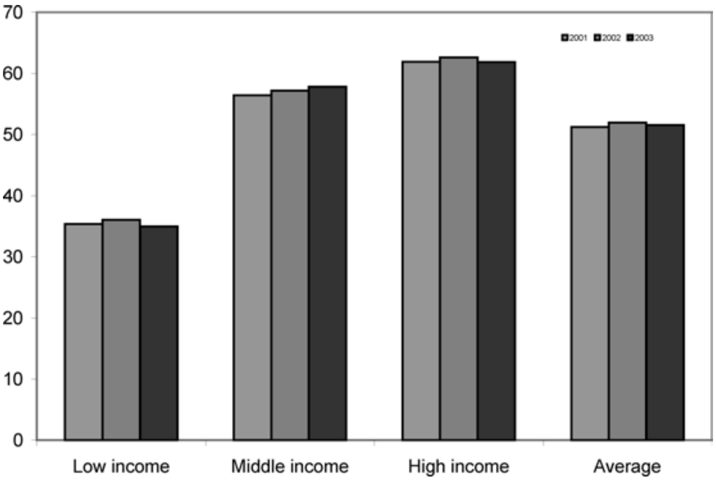


Chart 4.5: Distribution of labour force in services in small states (%)
Source: Based on Commonwealth Secretariat (2007)

cent. However, a majority of middle-income and almost all high-income small states had a high (equal to or greater than 50 per cent) share of services in GDP.

The services sector is also a major source of employment in small states. Chart 4.5 shows that on average 52 per cent of the labour force is engaged in the services sector in small economies. Its contribution to total employment is 35, 58 and 62 per cent in low-, middle- and high-income small economies, respectively. Across the sample, Luxembourg is the country with the highest percentage (77 per cent) and Comoros has the smallest percentage of labour force employed in the services sector (12 per cent).

In terms of geographic location, island small states have the highest share of GDP in services, followed by other small states (that is, those with access to water). The average share during 1990–2004 for island small states was 51 per cent as compared to 46 per cent for landlocked and 49 per cent for others (Chart 4.6).

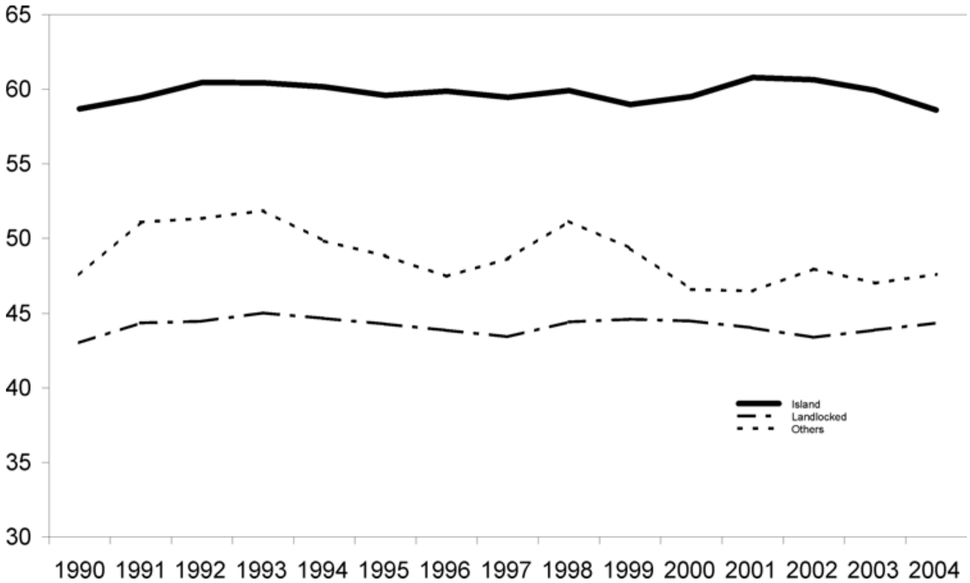


Chart 4.6: Share of services in GDP according to location of small states (%)
Source: Based on World Bank (2006)

The growth of the services sector has been impressive in many small states (see Table 4.2). A majority of countries for which data are available had positive average annual growth rates during the ten-year period from 1995 to 2004. Some countries, for example, Bhutan, Cape Verde, Equatorial Guinea, Mauritania and the United Arab Emirates, reported average annual growth rates of over 6 per cent in the services sector. Both island and landlocked small states recorded growth rates of around 3.5 per cent whereas others grew at 3 per cent. The average growth rate of services in small states was 3.6 per cent during 1995–2003 as compared to 3.1 per cent for the world.

Table 4.2: Growth rate of value-added services in small states (%)

	1990–94	*1995–99*	*2000–04*
Low-income states			
Bhutan	2.7	9.5	7.6
Central African Rep.	–5.5	3.2	–11.1
Comoros	0.9	0.5	–2.1
Gambia, The	4.6	3.3	5.2
Guinea-Bissau	2.9	–1.2	3.2
Mauritania	4.1	6.1	8.4
Papua New Guinea	3.6	–0.1	–0.9
Sao Tome and Principe	0.2	1.0	4.3
Timor-Leste	N/A	N/A	7.1
Average of low-income small states	1.7	2.8	2.5
Average of low-income states	4.4	6.9	6.7
Middle-income states			
Barbados	–1.4	2.4	2.4
Belize	7.5	3.7	7.6
Botswana	8.4	7.0	4.8
Cape Verde	5.6	6.8	5.5
Congo, Rep.	–1.1	–0.5	6.3
Costa Rica	5.3	4.1	4.9
Djibouti	–1.0	0.7	1.6
Dominica	3.6	3.5	7.7
Equatorial Guinea	6.9	12.8	7.5
Estonia	–2.3	5.5	6.2
Fiji	2.9	4.2	2.7
Gabon	3.0	4.2	0.5
Grenada	3.4	4.6	1.3
Guyana	2.3	3.4	1.9
Jamaica	4.1	1.5	1.7
Kiribati	6.1	5.1	–0.9
Lesotho	4.7	3.9	2.4
Mauritius	6.4	6.3	5.8
Namibia	5.4	3.9	4.4
Panama	5.9	4.5	4.4
Samoa	N/A	7.7	6.6
Seychelles	4.1	3.0	–1.9
St Kitts & Nevis	5.5	4.0	1.1
St Lucia	4.4	3.3	0.7
St Vincent & the Grenadines	5.3	5.0	2.3
Suriname	0.0	2.7	2.9
Swaziland	4.4	3.5	3.7

	1990–94	1995–99	2000–04
Tonga	2.0	2.6	–5.8
Trinidad & Tobago	0.7	4.1	5.1
Uruguay	6.5	2.8	–0.8
Vanuatu	9.2	1.5	–1.0
Average of middle-income small states	3.9	4.1	2.9
Average of all middle-income countries	3.6	3.7	4.6
High-income states			
Antigua and Barbuda	4.6	2.5	1.8
Cyprus	6.2	N/A	N/A
Iceland	1.4	5.4	3.3
Kuwait	N/A	3.0	9.0
Luxembourg	5.9	6.2	4.0
New Zealand	2.4	3.5	3.8
Norway	2.7	4.8	2.8
Oman	7.4	3.8	5.6
Singapore	N/A	N/A	8.3
United Arab Emirates	5.9	7.4	8.0
Average of high-income small states	4.6	4.6	5.2
Average of all high-income countries	2.4	3.3	2.4

Source: World Bank (2006)

Trade in services

Trade in services presents a significant share of GDP for most small states (see Table 4.3). The average share of trade in services of GDP was 39 per cent in 1990–2004 with the highest for high-income countries (47 per cent) and island small states (46 per cent) and the lowest for low-income states (29 per cent). However, the average statistics mask the underlying large variation in data, where the values ranged from 142 per cent (for Luxembourg) to 11 per cent (for Oman). The correlation between the share of trade in services in GDP with real per capita income (PPP adjusted) of small states is 0.4, which indicates that high per capita income is associated with greater trade in services.

The services sector also plays an important role in the foreign exchange earnings of small states. The share of exports of services in total trade is the highest for middle-income states, and the lowest for low-income states (see Chart 4.7).[5] For middle-income states, the share of exports of services in total trade was in the range of 40–45 per cent in 1990–2004 whereas it was between 30–40 per cent and 25–35 per cent for high- and low-income small states, respectively.

Table 4.3: Trade in services as a percentage of GDP (1990–2004)

Low income	*Trade in services*	*Middle income*	*Trade in services*
Central African Republic	14.9	Barbados	60.3
Comoros	30.7	Belize	36.4
Gambia, The	41.7	Botswana	14.8
Guinea-Bissau	14.9	Cape Verde	31.0
Mauritania	19.5	Congo, Rep.	37.3
Papua New Guinea	24.4	Costa Rica	18.3
Sao Tome & Principe	45.1	Djibouti	52.1
Solomon Islands	44.2	Dominica	47.6
Average for low-income small states	**29.4**	Equatorial Guinea	38.5
High income		Estonia	34.9
Antigua and Barbuda	97.2	Fiji	49.8
Bahamas, The	60.6	Gabon	22.5
Bahrain	22.3	Grenada	52.0
Cyprus	53.9	Guyana	43.1
Iceland	22.7	Jamaica	43.1
Ireland	38.4	Kiribati	93.8
Kuwait	25.1	Lesotho	13.1
Luxembourg	142.3	Maldives	74.7
Malta	52.1	Mauritius	38.8
New Zealand	15.1	Namibia	21.3
Norway	19.5	Panama	30.1
Oman	10.6	Samoa	49.0
Singapore	59.9	Seychelles	70.6
Average for high-income small states	46.6	St Kitts and Nevis	58.5
Geographic location		St Lucia	63.9
Island small states	46.3	St Vincent & the Grenadines	50.7
Landlocked small states	40.1	Suriname	34.8
Other small states	29.3	Swaziland	29.0
Tonga	15.7		
Trinidad and Tobago	13.8		
Uruguay	11.1		
Vanuatu	59.9		
Average for mid-income small states	41.0		

Notes: Values represent the average of available data during 1990–2004; *Source*: Based on World Bank (2006)

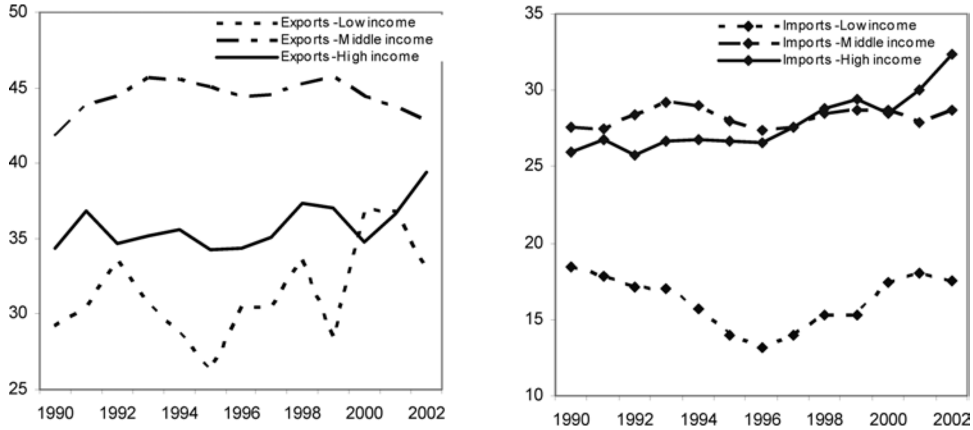


Chart 4.7: Share of export and import of services in total trade (1990–2004) (%)

Notes: Low-income states include Bhutan, Central African Rep., Comoros, Gambia, Guinea-Bissau, Mauritania, Papua New Guinea, Sao Tome & Principe and Solomon Islands; Middle-income states include Barbados, Belize, Botswana, Cape Verde, Congo, Djibouti, Dominica, Equatorial Guinea, Estonia, Fiji, Gabon, Grenada, Guyana, Jamaica, Kiribati, Lesotho, Maldives, Mauritius, Namibia, Panama, St Kitts & Nevis, St Lucia, St Vincent & the Grenadines, Samoa, Seychelles, Suriname, Swaziland, Tonga, Trinidad & Tobago, Uruguay and Vanuatu; High-income states include Antigua & Barbuda, Bahamas, Bahrain, Cyprus, Iceland, Ireland, Kuwait, Luxembourg, Malta, New Zealand, Norway, Oman and Singapore.

Source: Based on UNCTAD (2005)

Table 4.4 presents the export of different types of services categorised into three groups: transport, travel and other services, for the three income groups. For each country the authors report the average share of the export of these services in total service exports during 1990–2004. In all cases, the share of travel services is the highest as compared to other types of services. However, on average it appears to be more important for low- and middle-income states, since around 50 per cent of their service exports comprise travel services. In the case of high-income economies, travel is closely followed by transport services and their combined share is over 70 per cent of total service exports. When looking at individual countries, the authors observe that the share of travel services is greater than 50 per cent for 29 countries whereas the shares of transport, insurance and financial, and computer, communications and other services are greater than 50 per cent for seven, one and three countries, respectively.

Foreign direct investment

It is instructive to examine FDI in small and island states in order to assess what sectors attract FDI (taking the Caribbean as an example). Tables 4.5–4.7 present the

Table 4.4: Services by sector (% of service exports) for small states (1990–2004)

	Transport [a)]	*Travel* [b)]	*Insurance & financial* [c,d)]	*Others* [e)]
Low-income states				
Central African Rep.	38.7	22.5	24.2	14.7
Comoros	28.7	65.4	0.0	5.9
Gambia, The	12.7	81.6	0.1	5.6
Guinea-Bissau	9.2	43.3	2.5	69.4
Mauritania	15.1	70.5	0.0	14.4
Papua New Guinea	7.7	6.1	1.9	84.4
Sao Tome & Principe	4.5	72.4	4.3	18.8
Average	16.7	51.7	4.7	30.5
Middle income				
Barbados	2.0	72.7	11.7	13.7
Belize	9.9	68.7	0.4	21.0
Botswana	18.8	69.9	4.2	7.1
Cape Verde	53.2	28.6	0.5	17.7
Congo, Rep.	38.7	14.1	0.8	46.4
Costa Rica	14.4	62.3	0.3	23.0
Djibouti	61.9	17.9	0.0	20.3
Dominica	9.6	61.0	4.8	24.6
Estonia	51.5	30.8	0.9	16.8
Fiji	31.3	53.2	1.9	13.6
Gabon	45.1	6.7	7.6	40.5
Grenada	4.5	72.4	3.3	19.9
Guyana	10.9	43.2	6.3	41.6
Jamaica	16.4	70.0	1.2	12.4
Kiribati	20.5	9.0	1.3	69.2
Lesotho	5.1	62.9	0.1	31.9
Mauritius	25.6	53.4	1.5	19.5
Namibia	13.9	86.5	2.0	6.9
Panama	59.1	22.7	7.7	10.4
Samoa	7.3	63.9	0.4	28.3
Seychelles	39.7	57.2	0.8	2.3
St Kitts & Nevis	7.8	75.8	4.2	12.3
St Lucia	6.1	86.3	1.4	6.3
St Vincent & the Grenadines	7.7	67.8	5.9	18.6
Suriname	42.8	12.6	0.5	44.2
Swaziland	18.5	37.2	6.6	37.7
Tonga	27.9	56.8	0.3	15.1
Trinidad & Tobago	43.5	31.3	6.3	19.0
Uruguay	30.8	50.7	5.2	13.3

	Transport [a]	*Travel* [b]	*Insurance & financial* [c,d]	*Others* [e]
Vanuatu	17.8	57.1	3.6	21.5
Average	24.7	50.1	3.1	22.5
High income				
Antigua & Barbuda	17.6	71.3	2.6	8.6
Bahamas	N/A	N/A	0.0	7.8
Bahrain	42.7	48.4	0.0	8.9
Cyprus	18.6	56.2	4.2	22.4
Iceland	50.7	27.3	1.1	21.0
Ireland	16.5	29.5	10.4	43.7
Kuwait	82.7	12.0	4.2	1.1
Luxembourg	6.8	11.8	63.3	18.1
Malta	25.6	60.4	2.3	11.7
New Zealand	32.3	51.7	0.2	15.9
Norway	60.2	13.8	3.2	22.9
Oman	48.0	63.9	0.8	4.3
Singapore	30.0	23.7	5.3	41.0
Average	36.0	39.2	7.5	17.5

Notes: a) Transport services cover all transport services performed by residents for non-residents involving the carriage of passengers, movement of goods, rental of carriers with crew, and related support and auxiliary services; b) Travel services cover goods and services acquired from an economy by travellers in that economy for their own use during personal or business visits of less than one year; c) Insurance and financial services cover freight insurance on goods exported and other direct insurance such as life insurance; financial intermediation services such as commissions, foreign exchange transactions and brokerage services; and auxiliary services such as financial market operational and regulatory services; d) Zero values indicate that either the data was unreported or combined with another service category; e) Other services include international telecommunications, postal and courier; computer data; international news-related service transactions; construction services; royalties and licence fees; miscellaneous business, professional and technical services; and personal, cultural and recreational services.

Source: Based on World Bank (2006)

distribution of FDI in the Caribbean countries and Table 4.8 gives an overview of the strategies of the foreign investors in the region. The main message from these tables is that FDI is going increasingly to the services sector. There are a few exceptions to this such as the bauxite, gold and timber industry in Guyana, oil and gas in Trinidad and Tobago, and apparel in Jamaica and the Dominican Republic. FDI inflow in services is mainly towards hotels, telecommunications (OECS), IT (Jamaica) and financial services (Jamaica, Barbados and Bahamas).

Table 4.5: FDI in the Organisation of Eastern Caribbean States (OECS)

	Type of FDI: approximate distribution 1998–2003*	*Main investor countries*
Anguilla	Tourism (90%) Manufacturing	US, Italy, Caribbean
Antigua	Tourism 37% Construction Commercial	US, UK, Caribbean
Dominica	Tourism (46%) Agri-business	Caribbean, US, Canada
Grenada	Tourism (51%) Sporting Education	US, Caribbean
St Kitts and Nevis	Tourism (86%) Banking	Canada, US
St Lucia	Tourism (56%)	US, Caribbean
St Vincent	Tourism (87%)	Italy, UK, US

Notes: * Excludes land sales and reinvested earnings
Source: Eastern Caribbean Central Bank

Table 4.6: Sectoral distribution of inward FDI

	Dominican Republic			*Guyana*			*Jamaica*		*Trinidad and Tobago*		
	1990	*1995*	*1999*	*1992*	*1995*	*1999*	*1998*	*2000*	*1990*	*1995*	*2000*
Primary	3.5	2.5	1.6	90.5	35.6	74.9	43.0	38.4	58.5	90.0	90.3
Secondary	37.4	29.2	27.2	0.2	21.0	0.7	22.0	9.5			
Tertiary	59.1	68.3	71.2	9.3	43.4	24.4	34.0	52.7	39.7	11.4	15.3

Source: ECLAC (2003)

Further data from UNCTAD on the distribution of FDI inflows to small countries across different regions shows that FDI inflows have increased in the tertiary (services) sector and decreased especially in the primary sector. Such FDI, especially when directed towards export-oriented services, offers various economic benefits to the host economies, including increased export earnings and job creation, higher returns to labour and upgrading of skills (UNCTAD, 2004).

Table 4.7: Sectoral pattern and source of FDI in the Caribbean Community and Common Market (CARICOM)

Country	*Main sectoral and industrial recipients of FDI*	*Main sources of FDI*
Bahamas, The	Tourism, financial services and infrastructure	Belgium, France, Germany, USA, Hong Kong, UK, USA, Netherlands
Barbados	Tourism, agriculture, manufacturing, financial services and informatics	Canada, UK, USA
Belize	Agriculture/mariculture (shrimp farming) manufacturing (agro-processing), tourism and infrastructure (telecommunications)	China, Taiwan, UK, USA
Guyana	Mining (gold), forestry, infrastructure (power and telecommunications) and trade	Canada, South Korea/Malaysia, UK, US Virgin Islands
Jamaica	Tourism, mining and manufacturing	Canada UK, USA Caribbean,
OECS	Agriculture, tourism and manufacturing	UK, USA, other European countries, particularly Italy
Suriname	Mining and manufacturing	The Netherlands, USA
Trinidad and Tobago	Energy (petroleum and petrochemicals, natural gas) electricity, transportation and communications, and manufacturing	Asia, Spain, UK, USA

Source: ECLAC (2003)

Table 4.8: Strategies of foreign investors in the 1990s in the Caribbean

	Corporate strategy		
Sector	*Resource-seeking*	*Efficiency*	*Market-seeking*
Primary	Oil/Gas (Trinidad and Tobago); Bauxite (Guyana and Jamaica); Aluminium (Jamaica); Gold (Guyana); Timber (Guyana)		
Manufacturing		Apparel (Jamaica, Dominican Republic and Haiti)	
Services			Financial (Jamaica, Barbados, Bahamas, St Lucia); Tourism (Jamaica, Barbados, Bahamas, OECS); Telecommunications (OECS, Guyana, Jamaica, Trinidad and Tobago, Dominican Rep.); Electricity (Dominican Republic, Guyana); IT (Jamaica)

Source: ECLAC (2003)

Notes

1. Although their populations are larger than 1.5 million, Jamaica, Lesotho, Namibia and Papua New Guinea were included because of the similarity of their characteristics with small states.
2. These reports consider developing and transition member countries of the World Bank only.
3. See Appendix for the list of countries included in this report. Marshall Islands, Federal States of Micronesia and Palau are not included in the analysis due to lack of sufficient data.
4. According to World Bank's income classification, economies are divided according to 2005 Gross National Income (GNI) per capita. The groups are: low income, $875 or less; lower middle income, $876–$3,465; upper middle income, $3,466–$10,725; and high income, $10,726 or more. See http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20421402~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html#High_income [accessed 23 May 2008]
5. The share of export of services in total trade for individual small states is presented in the Appendix.

5

Developing trade in services: a framework

Towards a framework

Developing trade in services is a complicated process and many countries do not have an explicit policy for this area or a detailed, overall plan to develop trade in services. Trade in services, a catalyst to promote economic diversification away from traditional sectors, involves a fundamental shift in mindset throughout the whole economy along with different types of actions. Here small countries might be at an advantage, because in theory they are more flexible to introduce new economic policies (though this will also depend on political systems).

The constraints to trade in services are complex and go beyond traditional trade constraints. A policy-relevant approach is to distinguish among three sets of constraints (te Velde, 2006). These include:

- supply-side or domestic capacity constraints;
- the domestic regulatory and institutional framework; and
- external constraints (for example, international trade in services agreements).

This approach is useful for several reasons. First, it provides an analytical lens and can be used to identify the myriad of constraints to trade in services. Second, it delineates clear responsibilities for different stakeholders involved. Co-ordination between the public and private sectors is required to ensure that the constraints identified are properly tackled. Finally, unlike in the case of trade in goods, domestic regulatory frameworks can be a key. Thus, the approach points to what types of interventions are appropriate. In Section 6, the authors examine the performance of exports of services in a number of sectors in Botswana, Mauritius, St Lucia, Singapore, the United Arab Emirates and Vanuatu in the context of these three sets of constraints.

(i) Supply-side constraints

Supply-side constraints on the export capacity include:

- **Size**: The limited size of the domestic market raises the need to increase market access to reap the economies of scale. Some services have a minimum efficient scale, which is greater than the size of the domestic market in many small states.

- **Information:** A majority of exporters of services in small states are small-scale producers (Chaitoo, 2007). These exporters operate on a small scale and face a lack of information on markets and regulations. In addition, they are unable to market their products, which may lead to a lack of information on the consumer's side as well. Services products are often 'experience' goods, where sales depend on a track record of international credibility and profile. It can take time to build up international repute and credibility, especially because the fixed costs of establishing credibility are relatively costly for small services providers.
- **Technology**: Exporters in small states have limited access to (new) technology, which reduces their competitive edge.
- **Financial resources**: Service providers, especially those operating at a small scale, face constraints to access financial resources.
- **Human resources**: Some services, such as professional business, financial and educational services, are skill intensive and require appropriately trained staff. However, most small states have a poor tertiary education record and/or high rates of emigration, which severely limits the availability of human resources.
- **Infrastructure**: Small states are typically characterised by a weak physical infrastructure (such as unpaved roads, underdeveloped ports, poor connections by air etc.) and poor information and communications technology (ICT). Poor infrastructural facilities restrict domestic as well as foreign investment in the economy.

(ii) Domestic regulatory framework

The regulatory framework in small states is generally out of date and in some cases – for instance, when new sectors such as offshore schools or recreational activities emerge – an appropriate regulatory framework might be entirely absent. Standard operational matters are tedious for businesses with heavy reporting and administrative requirements. It is often difficult and time consuming to register a new company and in many cases regulations do not permit certain types of business operations.

Various government departments are involved in regulating and developing services for exports, and need to co-ordinate their activities. In order to achieve a welcoming investment climate, co-ordination is required not only among government agencies but also between the public and private sectors on regulatory issues relevant for export of services.

(iii) External constraints (trade barriers)

Following Hoekman and Braga (1997), trade barriers can be grouped into the following[1]:

- Quotas (for example, the number of flights on a route may be restricted);
- Local content and prohibitions (for example, production activities and supplies may be restricted to nationals only);

- Price-based instruments (for example, visa fees and entry/exit taxes or subsidies), which tend to hit small traders more than large scale traders;
- Standards and accreditation requirements (for example, non-recognition of degrees/certificates/diplomas obtained in foreign countries);
- Licensing and procurement requirements;
- Discriminatory access to distribution networks; and
- No commitment on mode 4 of supply of services (modes of supply are explained below).

Promising services sectors

Services can be grouped into various categories. The General Agreement on Trade in Services (GATS) defines around 160 service sub-sectors and groups them into four broad categories:

i) Infrastructure services (for example, communications, financial, transport and energy);

ii) Social services (for example, education and health);

iii) Business-type services (for example, distribution, professional, tourism, construction, engineering and environmental services); and

iv) Other services (for example, recreational and cultural).

Services can be delivered to other countries in four ways, known as modes of supply. These are:

- **Mode 1: Cross-border supply**. Cross-border supply occurs when a service crosses a national border. An example is the online purchase of insurance or software by a consumer from a producer abroad. This is included in the Balance of Payments (BoP) of a country. World trade in this mode amounted to US$1,000 billion in 2000 according to WTO estimates.
- **Mode 2: Consumption abroad**. Consumption abroad occurs when a consumer travels abroad to consume from the service supplier as with tourism, education or health services. This is also included in the national BoP statistics. World trade in this mode amounted to US$500 billion in 2000.
- **Mode 3: Commercial presence**. Commercial presence refers to the services sold by a foreign-owned company in the host economy (for example, services provided by the branches of foreign banks). These services are not included in BoP data, but are sometimes added to the foreign affiliate trade in services (FATS) statistics. World trade in this mode was estimated to be US$2,000 billion in 2000.
- **Mode 4: Temporary movement of natural persons**. Temporary movement of natural persons occurs when independent service providers or employees of a

multinational firm temporarily move to another country to provide services. This is not captured by trade data, but is often proxied by compensation of employees and remittances in the BoP statistics. World trade in this mode was estimated to be US$500 million in 2000.

Not all service categories are suitable for exporting and some services need large markets to operate. Some examples of existing successful service exporters are listed in Table 5.1, which also includes small states in certain sectors, for example, Mauritius in tourism and finance, and the Caribbean in tourism, offshore medical schools and health-related services.

Key services differ across countries according to their comparative advantage. There are several ways to identify such services in small countries, and the following indicators are important:

Table 5.1 Examples of successful developing country service exporters

		Examples in developing countries
1)	Business services	India is the main Business Processing Outsourcing (BPO) centre, but the exports of various African countries such as Mauritius, Ghana and South Africa have also increased
2)	Communication services	Only few examples of successful international expansion in the telecommunications sector in Africa, mainly from large developing economies that are able to exploit large domestic markets (for example, South Africa and Egypt)
3)	Construction and engineering services	South Africa in the US
4)	Distributional services	South Africa in rest of Africa
5)	Educational services	South Africa and Brazil as regional hubs for tertiary education, and the Caribbean islands for offshore medical schools
6)	Financial services	Financial services exports from Mauritius and the Caribbean
8)	Health and social services	South Africa, India, Thailand and the Caribbean are important competitors at the international level
9)	Travel-related services	Several successful examples in developing countries, where tourism is one of the main export sectors (for example, the Caribbean countries, Mauritius, Tanzania and Kenya)
10)	Recreational, cultural and sporting services	South Africa as a sports event organiser
11)	Transport services	Air cargo hub developed by Kenya and South Africa

- **Current or potential capacity to export**. This depends on, among others:
  - the local and export market size and the growth potential;
  - land, labour and other resource availability and cost;
  - capacity of production expansion; and
  - transportation costs and availability.
- **Competitiveness vis-à-vis other exporters of services.** For instance, India and South Africa have had strong growth in IT-enabled services, and small states need to compete with them. Similarly, Philippines, South Africa, India and others are actively training nurses to work overseas.
- **Sectoral developments in the import markets**. For example, moves towards offshoring services or concentration in tour operators.

Based on these indicators, a number of services could be identified as important for small states. For example, research in the context of the Caribbean (for example, te Velde, 2005b) shows the significance of:

Tourism: The World Tourism and Travel Council (WTTC) finds that tourism contributes 15 per cent to GDP and 16 per cent to employment in the Caribbean region. It is the main foreign exchange earner in many Caribbean countries, which export different types of tourism, ranging from mass tourism (for example, in Barbados) and cruise ships (several islands and Belize) to eco-tourism (for example, Suriname and Belize) and cultural tourism.

Financial services: The offshore financial sector has contributed significantly to the exports and GDP of the Caribbean region. For example, in the early 1990s, the sector contributed about 24 per cent to services exports and 2 per cent to GDP.

Education services: There are more than 100 partnerships between Caribbean and UK/US institutes. There are many medical offshore schools in the region (Brandon, 2003). Education services are also supplied through (temporary) movement of people – for example, Caribbean countries were responsible for 10 per cent of non-European Union (EU) work permits for teachers in the UK during 2001-2003.

Health services: The importance of health tourism (for example, surgery) is well known for the Caribbean region.

Business IT services: The market for offshore services such as IT and other back-office operations is increasing rapidly worldwide. The Caribbean has made inroads in the sector, exporting mainly to the US. Jamaica's export processing zones (EPZs) include about 15 companies, which employ over 5,000 workers in areas such as helpdesks, travel reservations and software development. A few Jamaican companies also specialise in data processing, servicing customers in New York, Toronto and London. Trinidad and Tobago has also entered the market for offshore services. It has a number of call centres employing around 1,000 workers. St Lucia has a major call centre (employing more than 200 workers) with plans for expansion.

Cultural services: Three types of cultural services are emerging in the Caribbean:

i. Music: The music industry in the Eastern Caribbean based on festival tourism is worth US$ 20 million, of which the St Lucia Jazz Festival contributes about US$ 14 million. Jamaican Reggae was estimated to be worth US$ 1.2 billion in 1995 and the music industry in Barbados, which has grown with the success of soca artists, is estimated to be worth US$ 15 million.

ii. Street festivals: Street festivals are a frequent event in the Caribbean. In recent years, they have also increased in foreign countries, for example, London hosts an annual Notting Hill Carnival.

iii. Film and video production: Film shooting by overseas production companies for entertainment purposes has also increased in the Caribbean. The government encourages and invites foreign companies to shoot films in the region.

Links between services sectors and other sectors

Growth strategies in small states have in the past been based on agriculture and to some extent manufacturing, although to be sure, services have for a long time been a component of growth in many small states anyway. A growth strategy based on services, where appropriate, would often imply a shift in thinking – as the authors argue in the conclusions. However, this does not mean that other sectors will be or should be neglected, either implicitly or explicitly. Explicitly, because a growth strategy based primarily on developing services could be complemented by strategies to also improve the contribution of agriculture to growth, e.g. by promoting eco-friendly bananas in St Lucia or nutmeg in Granada. And implicitly, because the promotion of services may also help other sectors such as agriculture through direct and indirect linkages.

The authors outline below the direct and indirect linkages between tourism and the rest of the economy, notably agriculture below, but one can also envisage linkages between other services sectors and the rest of the economy.

There are quite a lot of examples of direct linkages between tourism and agriculture. Hotels and restaurants, whose revenues are a key source of (foreign) income for many small states, make large food and drinks expenditures. Although it is well known that some types of food and drinks are imported, there is also considerable scope for local suppliers to sell their goods to hotels and restaurants. This includes locally-supplied food, but also fruit and fruit juices, rum and flowers. There are case studies that show how local initiatives may boost inputs provided by local farmers (see for example, the Overseas Development Institute [ODI]-Pro-Poor Tourism [PPT], 2004). Hotels and restaurants also need electronics, furniture and other manufactured goods, some of which are niche products (tailor-made accommodation or furniture); in some cases these can become export products in their own right.

There are also indirect effects. Econometric studies (Lejaragga and Walkenhorst, 2006) capture the dynamic effects of tourism on growth and these studies suggest that growth can be tourism-led, and in some cases tourism contributes more to growth than some traditional sectors. The effects of tourism are greater the poorer the country, suggesting that tourism is a first step towards diversification; however, as countries become more developed they move increasingly into higher value-added sectors. The indirect effects of tourism on the rest of the economy work through infrastructure (for example, air travel or roads); human resource development (for example, training of the workforce); diversification; and private sector development (especially small and medium enterprise [SME] development and entrepreneurship linkages).

For instance, Subramanian and Matthijs (2007) point to the dynamic effects of tourism. Increased air travel for tourism reduces the cost of airfreight from African countries to Europe and provided new transport opportunities for small quantities of fresh products. Tourism also increases local demand for high quality fruit and vegetables and provides an outlet for produce not meeting export standards. More generally, they argue that by positioning itself as a relatively close and attractive holiday destination, the gain for sub-Saharan Africa could not just be direct (in terms of tourism services, hotels, restaurants etc.) but also indirect: the fact that more and more direct flights arrive in African airports makes transport cheaper and export markets more readily accessible for African goods. This argument is very important for small countries, which would face greater isolation from world markets without flights for tourists.

The management, entrepreneurial and other skills that the tourism sector, and especially hotels with links to foreign business, provides constitute important long-run effects of tourism. Within the hotel industry, there is a trend towards greater investment in staff training, with up to 1 per cent of revenue being earmarked for this purpose. Some of this training is general and helps to build skills relevant for other sectors if and when workers move across sectors.

What all of this suggests is that the development of services can help other sectors, and in many cases already does, and in other cases linkages might be improved by supportive interventions.

Next steps: country case studies

In the next part of the book, the authors review how some small states have developed their knowledge-based and service industries in the context of the framework discussed in this section. Hence, they analyse the experience of Botswana, Mauritius, St Lucia, Singapore, the United Arab Emirates and Vanuatu – small countries that have successfully developed one or more services sectors – and examine their performance in the following five promising service sectors:

- Financial services;
- Education services;
- Tourism services;
- IT-enabled services; and
- Professional business services.

For example, Botswana and Mauritius are working towards making their countries the regional hub for financial services. Singapore has been immensely successful in attracting foreign business schools and developing a strong educational services sector and also becoming an international hub for other services such as finance, IT-related services, transport and tourism. St Lucia is actively promoting tourism, especially event tourism, and also hosts an IT call centre. The UAE is an emerging success story that is in the process of diversifying its economy to rely heavily on knowledge-based services. Vanuatu is an important example for other Pacific countries that face numerous economic and environmental challenges due to their small size and remote geographic location. The case studies illustrate the key public policies and economic conditions that have successfully helped to remove constraints to the development of service industries in these countries, distinguishing among domestic capacity constraints, domestic regulatory constraints and external constraints. They also discuss the challenges that still remain.

Note

1. Non-trade related external constraints also exist such as the level of competition abroad.

PART II

Country Case Studies on Developing Trade in Services in Small States

6

Botswana[1]

Botswana is a landlocked country located in sub-Saharan Africa (SSA) with a real per capita GDP (purchasing power parity [PPP]-adjusted) of US$9,652 and a total population of 1.8 million in 2005. It has experienced one of the most impressive growth rates in the world over the last four decades and had the highest rate of per capita growth in the world between 1965 and 1998. The average annual GDP growth rate since the 1990s has been 5.3 per cent (Chart 6.1).

Services are an important part of the economy, contributing more than 45 per cent to GDP. The share of services has risen steadily, particularly during the 1990s (Chart 6.2). The services sector of Botswana is diverse. It ranges from small services, which make a negligible contribution to employment (for example, environmental and recreational, cultural and sporting services) to large sectors providing a high contribution to employment and GDP (for example, construction) and substantial exports (for example,

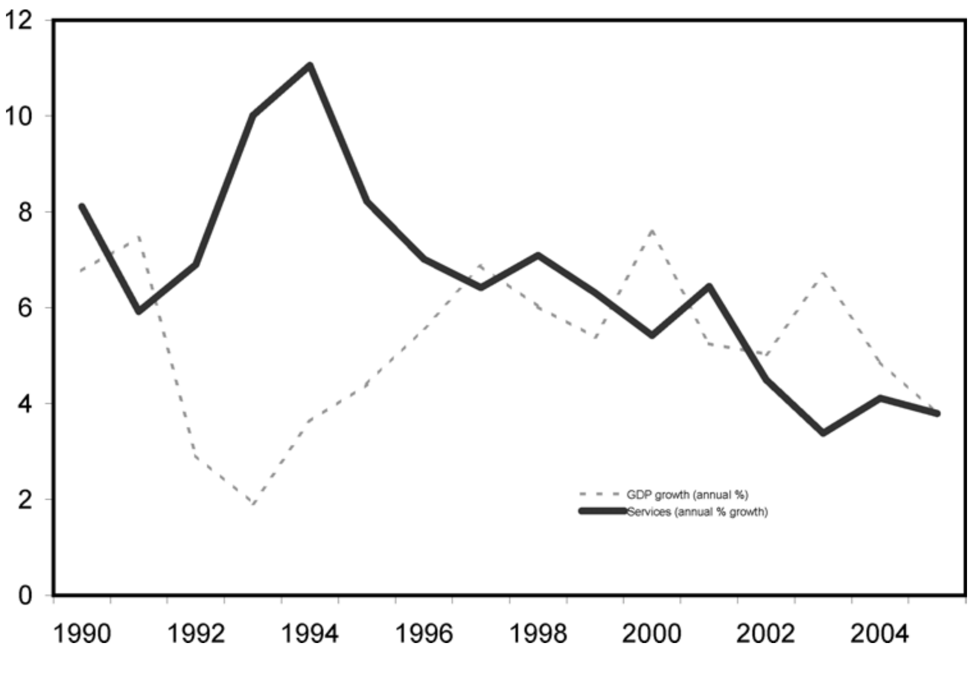


Chart 6.1: Annual growth of services in Botswana (%)
Source: Based on World Bank (2006)

tourism). Of the various types of services, the contribution of general government services to GDP is the highest followed by business and then trade, hotels and restaurant services (Table 6.1).

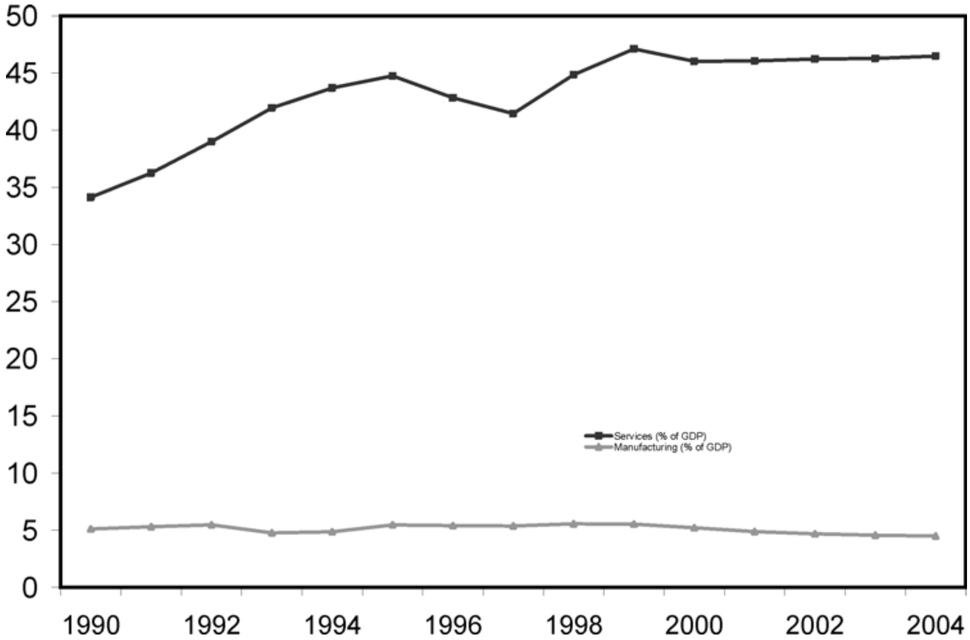


Chart 6.2: Contribution of services to GDP in Botswana (%)
Source: Based on World Bank (2006)

Table 6.1: GDP composition by services in Botswana (% of value added)

Services	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05
Water & electricity	2.1	2.1	2.0	2.1	2.2	2.1	2.2	2.2	2.3	2.1
Construction	6.2	6.2	5.7	5.9	5.6	5.2	5.4	5.0	4.9	4.5
Trade, hotels & restaurants	9.9	10.7	9.8	9.6	9.5	9.3	9.9	9.8	10.6	9.1
Transport, post & TLC	3.6	3.6	3.4	3.7	3.6	3.3	3.4	3.1	2.9	2.8
Business services	11.1	10.8	10.3	10.5	10.2	9.8	10.4	9.7	9.6	9.2
General government	15.4	15.8	15.1	15	14.8	14.5	15.4	16.1	16.4	15.6
Social & personal services	4.4	4.4	4.0	4.0	3.9	3.6	3.8	3.6	3.7	3.4

Note: Year runs from July-June
Source: Bank of Botswana (2005)

The importance and potential of the services sector in Botswana is underlined by its significant contribution to employment (61 per cent of total employment and 75 per cent of female employment). The largest private and parastatal employers include commerce and construction, which are also among the most labour-intensive services in the economy. The contribution of commerce in total employment has steadily grown in the last decade, whereas it has remained fairly constant for other sectors.

While total trade as a percentage of GDP has declined since the mid-1990s, trade in services as a percentage of GDP has increased (Chart 6.4). The share of both export and import of services has increased in the country's total trade in the last two decades, but the rise in the share of exports is particularly impressive, increasing from 9 per cent in 1985 to 17 per cent in 2002. Botswana now appears to be in transition from a net importer to a net exporter of services (see Table 6.2). In 1996, Botswana's exports of services were less than half of its imports; however, the trend reversed in 2005 when exports exceeded imports. This expansion of trade in services is not surprising considering that Botswana is a small landlocked country for whom trade in manufacturing is

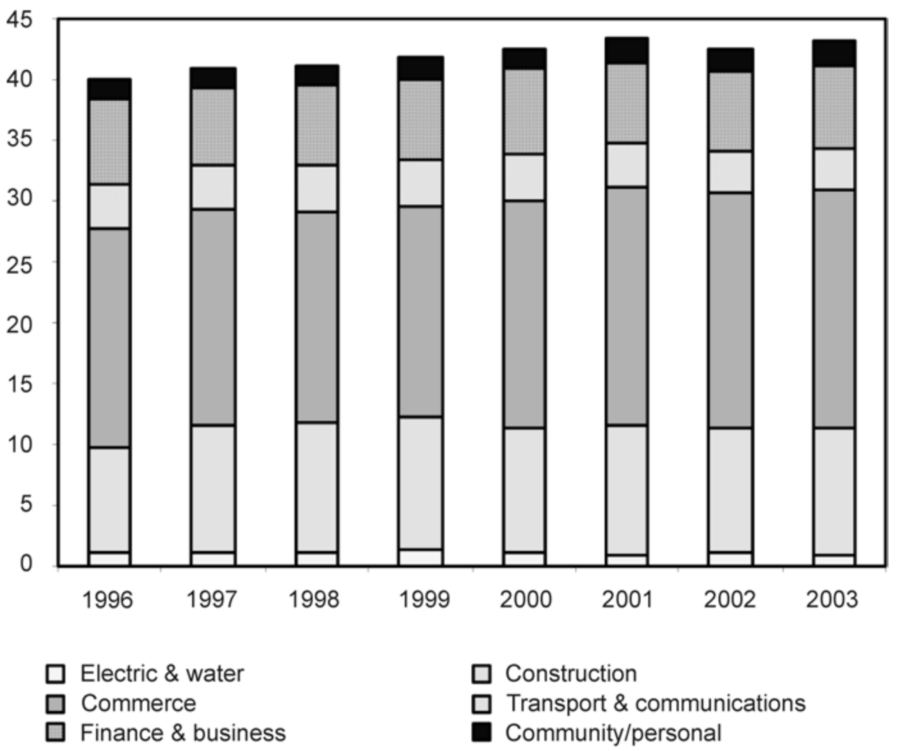


Chart 6.3: Sectoral employment for services in Botswana (%)
Note: Charts cover the private and parastatal sectors
Source: Based on statistical information in te Velde and Cali (2007)

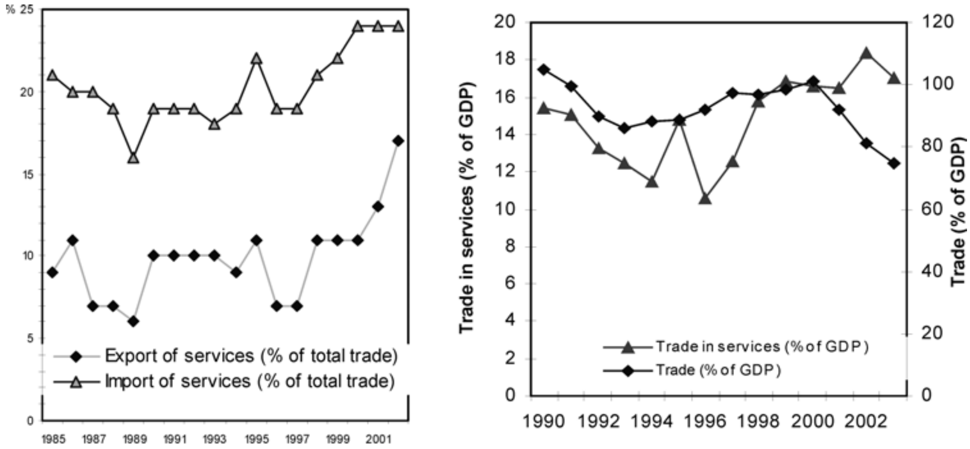


Chart 6.4: Trade in services in Botswana (%)
Source: Based on World Bank (2006) and UNCTAD (2005)

expensive. This is because of high production costs, which are affected by the market size, and high transportation costs, which are affected by inaccessibility to sea.

In Botswana, foreign direct investment (FDI) has been playing an increasingly important role in the promotion of crucial service sectors, such as business, financial services and tourism. The share of the service sectors in inward FDI is increasing, while

Table 6.2: Botswana's trade in services (US$ million)

	1996	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*[1]
Services	**−602**	**−841**	**−988**	**−721**	**−1,136**	**−1,010**	**−182**	**−46**	**−204**	**165**
Export	541	767	1,270	1,706	1,657	2,083	3,108	3,184	3,511	4,497
Import	1,143	1,609	2,258	2,427	2,793	3,093	3,290	3,230	3,715	4,332
Transport	−467	−638	−693	−750	−888	−900	−1,054	−887	−977	−1,304
Export	133	138	210	251	265	308	351	342	390	434
Import	599	776	903	1,001	1,152	1,208	1,405	1,228	1,366	1,738
Travel	52	157	303	404	125	151	856	1,124	1,282	1,428
Export	310	495	903	1,083	1,134	1,345	2,019	2,261	2,578	2,871
Import	258	337	600	679	1,009	1,193	1,163	1,137	1,296	1,444
Other services	−188	−361	−599	−375	−373	−261	16	−284	−509	−34
Export	98	135	156	372	259	431	738	581	544	1,191
Import	286	496	755	747	632	692	722	865	1,053	1,150

Note: 1) Revised estimates
Source: Bank of Botswana (2005)

that of mining is decreasing, although the latter is still the largest recipient of FDI. Overall, services captured 36 per cent of the total FDI stock in 2004 and 90 per cent of non-mining foreign investments. The reallocation of FDI from mining to services is in part due to the divesture of one of the largest mining companies in Botswana, and in part due to the increasing inflows, especially in finance and to a lesser extent in hospitality (linked to the tourism industry) (Bank of Botswana, 2005). The role of the retail and wholesale sectors in attracting FDI is also important, while transport and communications and utilities have increased their weight marginally (and may increase with possible privatisations).

Performance of selected services

Financial services

The financial services sector is the largest service sector in value of export revenues after travel-related and transport services, and is also an important contributor to GDP and total employment in Botswana. The direct contribution of the sector to GDP was 4.5 per cent in 2004–05 according to estimates provided by Bank of Botswana.

Trade in financial services has grown substantially over recent years, indicating large potential in this sector. Financial services exports, both as a percentage of GDP and commercial service exports, from Botswana have risen consistently since 1996 (Charts 6.5 and 6.6).

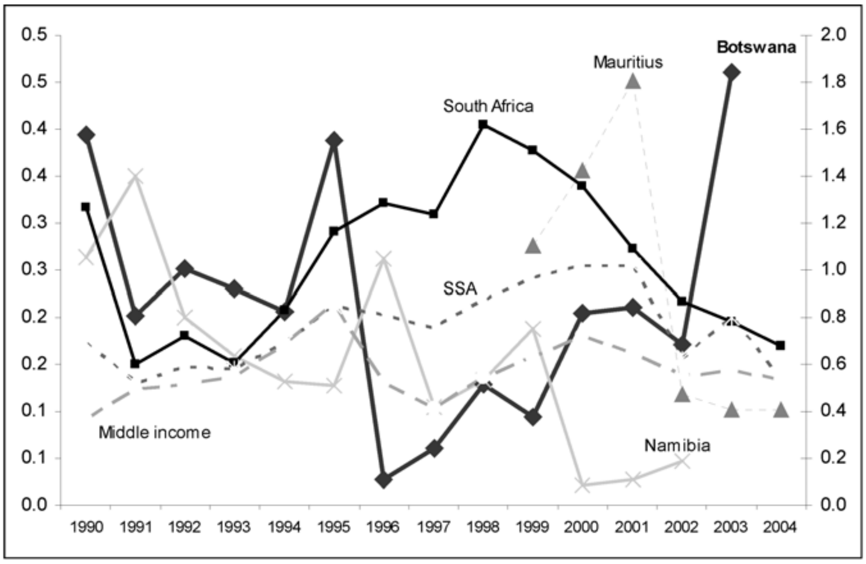


Chart 6.5: Financial services exports (% of GDP)
Note: values for Mauritius are on the right axis
Source: te Velde and Cali (2007)

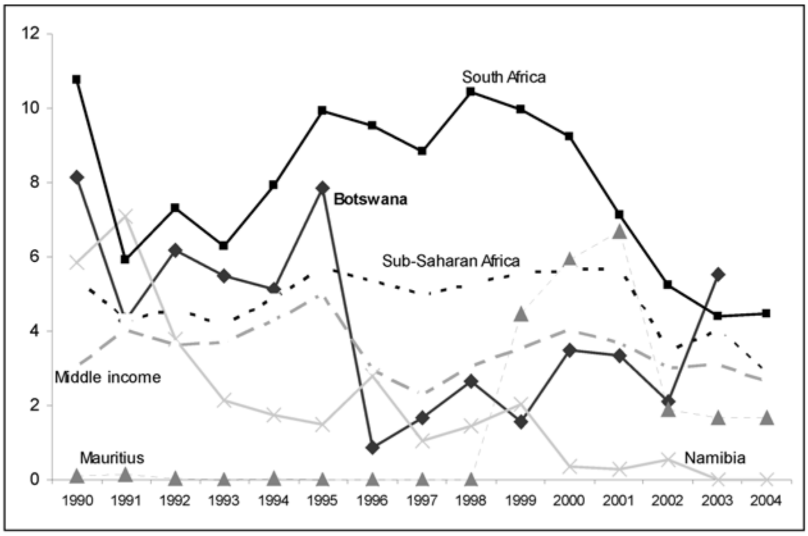


Chart 6.6: Financial services exports (% of GDP)
Source: te Velde and Cali (2007)

Financial services exports occur in three main categories: insurance services, traditional banking services and back-office services. In Botswana, insurance services is the largest sub-sector in terms of trade (in 2005, the worth of exports and imports was 173 million pula [P] and 135 million pula, respectively). Trade in banking and other financial services is significantly less, with P23 million worth of exports and P15 million of imports in 2005. However, importantly, 2005 was the first year in which Botswana experienced a trade surplus in this category.

The level and share of FDI in financial services has also risen steadily; however, it is still a small part of total FDI and non-mining FDI (Table 6.4). Financial services

Table 6.3: Botswana's trade in financial and insurance services in pula (thousands)

		1997	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*
Insurance	Exports	6,132	13,962	16,702	33,463	47,357	50,084	172,960	231,578	172,812
Insurance	Imports	62,315	67,409	80,460	93,359	78,967	90,024	106,567	191,067	134,963
Other financial services	Exports	5,399	13,025	5,345	21,128	16,438	8,612	11,506	17,266	23,175
Other financial services	Imports	8,576	14,142	17,934	14,161	18,384	19,949	27,390	26,688	14,545

Note: Charts corresponding to exports (imports) refer to foreign currency purchases (sales) reported by banks
Source: Bank of Botswana (2005)

Table 6.4: FDI stock in financial services in pula (millions)

	1999		*2000*		*2002*		*2003*		*2004*	
	Equity	*Total*	*Equity*	*Total*	*Equity*	*Total*	*Equity*	*Total*	*Equity*	*Total*
Finance	466	523	516	619	648	803	718	873	931	931

Source: Bank of Botswana (2005)

represented 0.2 per cent of total FDI in 2004 as compared to less than 0.1 per cent in 1998. However, its share in non-mining FDI rose from 0.2 per cent in 1998 to 0.5 per cent in 2004.

Educational and health services

In Botswana, primary and secondary enrolment ratios are high. However, the tertiary education sector, which plays a vital role in the economic development of a country by ensuring an adequate set of skills for the economy's needs, is rather underdeveloped. In a country of approximately 1.7 million people, tertiary student education enrolment is only 27,000 (te Velde and Cali, 2007).

Botswana's exports of education services are low, but imports are very high hence it is a fairly large net importer of educational services (especially from South Africa). The Botswana government supports students abroad, compensating for the lack of good quality and appropriate opportunities locally. The estimated value of imports of education services for Botswana is worth P1 billion in government expenditure. This may even be bigger if one considers the private component of this spending (e.g. private firms sponsoring scholarships, providing family support etc.).

Estimates for exports, which include living expenses of students, were around P21.5 million in 2004 (see Table 6.5). This value represents the bulk of Botswana's exports in educational services and has doubled over the past five years.

The direct weight of the tertiary education in GDP is likely to be relatively low as education is typically a non-commercial service in Botswana. The fairly widespread basic education is likely to keep pressure on the demand for tertiary education in

Table 6.5: Estimated costs paid to the University of Botswana by foreign students (pula)

	1999	*2000*	*2001*	*2002*	*2003*	*2004*
Tuition	5,650,800	8,079,000	7,671,400	11,050,100	12,258,600	12,241,550
Other fees	329,378	367,008	468,285	563,677	600,860	593,460
Living expenses	4,838,044	5,840,116	5,959,221	8,621,835	9,241,060	8,706,550
TOTAL	10,818,222	14,286,124	14,098,906	20,235,612	22,100,520	21,541,560
Foreign students (number and % in total)	854 (8.4%)	922 (7.9%)	801 (6.4%)	1,037 (7.8%)	997 (6.4%)	885 (5.7%)

Source: te Velde and Cali (2007)

Botswana. The contribution of the sector to total employment (private and parastatal) is limited (about 2.5 per cent in 2005), albeit increasing.

The direct impact of the health sector on GDP (through sector value added) is likely to be relatively significant, although its contribution is limited by the fact that it is not recorded at market prices as it is mainly publicly provided. Its contribution to GDP is recorded under *social and personal services*, which amounted to 3.4 per cent in 2004–05. The indirect impact of health services to the economy is probably much more important, as labour efficiency crucially dependss on health conditions.

Trade in health is mainly recorded as travel-related activities and in remittance flows. Given the paucity of data available, the authors are not able to estimate the size of health-related exports and imports; nevertheless assessments suggest that imports are higher than exports in health-related services (te Velde and Cali, 2006).

Tourism

Tourism is a very important sector for Botswana. It has experienced rapid growth over the past few years, with the number of licensed tourist establishments rising from 100 in 1998 to 226 in 2003.[2] The tourism industry is the most important service sector in terms of obtaining foreign exchange, and one of the most important sectors for its contribution to employment and GDP.

The direct effects of the tourism industry on the economy are substantial. A study by the Botswana Tourism Department in 1998 showed that, depending on the method used for calculation (that is, the expenditure or output approach), tourism contributed between 3–5 per cent to GDP in 1997. Since tourist expenditures have increased at higher rates than the overall economic growth rate during the past eight years, it is estimated that the sector's contribution to GDP has grown to more than 5 per cent now. The indirect effects of tourism on the economy are also considered to be substantial. According to the estimates of the World Travel and Tourism Council, the total contribution of tourism to Botswana's economy is around 8 per cent and the sector is responsible for providing over 9 per cent of total employment.

The share of tourism exports has increased substantially over time (Chart 6.7). Table 6.6 shows that the number of visitors to Botswana has doubled and their expenditure (in current US dollars) has almost trebled since 1990. According to estimates, around 88 per cent of the tourists are African, whereas the rest are from other countries including the US, UK, Germany, Netherlands, Australia and France.

Table 6.6: Selected tourism indicators for Botswana, 1990–2004

	1990	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
Arrivals of visitors (thousands)	543	521	512	607	750	843	1,104	1,049	1,037
Visitors' expenditures (millions of $)	117	162	93	136	175	234	222	230	319

Source: UNCTAD (2005)

Chart 6.7: Trade of travel services in total services trade of Botswana, 1980–2002 (%)

Notes: Travel services covers goods and services acquired from an economy by travellers in that economy for their own use during visits of less than one year for business or personal purposes.

Source: Based on UNCTAD (2005)

Information and communications technology services

The information and communications technology services sector has a slightly declining and fairly low direct importance in Botswana's GDP. The weight of the postal and telecommunications sectors was around 1.2 per cent in 2004–05 (Bank of Botswana, 2005). Given the rapid spread of mobile telecommunications throughout the country in recent years (there are currently three times the number of mobile phones compared to fixed lines), this is surprisingly lower than the average share of the previous ten years (1.4 per cent). Part of the explanation of the decline in the value of the sector may lie in the lower prices charged by telephone operators following the increased competition in the sector.

The indirect effect of the sector on the economy is potentially large, as communication services (and telecommunications in particular) are crucial inputs into various sectors (especially services) of the economy. The total share in employment of the transport and communications sector was about 4 per cent in 2003, with around half estimated to be in the communications sector.

Trade in communications and IT-related services have grown rapidly according to balance of payments data obtained from Bank of Botswana (2005). However, Botswana continues to be a net importer of computer services as well as communication services (see Table 6.7). In 2005, it had net imports of about P25 million and P96 million for computer-related services and communications respectively.

Table 6.7: Botswana's trade in IT and communications services (in pula, thousands)

		1997	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*
Computer services	Exports	61	171	49	109	2,278	11,043	8,193	1,778	5,376
Computer services	Imports	1,148	1,261	9,207	13,407	25,271	23,886	30,131	33,654	30,015
Communications	Exports	72	2,048	2,989	1,857	31,466	61,466	46,586	37,712	85,552
Communications	Imports	5,774	12,968	12,121	54,167	24,342	38,494	70,695	99,778	181,338

Note: Charts corresponding to exports (imports) refer to foreign currency purchases (sales) reported by banks

Source: Bank of Botswana (2005)

Professional business services

Data from the Bank of Botswana indicate a significant, albeit declining, direct importance of the professional business services sector (measured as real estate and business services) in GDP, which was around 3.4 per cent in 2004–05. This share is lower than the average towards the end of the 1990s, which was around 4 per cent. In terms of the sectoral share in employment, the only data available aggregates the sector with financial services. The total was 6.7 per cent in 2003, from which the share of business services may be estimated to be around 3 per cent, keeping the same proportion as that of the share in GDP between the two sectors.

Since this is a very heterogeneous services sector, and boundaries with other services sectors are unclear, it is difficult to obtain a precise picture of trade in the various subsectors. However, according to estimates obtained from Botswana's balance of payments data, exports of business services increased remarkably from 110 million pula (P) in 2004 to P543 million in 2005.[3] Around P464 million of these exports are estimated to be from mining-related services (due to De Beers' explorations). If the authors take out this seasonal component (which is related to traditional exports) exports in this sector are a modest P79 million. This is higher than the P67 million equivalent figure for 2004, but much lower than the P142 million in 2002. The import of professional business-related services in 2005 amounted to P377 million taking into account mining-related services and P228 million without mining-related services.

Supporting factors

Trade in services and the development of a services sector is affected by a number of factors including: supply-side or domestic capacity constraints; the domestic regulatory and institutional framework; and external constraints (that is, trade in services agreements). This sub-section provides a general overview of these factors for services in Botswana.

Domestic capacity and skills

Botswana enjoys a relatively good position in information and communications technology infrastructure with respect to other SSA countries (see Table 6.8). However, it seems to lag behind other countries in the same income group. The real concern for Botswana in terms of regional competition appears to be related to the high price of its ICT services, especially for international long distance telephone calls. Also, its ICT infrastructure is not sufficient for applications that require high amount of data transfer, such as centralised back-office operations of financial companies.

Botswana has a better road infrastructure than other SSA countries, and this has improved over the years. In 1990, 32 per cent of the total road network was paved; this increased to 48 per cent in 1995 (World Bank, 2006).

In terms of education, Botswana enjoys high levels of secondary education relative to most of its neighbouring countries (Table 6.9). Notwithstanding the general high level of basic education, Botswana still has relatively low rates of tertiary education and this has resulted in a deficit of specific skills (UNCTAD, 2003). The rapid pace of structural changes in the economy has prevented the educational system matching the needs of the various sectors of the economy, while the high incidence of HIV/AIDS is clearly exacerbating the skills deficit. This is creating problems for attracting FDI, particularly in financial services, since big financial companies find it very difficult to hire enough appropriately skilled workers. Entrepreneurialism is also lacking outside of the diamonds industry. This is also evident from the fact that the private banks in Botswana hardly lend to the private sector.

Table 6.8: ICT indicators for Botswana (2004)

	Botswana	*SSA*	*Upper-middle income group*
Access			
Telephone main lines per 1,000 people	79	17	220
International voice traffic (min. per person)	64		39
Mobile subscribers per 1,000 people	348	86	490
Population covered by mobile telephony (%)	85		84
Internet users (per 1,000 people)	25	15	133
Personal computers (per 1,000 people)	41	12	99
Quality			
International internet bandwidth (bits per person)	23	4	176
Affordability			
Price basket for fixed line (US$ per month, residential)	11.3	8.5	13.9
Price basket for mobile (US$ per month)	11.1	13.5	11.1
Price basket for Internet (US$ per month)	27	54.8	20.8
Price of call to United States (US$ per 3 minutes)	2.88	2.43	1.03

Source: World Bank (2006)

Table 6.9: Net enrolment rates (%) in Southern African countries (2004)

	Primary	*Secondary*	*Tertiary*
Botswana	82.1	60.9	6.2
Lesotho	85.9	23.1	2.8*
Mauritius	95.1	79.6	17.2
Namibia	73.7*	37.4*	6.1*
South Africa	88.8*	61.7**	15.3*
Swaziland	76.7*	29.0*	5.0
Zimbabwe	81.9*	33.9*	3.7*

Notes: * Charts are for 2003; ** Charts are for 2000
Source: UNESCO

Domestic regulatory and institutional framework

Botswana is regarded as having a friendly investment climate due to public sector efficiency, political and economic stability, and lack of corruption (UNCTAD, 2003; OECD, 2005). This is a major comparative advantage for the country, which can lead to the development of a competitive services sector. Nonetheless, some supply-side constraints exist because of inappropriate policies and administrative bottlenecks, and these need to be removed by regulatory bodies to improve efficiency and enhance FDI (UNCTAD, 2003). For example, Botswana has rigorous requirements for granting work permits, which makes the hiring of foreign nationals a complicated process. Enforcement of competition laws is also weak, which results in the abuse of market power and imposes high costs on consumers.

Supervision of the banking sector is relatively advanced and is in the hands of the central bank. A revised banking act has brought banking legislation in line with changes in global norms for regulation, supervision and payments. Despite this, Botswana has not yet made GATS commitments in banking services to signal a move towards more competition.

The supervision of the pensions and insurance industry is less advanced and is carried out by the Ministry of Finance and Development Planning, which has been devising a Non-Bank Financial Institutions Regulatory Authority (NBFIRA) framework.

The two main pieces of legislation regulating the operations of the tourism industry in Botswana are the Tourism Act (1992) and the Tourism Regulations (1996). The country introduced new tourism regulations in 2006, which state that the following tourist enterprises are reserved for citizens of Botswana or companies that are wholly owned by citizens of Botswana: camping sites including caravan sites, guest houses, *makoro* operations, mobile safaris, motorboat safaris and transportation.[4] However, because Botswana made World Trade Organization (WTO) commitments, it seems that these new regulations go against existing GATS commitments with potential consequences for the competitiveness of the sector.

The tertiary education sector is regulated by the Tertiary Education Act (2005), and the registration of institutions is regulated by the Tertiary Education Council under the supervision of the Ministry of Education. There does not seem to be an explicit prohibition for the establishment of foreign institutions, although no foreign institution is currently operating in Botswana.

External conditions

Botswana is member of the WTO and of a series of regional agreements, including the Southern African Customs Union (SACU), Southern African Development Community (SADC) and the African Union. Negotiations with the EU and US are also ongoing and these may also include services provisions. Economic Partnership Agreements (EPAs) with the EU have the possibility of including services, with special and differential support measures. The outcome of such negotiations may have some impact on the potential development of Botswana's services sector by inducing the liberalisation of (some) sectors to imports from the EU or by including complementary measures.

Botswana has been cautious in making GATS commitments, such as granting national treatment and market access to foreign firms in scheduled sectors. Table 6.10 shows Botswana's commitments, which cover a few professional business services (architecture, engineering, medical, dental and veterinary services; computer and related services, such as consultancy, software implementation and database services; research and development; and real estate) and two tourism-related activities (hotels and restaurants, and travel agencies and tour operators). Measures affecting supply of computer services through commercial presence were generally either unbound or subject to the requirement that foreign companies must be allowed to practice in their home country, and that qualifications of foreign nationals must be recognised by the appropriate public body.

Botswana did not participate in the extended GATS negotiations on basic telecommunications (the Fourth Protocol) or on financial services (the Fifth Protocol). The Botswana Telecommunications Authority (BTA) was not convinced that joining the WTO Basic Telecommunications Agreement would offer immediate benefits. Hence, despite market liberalisation in 1996, the telecommunications sector is a de facto monopoly, dominated by the only fixed-line voice services provider, Botswana Telecommunications Company.

Table 6.10: GATS commitments by Botswana

Services	*Commitment*	*Services*	*Commitment*	*Services*	*Commitment*
Business	Yes	Educational	No	Travel	Yes
Communications	Yes	Environmental	No	Transport	No
Construction & engineering	No	Financial	No	Recreational, sporting & cultural	No
Distributional	No	Health & social	No	Other	No

Source: te Velde and Cali (2007)

Institutional support structure

In order to promote the trade, industry and services sectors, Botswana has developed organisational infrastructure both within the public and private sectors. Within the public sector, Botswana Export Development and Investment Authority (BEDIA) was created as an autonomous body in 1997 to promote the industrialisation process and diversify the country's economic base. BEDIA has been promoting exports in various countries by organising exhibitions. It has also established overseas offices in South Africa and the UK.

The institutional infrastructure of the private sector revolves around four organisations: the Exporters Association of Botswana (a non-governmental trade organisation, which acts to facilitate global trade and enhance economic growth and diversification from traditional exports to non-traditional exports [manufactured goods and services]); the Botswana Confederation of Commerce, Industry and Manpower (a large association of the business community with members representing all sectors of the economy); the Botswana Chamber of Commerce and Industry; the Junior Chamber Botswana (committed to providing young people with opportunities to develop the leadership skills, social responsibility, entrepreneurship and fellowship necessary to create a positive change).

Conclusions

The analysis for Botswana reveals that the country is trying to develop a sound services sector. An important initiative in this regard is the establishment of the International Financial Services Centre (IFSC) in 2003. IFSC aims to establish a cross-border financial services industry to make Botswana the regional (or African) hub for business services, such as the management of companies' inbound telephone calls through call centres, administrative and shared service activities etc.

The IFCS operates as a special licence for companies which carry out offshore financial services operations, allowing them to pay a lower taxation rate (15 per cent instead of the standard 25 per cent until 2020; and exemptions from withholding tax). It also helps new companies with the lengthy administrative procedures for starting their businesses. The IFSC approved five applications of companies in 2005, bringing the number of certified companies operating under the IFSC to 29.

While the IFSC has been successful in attracting these companies, conditions remain weak for a significant number of back-office services. Two main types of complementary policies are required: skills development and the development of an appropriate IT infrastructure. Without these, even a favourable incentive framework supported by the IFSC cannot keep companies in Botswana. The relatively poor quality of IT infrastructure, including poor data exchange processes, is believed to have been the major cause of a known international bank's decision to relocate part of its back-office operations away from Botswana. The bank was not able to secure the right calibre of staff on an ongoing basis, and the IT infrastructure did not match the requirements of the company. Other banks also list the lack of skilled labour as one of their primary concerns; this is an issue worsened by the strict immigration regime.

Certain examples exist in Botswana that show that the public sector **can** play an important role alongside the private sector in the development of the services sector. A case in point is the Botswana Accountancy College, where the government assisted the private sector – so promoting tertiary education in the country and plugging a significant skills gap over the course of 10 years (see Box 6.1). However, such examples are few and not sufficient to meet the requirements of the country. More efforts need to be undertaken to improve the ICT infrastructure and the availability and quality of local skills to make Botswana the regional hub of financial services and increase its net exports of services.

Box 6.1: The Botswana Accountancy College: filling the skills gap

The Botswana Accountancy College (BAC), founded in 1996, is a private college that provides training in accountancy, computing, business management and insurance. It is a private college subsidised by the government and Debswana, one of the major mining companies in the world. The college aims to provide world-class tuition to reduce Botswana's reliance on foreign expertise. The qualifications provide an excellent start to student careers in business and technology. The majority of students are sponsored by the government, while others are sponsored by private companies or are self-sponsored.

The number of students graduating from BAC has increased steadily. All of its qualifications are internationally recognised and the college is one of few outside Britain to be awarded the Chartered Institute of Management Accountants' 'Quality Through Partnership' award. BAC is a classic example of how successful public–private partnerships can make an important difference for economic development.

When the BAC was founded in 1996, Botswana had only four registered Batswana accountants. As of 2007, there were 400. This example shows that a public–private partnership can build up a tertiary education college from scratch and fill an important skills gap.

Source: BAC website (www.info.bw/~bac/) and te Velde and Cali (2007)

Notes

1. This sub-section is based on te Velde and Cali (2007).
2. Source: Department of Tourism, Government of Botswana.
3. The following sectors are aggregated: computer services, merchanting, leasing, legal, accounting, management, advertising, market research, R&D, architecture, engineering, technological services, and agriculture, mining etc.-related services. The **other business services** category is not taken into account, as this seems to capture a wide variety of services not necessarily related to business services (it is a kind of residual category, used when the classification of other transactions is unclear).
4. A makoro is a type of canoe, traditionally made by digging out the trunk of a large straight tree and pushed with a pole. Makoro safaris are a popular way for tourists to visit the Okavango Delta in Botswana.

7

Mauritius

Mauritius is a middle-income African island state located in the Indian Ocean. In 2005, it had a real per capita GDP (PPP-adjusted) of US$11,141 and a population of about 1.2 million. Its average annual GDP growth rate during the 1990s was over 5 per cent, but this dropped to 4 per cent during 2000–05 (Chart 7.1).

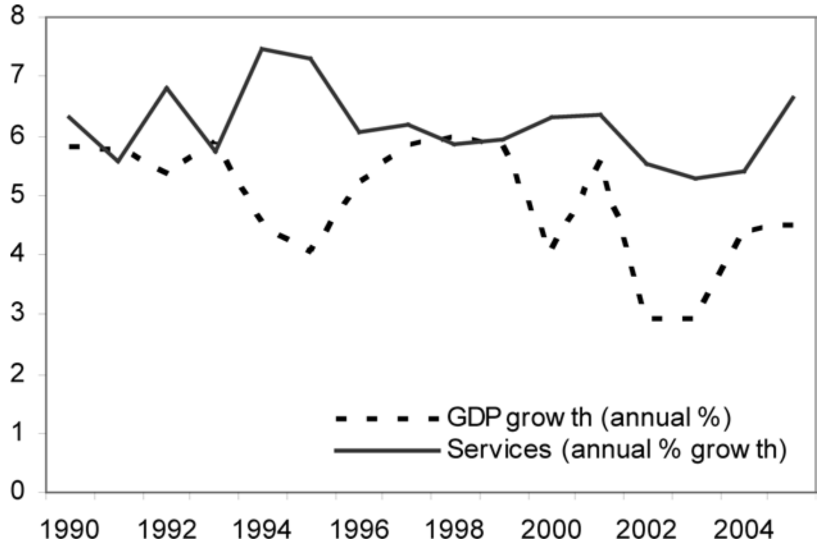


Chart 7.1: Annual growth of GDP and services in Mauritius (%)
Source: Based on World Bank (2006)

There has been a shift in the structure of GDP in Mauritius. The contribution of agriculture and manufacturing (the Export Processing Zone [EPZ] sector) to GDP has been declining, especially over the past five years, while the share of services has been growing rapidly, including in retail trade, financial services, hotels and restaurants, and telecommunications. Similar shifts are noticeable in the employment structure of the economy. For example, employment in agriculture and manufacturing declined by 10,000 and 20,000 people respectively during 2000–2004, while employment increased in *all* services.

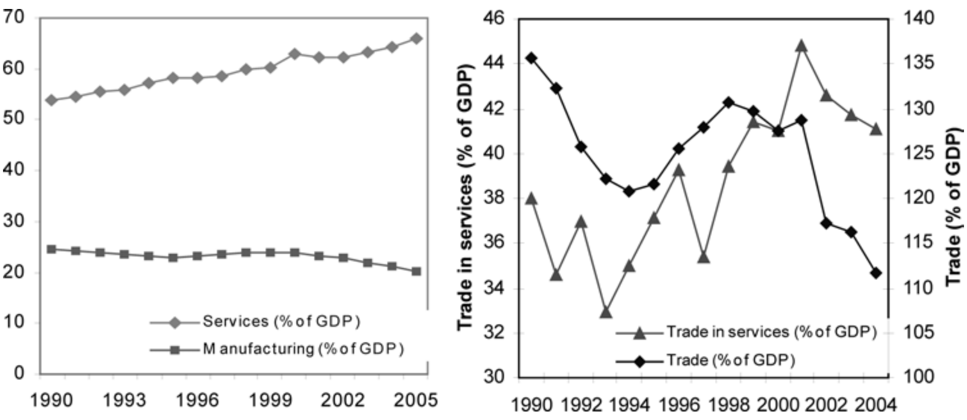


Chart 7.2: Contribution of services and trade in services to GDP in Mauritius
Source: Based on World Bank (2006)

The services sector plays a very important role in the economy, contributing about 60 per cent to GDP (Chart 7.2). Interestingly, whereas the average annual GDP growth rate has declined over the years, growth in the services sector has stayed fairly constant at about 6 per cent over the last decade. The contribution of services to total employment is also substantial and 57 per cent of total employment was provided by the services sector in 2005.[1]

There has also been a significant increase in trade in services. Chart 7.2 shows that the ratio of trade in services to GDP has increased steadily since the 1980s, while that of total trade to GDP exhibits a downward trend. Both exports and imports of services have risen since mid-1980s; however, the rise in exports is particularly impressive and Mauritius has been a net exporter of services since then (Chart 7.3).

Table 7.1 presents the contribution of different services to GDP in 2000 and 2005. The five largest sub-sectors in services in terms of their contribution to GDP in 2005 were: transport, storage and communications (11 per cent); wholesale and retail trade, repair of motor vehicles and motorcycles, and personal and household goods (10.5 per cent); financial intermediation (9 per cent); real estate, renting and business activities (9 per cent); and hotels and restaurants (6.7 per cent). Of these, the sub-sectors that experienced the highest growth from 2000 to 2005 were hotels and restaurants, real estate, renting and business activities, and financial intermediation.

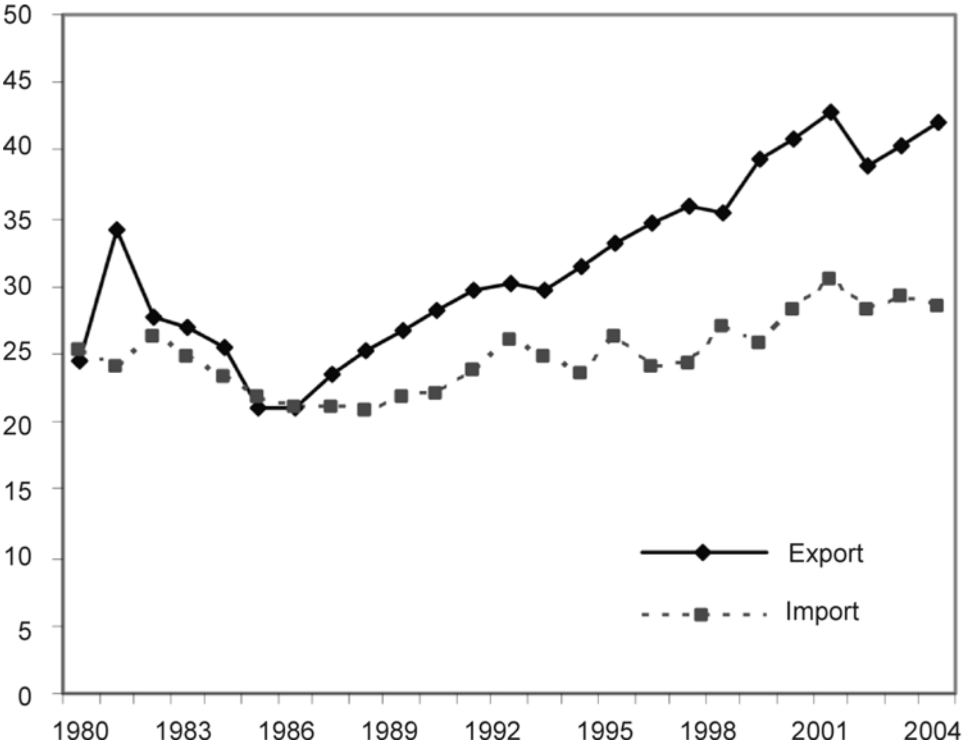


Chart 7.3: Exports and imports of services as a % of total trade in Mauritius
Source: Based on UNCTAD (2005)

Table 7.1: Share of services sector in GDP (at market prices) in Mauritius (%)

	2000	*2005*
Services sector	59.23	62.94
Wholesale & retail trade, repair of motor vehicles and motorcycles, personal & household goods	10.65	10.53
Hotels and restaurants	5.71	6.71
Transport, storage and communications	11.36	11.04
Financial intermediation	8.44	9.05
Real estate, renting and business activities	7.77	8.97
Public administration and defence; compulsory social security	5.86	6.19
Education	3.96	4.20
Health and social services	2.58	3.01
Other services	2.91	3.24

Source: Central Statistics Office (2006)

Performance of selected services

Financial services

Mauritius has a well developed financial system, which comprises commercial and investment banks, insurance companies, stockbrokers, venture capital companies, fund managers, foreign exchange dealers, leasing companies, credit institutions, asset managers and bond dealers. It is one of the few developing economies where domestic bank assets are approximately 100 per cent of GDP, and contractual savings exceed 40 per cent of GDP (World Bank, 2003).

The contribution of financial services to GDP increased from about 8 per cent in 2000 to 9 per cent in 2005, and it accounted for 6 per cent of total employment in 2005.[2] The sector has been growing at a fast pace and the average annual growth rate during 2002–2005 was over 7 per cent (insurance services had an average growth rate of 5 per cent whereas other services, mainly banking, had an average annual growth rate of 8 per cent). Exports of financial services picked up sharply in the late 1990s, but constitute a lower share of overall service exports as compared to other middle-income and SSA countries since 2002 (Chart 7.4).

Banks form the largest component of the financial services sector, with domestic banks constituting two-thirds of the domestic financial system. The domestic banking sector had an average annual growth rate of 13 per cent during 1998–2003. However, the

Chart 7.4: Financial services exports by Mauritius (% of commercial service exports)
Source: Based on World Bank (2006)

banking sector is highly concentrated with few dominant players: they include two large domestic banks, Mauritius Commercial Bank and the State Bank of Mauritius (SBM), which have a 70 per cent market share, and two foreign banks, HSBC and Barclays, which have a 22 per cent market share.[3]

In contrast to the banking sector, foreign exchange, treasury bills and bond markets are underdeveloped in Mauritius. The domestic insurance sector is efficient and well established, as indicated by the insurance penetration (premiums/GDP) value of 4.1 per cent in 2001, while insurance company assets constituted 18 per cent of GDP (Vittas, 2003). Exports of insurance services remained insignificant during the 1980s and 1990s, but have picked up since the late 1990s (Chart 7.5).

Mauritius attracts considerable foreign direct investment (FDI) in financial services due to multiple factors, such as a low tax environment, friendly investment climate, good ICT infrastructure and location. In 2002, the offshore financial sector included 14 banks, 15 insurers, 221 global funds and approximately 20,000 global business licence companies engaged in the non-financial services of personal/family trusts (World Bank, 2003).

Educational services

Mauritius has one of the highest total literacy rates in the African region. In 2005, its gross enrolment ratio for secondary and tertiary education stood at 88 and 17 per cent, respectively.[4] Total tertiary education enrolment expanded by 10.7 per cent in 2005 as compared to 1.5 per cent in 2004. The gross tertiary enrolment rate also increased from 24.2 per cent in 2004 to 28.4 per cent in 2005 (Tertiary Education Commission, 2006).[5]

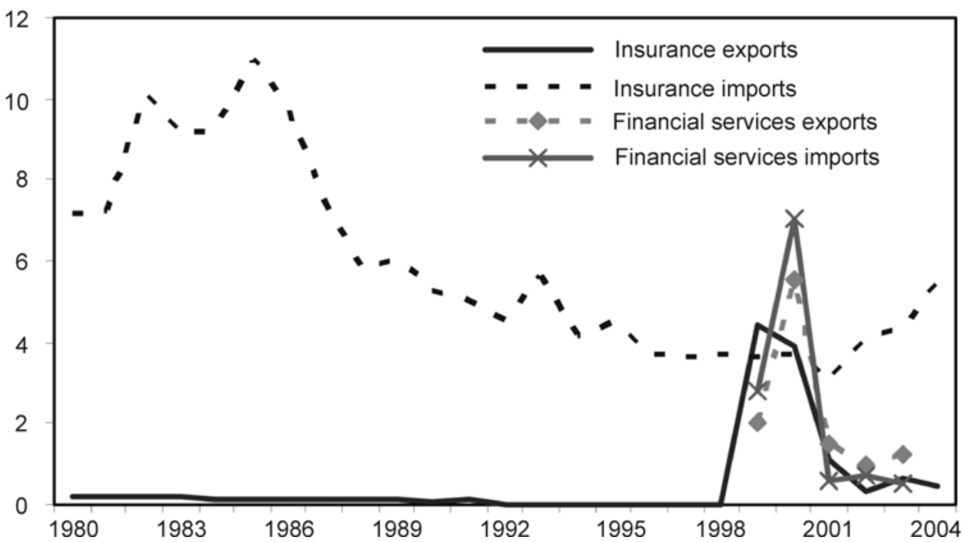


Chart 7.5: Exports and imports of financial services for Mauritius (as % of total trade)
Source: Based on UNCTAD (2005)

The education sector has been growing at an average annual growth rate of about 6 per cent during 2002–2005, and its contribution to GDP was about 5 per cent in 2005.

Mauritius has a fairly high outbound mobility ratio (defined as: 'mobile students coming from a country as a percentage of all tertiary students in that country') and a relatively high gross outbound enrolment ratio (defined as: 'mobile students coming from a country as a percentage of the population of tertiary student age in their home country') as compared to some other African countries such as South Africa and Kenya (see Table 7.2). In 2005, about 2,330 students left the country for higher studies making the total number of Mauritian students studying abroad 7,357.[6] This represents an increase of 34.5 per cent in the number of overseas students when compared to 2003. About 87 per cent of these students are based in four countries, namely France, India, Australia and the UK. Overall, Mauritius is a net importer of educational services with a net mobility rate, defined as 'the difference between inbound and outbound students as a percentage of total tertiary enrolment in the country', of 40.2 per cent.

Table 7.2: Student mobility in selected African countries

Country	*Outbound mobility ratio (%)* [a]	*Gross outbound enrolment ratio (%)* [b]	*Main destinations*	*Net mobility rate (%)* [c]
Botswana	71.6	4.5	South Africa, Australia , UK, USA , Malaysia	...
Kenya	13.0	0.4	USA, UK, Australia, India, Canada	...
Lesotho	74.3	2.0	South Africa, UK, USA, Australia	72.4
Madagascar	9.5	0.2	France, USA , Germany , Switzerland , Canada	6.6
Mauritius	40.6	7.0	France, South Africa, UK, Australia, India	40.2
Mozambique	10.6	0.1	Portugal, South Africa, USA, UK, Australia	...
Namibia	58.1	3.5	South Africa, USA, UK, Australia, Germany	49.4
Rwanda	7.6	0.2	France, Belgium, USA, Burundi, UK, Germany	7.3
Seychelles	...	6.3	UK, Australia, France, New Zealand, Mauritius	...
South Africa	0.8	0.1	USA, UK, Australia, Cuba, Germany	–6.2
Swaziland	31.9	1.7	South Africa, USA, UK, Lesotho, Australia	30.0
Uganda	2.8	0.1	UK, USA, Germany, India, Tanzania	...
Tanzania	9.1	0.1	USA, UK, South Africa, Australia, Germany	8.5
Zambia	14.7	0.3	South Africa, USA, UK, Australia, Namibia	...

Notes: a) Outbound mobility ratio is the percentage of mobile students coming from a country/region to all tertiary students in that country/region; b) Gross outbound enrolment ratio is the percentage of mobile students from a country/region to the population of tertiary student age in their home country. This indicator expresses the volume of studies abroad on the same scale as the volume of studies at home as measured by tertiary gross enrolment ratios; c) Net mobility rate is the net inflow of mobile students to a country minus its number of students abroad as a percentage of the total tertiary enrolment in the country/region.

Source: te Velde and Cali (2007)

Although Mauritius is relatively well-endowed in human resources as compared to other small states, it still lacks certain technical skills required to move into high skill activities such as financial services. It aspires to become the regional and international hub of education, and is therefore undertaking intensive efforts to improve FDI in education services and attract foreign students. In 2005, almost 50 institutions in Mauritius were foreign owned by countries including Australia, France, India, the UK and South Africa.

Tourism

Tourism plays a crucial role in the Mauritian economy. Its contribution to GDP averaged around 7 per cent during 2002–05 and its annual growth rate during 2002–2005 was about 4 per cent. Tourism contributes substantially to the economy's total employment and accounted for 21 per cent of the total employment in 2005.

Table 7.3 confirms the importance of tourism for Mauritius. Tourism accounts for more than 50 per cent of the total trade in services. Its share has stayed fairly constant throughout the 1990s, but has increased to 59 per cent in recent years.

Table 7.3: Share of travel in total trade of services in Mauritius (%)

Year	*Travel*	
	Exports	*Imports*
1990	50.47	22.22
1991	47.65	24.53
1992	51.80	27.16
1993	53.66	24.45
1994	56.45	26.15
1995	55.26	24.79
1996	52.48	26.57
1997	53.50	26.38
1998	54.05	25.72
1999	52.40	25.69
2000	50.65	23.82
2001	50.97	24.39
2002	53.26	25.72
2003	54.43	23.84
2004	58.81	24.90
Average	**53.06**	**25.09**

Notes: Travel services covers goods and services acquired from an economy by travellers in that economy for their own use during visits of less than one year for business or personal purposes.

Source: UNCTAD (2005)

The performance of Mauritius in tourism over the years is very impressive. The arrival of visitors and expenditures incurred by them has quadrupled since 1990 (Table 7.4). In 2005, an estimated 781,600 people visited Mauritius. Over 50 per cent of these were from European countries including France, Germany, Italy and the UK, followed by Reunion (13 per cent) and South Africa (8 per cent). The government announced its aim to attract 2 million visitors by 2015. Chart 7.6 shows that achieving this target would require a radical increase from past growth rates until 2015.

Table 7.4: Selected indicators of tourism for Mauritius, 1990-2004

	Arrivals of visitors (thousands)	*Average length of stay (days)*	*Total expenditures of visitors (millions of $)*	*Visitors' expenditures excluding transport (millions of $)*
1990	292	12.2	N/A	244
1991	301	12.3	N/A	252
1992	335	12.3	N/A	299
1993	375	12.3	N/A	304
1994	401	11.4	N/A	357
1995	422	10.7	616	430
1996	487	10.6	705	504
1997	536	10.5	666	478
1998	558	10.3	672	496
1999	578	10.4	718	543
2000	656	10.4	732	542
2001	660	10.4	821	624
2002	682	10.5	829	612
2003	702	10.4	959	696
2004	719	10.6	1,153	853

Source: UNCTAD (2005)

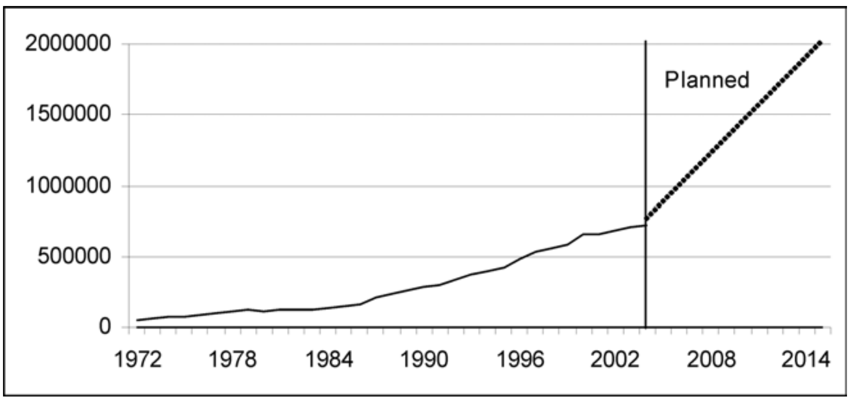


Chart 7.6: Number of tourist arrivals: past and future

Transport, communications and information technology

In Mauritius, the contribution of the transport, storage and communications sector to GDP and total employment was 13.5 and 7.1 per cent respectively in 2005. The sector has been growing at a very fast pace and grew at a rate of over 8 per cent in 2004 and 2005.

The share of transport in the total trade of services in Mauritius has decreased slightly in importance since 1990, primarily due to the growth of the tourism and financial services sectors (see Table 7.5).

Trade in communications and computer and information services constitutes a small part of total trade in services of Mauritius. As is evident from Table 7.6, the average annual share of exports of communications services during 2000–04 was about 2 per cent only. The share of exports of computer and information services is even smaller and came to less than 1 per cent during the same time period. However, this share is rising and, interestingly, Mauritius became a net exporter of computer and information services in 2003 (Chart 7.7).

Table 7.5: Share of transport in total trade of services in Mauritius (%)

	Transport	
	Exports	*Imports*
1990	32.54	49.85
1991	32.85	46.56
1992	32.43	44.74
1993	27.51	45.40
1994	26.97	42.74
1995	25.68	39.25
1996	22.65	37.12
1997	23.51	37.40
1998	21.84	34.05
1999	19.67	34.48
2000	20.85	34.24
2001	19.24	32.19
2002	23.95	38.77
2003	26.18	44.17
2004	25.62	45.84
Average	**25.43**	**40.45**

Notes: Transport services covers all transport services performed by residents of one economy for those of another and involving the carriage of passengers, movement of goods (freight), rental of carriers with crew and related support and auxiliary services.

Source: UNCTAD (2005)

Table 7.6: Trade in communications, computer and information services (% of total trade)

		2000	*2001*	*2002*	*2003*	*2004*
Communications	Exports	1.49	2.60	2.68	1.60	1.37
	Imports	2.12	1.56	4.60	2.48	1.95
Computer and information services	Exports	0.26	0.50	0.54	0.72	0.85
	Imports	0.70	1.09	1.04	0.89	0.82

Source: UNCTAD (2005)

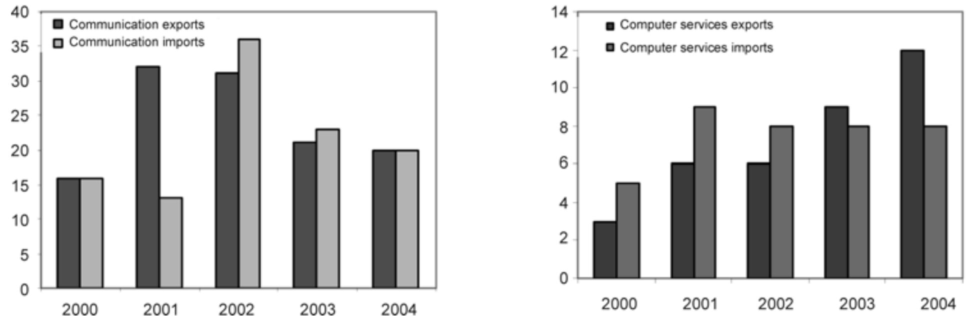


Chart 7.7: Exports and imports of communications and computer services for Mauritius
Source: Based on UNCTAD (2005)

Professional business services

Real estate, renting and other business activities constitutes another important services sub-sector for Mauritius. Their combined contribution to GDP was 9.3 per cent in 2002 and increased to 10.2 per cent in 2005. According to estimates of the Central Statistics Office, the average annual growth rate of this sub–sector sector during 2002–2005 was 6.6 per cent.

Trade in business services, which includes merchanting and other trade-related services, operational leasing services, and miscellaneous business, professional and technical services, increased steadily until 2001, but has declined in more recent years (Chart 7.8). Throughout the 1980s, Mauritius was a net exporter of business services, but became a net importer during the 1990s. The trend reversed in 2001 and it became a net exporter again. However, the share of business services exports in total trade of services continues to exhibit a declining trend and has almost halved from 25 per cent in 1980 to 11 per cent in 2004.

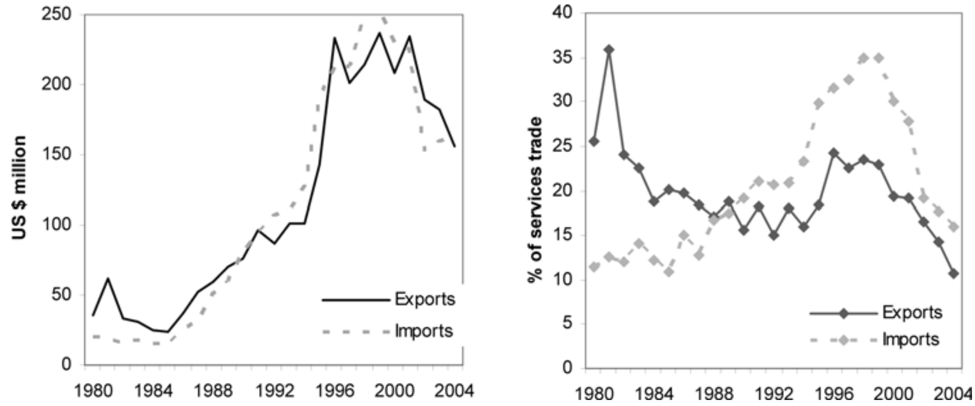


Chart 7.8: Trade in other business services in Mauritius, 1980-2004
Source: UNCTAD (2005)

Supporting factors

Domestic capacity and skills

Mauritius has a well-developed basic infrastructure relative to other African and upper-middle income group countries. The road network of the country has expanded steadily over the years, with 2,020 km of roads by 2005. Air transport and sea transport facilities are also well established and the main harbour, Port Louis, has been modernised and expanded recently (OECD, 2005).

The telecommunications and information technology network of Mauritius is also well established in comparison to other SSA countries, as well as to the average of the upper-middle income group (Table 7.7). However, Mauritius Telecom is the *de facto* monopoly for most telecommunication services and was a *de jure* monopoly until January 2003. A second network operator, Mahaganar Telecom (Mauritius) Ltd., has since been licensed but has not yet started its operations.

The telephone density of Mauritius in 2004 was 287 main lines per thousand inhabitants, which is far greater than the average telephone density for SSA (17 main lines per thousand inhabitants). Similarly, Mauritius enjoys an advantage in information technology in terms of access, quality and price. The number of internet users (per thousand people) in Mauritius was 146 whereas the average for SSA and the upper-middle income group was 15 and 133 respectively.

Regulations have led to the development of an efficient financial services infrastructure, such as payment, securities trading and settlement systems, which has stimulated the growth of the financial services sector. Financial services are easily accessible by

Table 7.7: ICT indicators for Mauritius (2004)

	Mauritius	*SSA*	*Upper-middle income group*
Access			
Tel. main lines per 1,000 people	287	17	220
International voice traffic (min. per person)	83		39
Mobile subscribers per 1,000 people	505	86	490
Population covered by mobile telephony (%)	99		84
Internet users (per 1,000 people)	146	15	133
Personal computers (per 1,000 people)	176	12	99
Quality			
International Internet bandwidth (bits per person)	146	4	176
Affordability			
Price basket for fixed line (US$ per month, residential)	7.4	8.5	13.9
Price basket for mobile (US$ per month)	4.8	13.5	11.1
Price basket for Internet (US$ per month)	15	54.8	20.8
Price of call to United States (US$ per 3 minutes)	1.67	2.43	1.03

Source: World Bank (2006b) Information and Communications for Development 2006: Global Trends and Policies. *Washington DC: World Bank*

the businesses as well as households, with the result that there is more than one bank account per capita (World Bank, 2003).

In terms of skills availability, Mauritius has a very high rate of secondary enrolment. However, the rate of tertiary enrolment, although high relative to SSA, is still fairly low (Table 7.8). Hence, the country lacks the skills required for further development of highly skill-intensive sectors such as the financial services and information and communications technology sectors. The government is, however, actively pursuing a development strategy to improve tertiary education and make Mauritius the hub of regional and international educational excellence. It aims to achieve a target of 45 per cent for gross tertiary enrolment ratio by 2015.

Domestic policy and institutional framework

Mauritius is considered to have a stable political system underpinned by strong institutions and the rule of law by international organisations such as the World Bank and the International Monetary Fund (IMF). Subramanian and Roy (2001) highlight the importance of efficient and well-functioning institutions in explaining the strong growth performance of Mauritius. It enjoys a clear comparative advantage over other South African countries in terms of governance. This is evident from Table 7.9, which gives a comparison of various World Bank indicators ranging from political stability to the enforcement of the rule of law for selected African countries, and the average for the upper-middle income group and all small states. Mauritius has the highest value for

Table 7.8: Gross enrolment rates (%) in Southern Africa (2004)

	Primary	*Secondary*	*Tertiary*
Botswana	82.1	60.9	6.2
Lesotho	85.9	23.1	2.8*
Mauritius	95.1	79.6	17.2
Namibia	73.7*	37.4*	6.1*
South Africa	88.8*	61.7**	15.3*
Swaziland	76.7*	29.0*	5.0
Zimbabwe	81.9*	33.9*	3.7*

Notes: * data refers to 2003; ** data refers to 2000

Source: UNESCO (2006)

political stability and rule of law indicators across the selected Southern African countries. It fares better than an average upper-middle income state in political stability, government effectiveness and rule of law, and an average small state in all governance aspects covered here.

Following prudent economic management and a long-term development strategy, the country has successfully diversified its exports and production structure over the years moving from a sugar-based economy into one based on four pillars of development: sugar, textiles, tourism and financial services. However, despite its impressive economic performance, unemployment has been rising since the 1990s due to labour market

Table 7.9: Governance indicators, selected Southern African countries (2004)

	Political stability	*Government effectiveness*	*Regulatory quality*	*Rule of law*	*Control of corruption*
Botswana	0.70	0.83	0.96	0.73	0.86
Lesotho	0.27	−0.33	−0.26	−0.03	−0.05
Namibia	0.46	0.29	0.45	0.22	0.18
South Africa	−0.24	0.74	0.44	0.32	0.48
Swaziland	0.23	−0.60	−0.36	−0.95	−0.95
Mauritius	0.91	0.60	0.33	0.84	0.33
Mozambique	−0.15	−0.39	−0.29	−0.60	−0.79
Zambia	−0.16	−0.84	−0.49	−0.54	−0.74
Zimbabwe	−1.86	−1.20	−2.15	−1.53	−1.01
Upper-middle income	0.54	0.42	0.53	0.43	0.39
Small states	0.40	0.25	0.27	0.32	0.30

Note: Units of measures range from about −2.5 to 2.5, with higher values corresponding to better governance outcomes.

Source: World Bank (2006)

rigidities and a mismatch between the labour force and the skills demanded by employers (World Bank, 2003).

In the financial services sector, the Bank of Mauritius (BoM) regulates all banks under the Banking Act of 2004 (which replaced the Banking Act of 1988) and the Financial Services Commission regulates the non-bank financial sector. The BoM has implemented the Basle Capital Accord and endorsed the Basle Committee's Core Principles for effective supervision of banks. The government has also implemented a Companies Act 2001 to improve the quality of auditing and corporate governance. The Act mandates the use of International Accounting Standards (IAS) and International Standards on Auditing (ISA) for all medium and large companies.

The government also appointed a Committee on Corporate Governance in 2001 to provide a framework for improved corporate governance. The Committee published a Code of Corporate Governance in Mauritius in 2003 after consultations with stakeholders.

To promote tertiary education in the country, the government has established a Tertiary Education Commission (TEC) with the aim of promoting and regulating post-secondary education in Mauritius. The TEC has put in place a new regulatory framework, the Strategic Framework 2007–2011, to develop an education sector of international standard in Mauritius and make it a regional and international knowledge hub and centre for learning (Tertiary Education Commission, 2007).

In the tourism sector, the Ministry of Tourism, Leisure and External Communications has devised the National Tourism Policy to ensure high-quality tourism for visitors. A Mauritius Tourism Promotion Authority was created in 1996 to promote Mauritius as a tourist destination in other countries, provide information to tourists and co-operate with tourism agencies overseas. In addition, the Tourism Authority was set up under the Tourism Act 2004, which aims to formulate necessary policy and nationally-integrated planning for the tourism industry, co-ordinate the activities of the various organisations concerned with the tourism industry, and supervise the operations of tourist enterprises.[7] The new tourism plans will require a new approach to tourism.

In terms of information and communications, Mauritius has a fairly advanced broad-based information policy, which is modelled around Singapore's ICT policy.[8] The government intends to make ICT the fifth pillar of the economy in addition to the sugar, textiles, financial services and tourism sectors. Mauritius has a Ministry of Information Technology and Telecommunications, which is responsible for devising the policy and administering programmes to improve telecommunications services. It also has an Information and Communications Technologies Authority, which is the regulator of the telecom sector and ensures the implementation and promotion of the government's policy objectives for the telecommunications sector.[9] The government established a parastatal body, the National Computer Board (NCB), in 1988 to promote the development of ICT. The NCB manages the National IT Strategy Plan that has been devised to accelerate development of the IT sector in Mauritius.

External conditions

Mauritius has been a member of the WTO since 1995. It has also negotiated trade agreements under the SADC and Common Market for Eastern and Southern Africa (COMESA) Protocols to encourage regional trade and under the African Growth and Opportunity Act (AGOA) to enter the US market.

Mauritius has not made specific commitments under GATS mode 1 (cross-border supply) and mode 2 (consumption abroad) for supply of services. It has, however, committed to the horizontal principle of most favoured nation (MFN) treatment concerning commercial presence (mode 3), albeit with certain limitations (Table 7.10).

In terms of the investment barriers to trade, Mauritius adopted legislation in 1993 to regulate and facilitate foreign investment in the country. It has signed nine bilateral FDI treaties, five with developed countries and four with less-developed countries to promote foreign investment. In addition, it has signed double taxation treaties with 28 countries (eight with developed countries and 20 with less-developed countries) to remove the double taxation of investments. Mauritius is a member of several international investment institutions and has ratified international agreements that regulate FDI such as the Multilateral Investment Guarantee Agency, International Centre for Settlement of Investment Disputes, Convention on the Recognition and Enforcement for Foreign Arbitral Awards, and World Intellectual Property Rights Organization (Ndulo et al., 2005).

Mauritius has made commitments in mode 4 (presence of natural persons), but with the limitation that its market is open only to highly-skilled individuals. However, it allows no discrimination for people permitted to enter under the market access commitment.

In the context of particular sectors, Mauritius has made specific GATS commitments in the financial services sector (both in banking as well as insurance), but with certain restrictions (Table 7.11).[10] Mauritius has also made specific commitments in the telecommunications sector. It has not liberalised its fixed telecommunications network, but has committed to a higher level of liberalisation in the sector. In addition, as shown in Table 7.11, it has made commitments in the tourism sector (hotels and restaurants; travel and tour operators; tourist guide services; and other services) with some limitations.[11]

Table 7.10: Commitments to commercial presence in Mauritius

Horizontal commitment to commercial presence	*Limitations to market access*	*Limitations to national treatment*
Yes	Yes	Yes

Source: Ndulo et al. (2005)

Table 7.11: GATS commitments of Mauritius

	Limitations to market access	*Limitations on national treatment*
Financial services		
Banking	1: Bound with restrictions 2: Bound with restrictions 3: Bound with no restrictions 4: Unbound with horizontal commitments	1: Bound with no restrictions 2: Bound with no restrictions 3: Bound with no restrictions 4: Unbound with horizontal commitments
Insurance	1: Unbound 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments	1: Bound with no restrictions 2: Bound with no restrictions 3: Bound with no restrictions 4: Unbound with horizontal commitments
Telecommunications services		
Basic telecommunications	1: Bound with no restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments	1: Bound with no restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments
Tourism services		
Hotels and restaurants	1: Bound with restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments	1: Bound with restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments
Travel and tour operators	1: Bound with restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments	1: Bound with restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments
Tourist guide services	1: Bound with restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments	1: Bound with restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments
Other services (car rentals, yacht chartering and cruising, duty free shops)	1: Bound with restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments	1: Bound with restrictions 2: Bound with no restrictions 3: Bound with restrictions 4: Unbound with horizontal commitments

Notes: 1=Cross-border supply; 2=Consumption abroad; 3=Commercial presence; 4=Presence of natural persons

Source: Ndulo et al. (2005)

Institutional support structure

Mauritius has institutions in both the public and private sectors to promote private-sector development. In the public sector, the Board of Investment is the primary organisation to facilitate and promote investment in Mauritius. It has developed a strong partnership with the private sector and its board of directors includes both public- and private-sector representatives. In the private sector, the Mauritian Chamber of Commerce and Industry (MCCI) is the oldest and most important institution for the business community.

In 2005, a collaborative partnership between industry and government was created in the form of a limited liability company, Enterprise Mauritius. The aim of Enterprise Mauritius is to promote exports and support enterprise development at the local level. It provides assessment, advice and consultancy services to businesses, provides them with assistance in accessing regional and international markets, facilitates networking opportunities and helps in the development of sector strategies.

The primary institution for state–business relations in Mauritius since 1970 is the Joint Economic Council (JEC), which was established to ensure a stable macro-economic environment, foster greater fiscal discipline, restore financial health and integrate all sectors of the economy in order to reduce distortions and improve efficiency of investment. It is managed by a council of 18 members, a chair who rotates every two years and a full-time director.

The JEC meets with the prime minister on a regular basis and participates in budget proposals. It is funded entirely by its members, which also include the main services associations: the Mauritius Chamber of Commerce and Industry, Mauritius Chamber of Agriculture, Mauritius Employers' Federation, Mauritius Sugar Producers' Association, Mauritius Export Processing Zone Association, Mauritius Bankers' Association, Mauritius Insurers' Association, Association des Hôteliers et Restaurateurs de l'île Maurice, and the Association of Mauritian Manufacturers.

Conclusions

The government of Mauritius has made intensive efforts to develop the services sector, especially in tourism, finance and ICT. An important initiative in this regard was the establishment in 2001 of Business Parks of Mauritius Ltd, a government-owned company created for the purpose of infrastructure development, to develop buildings and business parks in Mauritius that would, among other things, promote financial, ICT and education services. Other key steps taken by the government include the Integrated Resort Scheme (IRS) in the tourism sector, which aims to encourage the purchase of luxury villas by foreigners, the Scheme to Attract Professionals for Emerging Sectors (SAPES), which aims to attract skilled professionals in the finance and ICT sectors, and development of the Ebène Cyber City Project to make Mauritius the regional and international hub of ICT outsourcing (see Box 7.1 for details).

Box 7.1: Promoting services in Mauritius: some examples

The Integrated Resort Scheme (IRS)

The Integrated Resort Scheme (IRS) is a government initiative to promote tourism and construction services in the economy, besides foreign investment, through the construction and sale of luxury villas for residential purposes only to foreigners in Mauritius. The villas are required to be of international standards, offering high-class facilities such as golf courses, swimming pools, health and sports facilities, nautical activities and marinas to the buyers. The investors are offered various incentives, such as the issuance of a residence status for self, the spouse and dependents as soon as they acquire the luxury property on the island. Under the IRS scheme, 4,200 luxury villas are expected to be developed by 2010. However, the scheme has already started attracting foreigners and a large number of high-net-worth individuals have purchased the villas, boosting the demand for other goods and services.

Scheme to Attract Professionals for Emerging Sectors (SAPES)

The aim of the Scheme to Attract Professionals for Emerging Sectors (SAPES) is to promote the financial and ICT sectors by attracting skilled and professional foreign workers to work in the emerging sectors and live in Mauritius. SAPES offers various incentives to the workers in the form of a three-year contract for work; permission for setting up an office or practice; a three-year work and residence permit to the professional and spouse; exemption from payment of duties and taxes on imported household and personal items; and permission to purchase immovable property for personal use.

The Ebène Cyber City

Mauritius aims to become a regional hub for IT services. Development of a cyber city at Ebène, near the capital city of Port Louis, began in 2001 is one of the strategic initiatives in this regard. The Cyber City will consist of two cyber towers, a knowledge complex, a multi-media complex, a government administrative complex, common facilities and residential units. The City will have direct international connectivity made possible through the installation of a satellite reception station. The purpose is to attract international firms to set up their back-office operations, call centres and programming centres in Mauritius. Investing firms are being offered various incentives such as low corporate tax, free repatriation of profits and exemption of custom duties on equipment and raw materials.

Sources: Ackbarally, N (2002) 'Mauritius: A Cyber-Island in the Making.' *Contemporary Review*, September edition. Available at: http://findarticles.com/p/articles/mi_m2242 [accessed 28 May 2008]

Business Parks of Mauritius Ltd. http://www.e-cybercity.mu/index.html [accessed 28 May 2008]

As part of the Ebène Cyber City project, Cybertower One, an impressive 12-storey commercial building has been constructed. It includes companies such as Infosys, an Indian information technology group, and Accenture, a technology-outsourcer that employs about 600 people. It is now being augmented by Cybertower Two. The US$60 million development is a visible sign of Mauritius's government-led drive to make the island a hub for IT and business process outsourcing (BPO). Contributing to this, the 2005 publication *Investing in the ICT sector* by the Board of Investors clearly spells out that the government now aims to make the ICT sector the fifth pillar of the Mauritian economy in addition to sugar, EPZs, tourism and financial and business services. In order to create a favourable environment to develop ICT, and to promote the emergence of an information society in line with the Government Programme 2005–2010, the cabinet has agreed to the elaboration of a National Information and Communication Technologies Strategic Plan (NICTSP) with the aim of recommending a strategy and a detailed Action Plan for the period 2006–2010.

Notes

1. Source: Central Statistics Office (2006).
2. Source: Central Statistics Office (2006).
3. Source: World Bank (2003).
4. Source: UNESCO (2006).
5. This increase in enrolment rate is partly due to a smaller base compared to 2004. From 2005, the gross tertiary enrolment ratio is computed based on the age group 20–24 years instead of 19–24 years.
6. A majority of the overseas students, about 44 percent, are enrolled in a science and technology-related field (Tertiary Education Commission, 2006).
7. Source: Ministry of Information Technology and Telecommunications, Government of Mauritius.
8. Source: United Nations Economic Commission for Africa *National Information and Communication Infrastructure: Policies and Plans (e-strategies)*. Available online at http://www.uneca.org/aisi/nici/Mauritius/mauritius.htm [accessed 28 May 2008]
9. Source: Ministry of Information Technology and Telecommunication, Government of Mauritius.
10. It is worth noting that Mauritius also does not have any exchange controls in place.
11. In the tourism sector, Mauritius has also ratified a Protocol for the Development of Tourism, which aims to promote intra-regional travel in the SADC region to promote tourism.

8

St Lucia

St Lucia is a small Caribbean island state with real per capita GDP (PPP-adjusted) of US$5,700 and total population of about 160,000 people in 2005. As in other countries of the Organisation of Eastern Caribbean States (OECS), the share of services in GDP and trade is high and has increased over time (Charts 8.1 and 8.2).

The service sector drives the St Lucian economy. Some will argue that when tourism is taken out, St Lucia is not a service-driven economy (at least in terms of exports). However, there is already some evidence on the emergence of new service sectors. It is also good to realise that support services and tourism services now depend on one another, so that the growth in tourism depends on support services and vice versa.

St Lucia is at a critical juncture. It needs to diversify into services and knowledge based industries because of the intensification in competition with bigger countries such as Brazil, India and China due to lower tariffs worldwide and preference erosion. However, if it wants to move strongly into services trade beyond tourism, it needs to provide the emerging sectors with at least the same level of support and strategic direction as it did with tourism. In what follows, we will discuss the performance of selected service sectors, identify key factors and challenges behind the performance so far, and then discuss the institutional framework behind the development of trade in services.

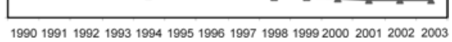


Chart 8.1: Share of services in GDP (%)
Source: Based on World Bank (2006)

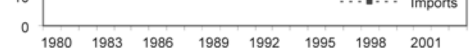


Chart 8.2: Services as % of all trade

Performance of selected services

Financial services

The financial services sector is responsible for more than 10 per cent of GDP. There are seven commercial banks, four of which are foreign owned. Various foreign-owned insurance companies are also present in the country. Domestically, the sector has been very buoyant over the last few years, with growth rates twice that of the economy as a whole.

However, as indicated by Chart 8.3, the export capacity of the sector seems limited. While the share of offshore financial services in exports of services in Barbados and other OECS countries was as high as 10 per cent in the 1990s, it was much lower in St Lucia where there are very few licensed offshore companies. The limited impact of the financial services sector is argued to be the result of St Lucia's late entry into the offshore sector. For example, whereas the Bahamas began to offer offshore financial services in 1936, Antigua and Barbados in the 1980s, and Belize and St Kitts in the 1990s, St Lucia entered the offshore sector relatively recently in 2000.

Educational services

The Sir Arthur Lewis Community College (SALCC) was established in St Lucia in 1985 to offer instruction in agriculture, arts, science and general studies, health science, teacher education and educational administration, and technical education and

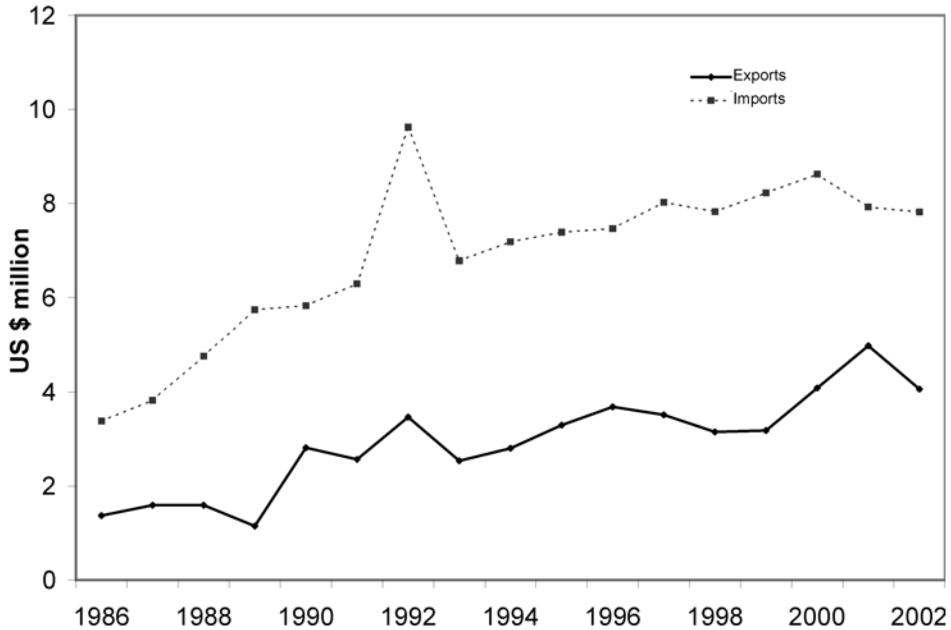


Chart 8.3: Export and imports of insurance services in St Lucia, 1986–2002
Source: UNCTAD (2007)

management studies. The SALCC does not offer a full university degree, for which students need to go to other universities in the region such as the University of the West Indies (UWI).

However, there are a few offshore medical schools in St Lucia. The best known is the Spartan Health Sciences University School of Medicine, which was founded in 1980 and consists of 13 permanent staff members. The cost of tuition is around US$3,550 per trimester for the basic sciences and the clinical sciences programme. The main target market for this institution is the United States. Other medical education institutions include the College of Medicine and Health Sciences (St Lucia) Ltd, which was set up in 2001 and operates in Rodney Bay, and the International American University, which was set up in 2003 and operates in Vieux Fort. Offshore schools contribute to the export of educational services and government revenue by paying a licence fee and an amount per student.

Tourism

The share of travel exports in total trade of services in St Lucia has been in the range of 80–90 per cent over the last decade and a half, and 20–25 per cent for imports. The tourism sector has increased rapidly over the years, with a doubling of stay-over arrivals and visitor expenditure in the past 15 years (Table 8.1). Capacity has increased at the

Table 8.1: Selected indicators of tourism for St Lucia, 1991–2006

	Total arrivals	*Visitor arrivals*	*Hotel occupancy (%)*	*No. of rooms available*	*Visitor expenditure (US$)*
1991	318,768	165,987	65.9	2,464	173
1992	348,869	183,937	73.7	2,659	209
1993	355,259	200,886	67.9	2,919	217
1994	395,410	223,872	71	2,954	225
1995	406,454	236,883	73.2	3,974	265
1996	421,746	241,232	66.6	3,986	269
1997	563,632	253,369	71.4	4,014	284
1998	629,598	257,530	75.3	4,077	283
1999	621,001	269,768	72.5	4,125	274
2000	726,254	282,703	67	4,428	279
2001	746,466	256,554	57	4,428	233
2002	648,364	261,184	56.1	4,428	210
2003	683,005	289,765	61.9	3,749	282
2004	791,151	309,872	68.7	3,974	326
2005*	719,844	325,480	64.8	4,556	356
2006*	669,154	309,561	64.9	4,737	284

Note: * = provisional.

Source: St Lucia Tourist Board

same rate, so that occupancy rates in the hotels have not changed dramatically. The estimates by the St Lucia Tourist Board suggest room capacity will sharply increase from 4,800 in 2006 to 8,000 in 2009 as a result of planned investments. The investors in this capacity increase include big brand hotels with their own marketing networks.

A large share of tourism revenues comes from events such as the St Lucia Jazz festival or the Carnival, which have emerged as major international festivals (see Box 8.1). The expenditure during St Lucia Jazz contributed to 8 per cent of the total tourism expenditure in St Lucia in 2006.

Transport, communications and information technology

St Lucia has a few IT-enabled exporting firms. For example, Helen IT Systems has operated a call centre since 2001 and currently employs around 300 people. Some new call centres opened up in recent years and others closed down. St Lucia has also attracted investment in the ICT sector, for example, Avantext (St Lucia) Ltd in Gros Islet and 'e-Services Group' in Castries.

No separate statistics are available for the exports of IT-enabled services, but the combined share of exports of computer, communications and other services in commercial service exports was about 9 per cent in 2002. The share of exports of transport services in commercial service exports was about 28 per cent in 2002 (Table 8.2). Overall, St Lucia is a net importer of both IT-enabled services as well as transport services.

Box 8.1: Event tourism in St Lucia

St Lucia has built up a basic institutional infrastructure to organise large events such as the Carnival and the Jazz festival with cultural inputs to attract visitors. The St Lucia Jazz festival has become an internationally-recognised event since its establishment in 1991. The festival emerged from the idea to market the country during the low tourist season. It apparently failed to attract many visitors the first time, but renewed efforts helped to make the ten-day event a success. The St Lucia Tourist Board is responsible for the organisation of the festival, whereas its costs are covered by merchandising, gate receipts, and contributions by the St Lucia Tourist Board and the government (for example, duty exemptions for items imported for the festival).

St Lucia Jazz was responsible for 8 per cent of visitor expenditure in 2006 and around 2 per cent of all visitors. Most visitors are from the US, Canada, the UK and the Caribbean. However, there was a sharp drop in visitors in 2007 because of the Cricket World Cup, more expensive airfares and weaker marketing.

The St Lucia Carnival is organised by the Cultural Development Foundation. The carnival emerged in 1948 when the first steel band was imported from Trinidad and Tobago. The World Carnival Conference led to the signature of accords to increase co-operation across countries. In order to prevent a clash of dates with other carnivals (for example, the famous carnival in Trinidad and Tobago), the event was changed permanently to July. There are agreements with neighbouring countries to participate in each other's carnivals so as to attract more tourists. Regional and international recognition of the St Lucia Carnival is growing and it attracted 2,098 tourists (0.3 per cent of all visitors) in 2003.

Table 8.2: Computer and transport services in St Lucia (% of service exports)

Year	*Exports of transport services*	*Exports of computer, communications and other services*
1990	10.31	21.44
1991	12.01	30.16
1992	11.68	29.26
1993	13.67	26.19
1994	14.54	27.31
1995	14.76	24.87
1996	11.64	23.05
1997	10.61	23.29
1998	20.79	18.77
1999	22.06	23.61
2000	24.28	21.56
2001	23.59	28.21
2002	27.97	8.47
Average	16.76	23.55

Notes: Transport services covers all transport services performed by residents of one economy for those of another and involving the carriage of passengers, movement of goods (freight), rental of carriers with crew and related support and auxiliary services.

Source: UNCTAD (2005)

Professional business services

It is nearly impossible to get a clear picture of the exports of professional services since such data are difficult to obtain. However, the available data suggests that St Lucia is a net importer of such services, although the exports of these services have increased from almost nil to about 5 per cent of total trade in services (Chart 8.4).

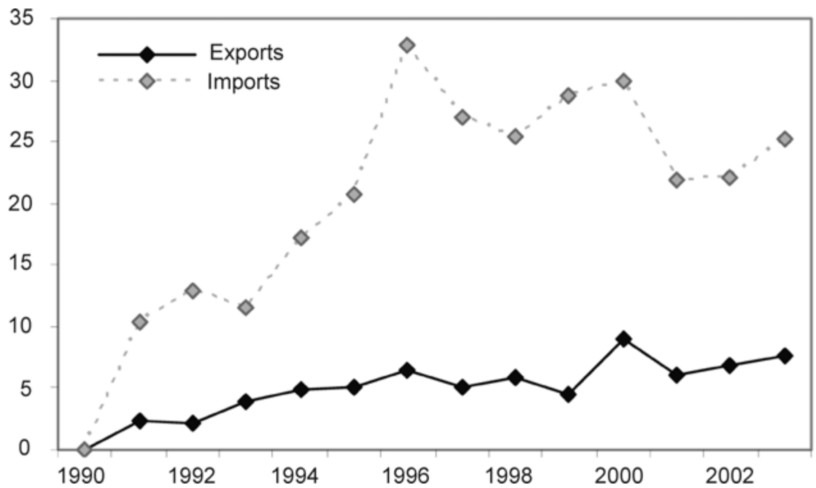


Chart 8.4: Trade in other business services in St Lucia (% of total trade in services)

Source: UNCTAD (2005)

Supporting factors

The evolution of St Lucia's services sectors provides some important examples of factors that can support trade in services.

Domestic capabilities

Box 8.2 discusses factors behind the growth of tourism services. While private interests were the initial driving force behind tourism activity, the government has backed it in various ways. For example, the government was an active supporter of development of the north of the island, paving the way for further tourism.

The general perception in St Lucia is that there is a skills mismatch between the education and training courses and degrees offered and what is needed for the development of the services sectors. While the main call centre may initially not have had difficulties recruiting (good Spanish and English language skills are available), the situation is entirely different if many more call centres came to St Lucia or for more advanced IT jobs such as software development. The education system is not geared towards such sectors. A major problem is the lack of specialised and high-value-added skills. With a need to move up the value chain, the tertiary education sector needs to be developed. A special challenge for a small country such as St Lucia is that it is difficult to move into education and training of all sectors, so a selective approach is almost necessary.

Box 8.2: The emergence of tourism in St Lucia

There are various views on what caused the emergence of the tourism industry in St Lucia, but there is a consensus that government played a useful role over the years, including the proactive use of infrastructure. Public-sector representatives point to the commercial interests of individuals in setting up hotels in the 1970s as the kick-starter of the tourism industry. Some significant government support for tourism came later – for example, marketing budgets have increased markedly over the past decade.

Private sector representatives are quick to point out that the government (with development finance support and private entities) played a useful role in developing the north of the island in the 1970s, where most hotels are currently located, reinforcing the importance of tourism. This involved the provision of infrastructure such as the Pigeon Island Causeway, which paved the way for more hotels, and the initial development of Rodney Bay Marina (by a self-made millionaire), leading to a US$50 million a year yachting sector.

Reynolds (2003) argues that before 1965 there was no tourism industry, but with a government willing to go to great lengths (generous incentives and access to the best beaches), to set the tourism sector off in order to reduce the dependence on bananas (and sugar before that). Lots of new hotels were built, fuelling a construction boom. Tourism is now more than four times the size of the banana sector.

Source: Interviews in St Lucia; Reynolds, Anderson (2003) *The Struggle for Survival: An Historical, Political, and Socioeconomic Perspective of St Lucia*

A particular current interest of the government is to develop information and communications technology (ICT) parks. Just as the development of tourism required an integral approach in St Lucia, developing ICT parks and services Export Processing Zones (EPZs) requires a lot of integral planning, as shown by the experience of other small states, such as Ireland, Singapore and Dubai. One key ingredient to the approach will be appropriate human resource development, so that St Lucia can compete with other players in the global economy. Thus, if the government takes ICT initiatives seriously, it would need to upgrade the local tertiary education institute into a full university and offer appropriate courses on ICT as well.

In addition, St Lucia's government would need to further develop the ICT infrastructure. For example, new call centres may not be able to afford a direct fibre cable that allows communication with few delays, and may need to acquire satellites first. Table 8.3 shows that the ICT indicators for St Lucia are no worse that the regional averages. In fact they are better in terms of access to ICT, indicating that St Lucia has a certain base on which it can build its ICT infrastructure further.

Policy and institutional framework

In terms of overall performance, governance in St Lucia according to 2005 World Bank governance indicators, appears to be better than an average small state, an upper-middle income country as well as the regional average (Table 8.4).

Table 8.3: ICT indicators for St Lucia (2005)

	St Lucia	*Latin America & Caribbean*	*Upper-middle income group*
Access			
Tel. main lines per 1,000 people	321	177	230
International voice traffic (min. per person)	218	N/A	46
Mobile subscribers per 1,000 people	573	439	671
Population covered by mobile telephony (%)	80	90	N/A
Internet users (per 1,000 people)	339	156	196
Personal computers (per 1,000 people)	160	88	113
Quality			
International internet bandwidth (bits per person)	95*	161	218
Affordability			
Price basket for fixed line (US$ per month, residential)	13.9	10.0	12.1
Price basket for mobile (US$ per month)	11.8	9.4	9.5
Price basket for Internet (US$ per month)	22.1	25.8	17.0
Price of call to United States (US$ per 3 minutes)	N/A	1.80	1.06

Note: * value is for the year 2000; N/A=not available

Source: World Bank (2006b) Information and Communications for Development 2006: Global Trends and Policies. *Washington DC: World Bank*

Table 8.4: Governance indicators for St Lucia, 2005

	2005	*Upper-middle income group (2005)*	*Caribbean (2005)*	*Small states (2005)*
Political stability	1.10	0.54	0.58	0.40
Government effectiveness	1.12	0.42	0.60	0.25
Regulatory quality	1.14	0.53	0.57	0.27
Rule of law	0.82	0.43	0.47	0.32
Control of corruption	1.15	0.39	0.61	0.30

Notes: Units of measures range from about –2.5 to 2.5, with higher values corresponding to better governance outcomes;
Source: World Bank (2006)

The role played by policy and institutional frameworks differs by sector. The Tourism Incentives Act of 1996 replaced the Hotel Aids Ordinance No. 25 of 1959, and provides incentives (for example, fiscal incentives) to the tourist industry. The Act grants income tax reductions, and customs duty and consumption tax waivers for the importation of supplies, equipment and materials needed for the construction of a hotel. Large hotels pay no taxes and duties for a long period and without any conditionalities, which has led many locally-owned hotels to believe that they are not the main beneficiaries of the Act. The recent budget provides incentives to foreign hotels at the top end of the market only.

The Banking Acts of 1991 and 1993 regulate banking sector activities. Licences are examined by the Ministry of Finance and the Eastern Caribbean Central Bank (ECCB). This does not seem to be particularly constraining and the sector is growing rapidly. In 2001, St Lucia passed offshore banking regulations, but few offshore companies have acquired licences. This is an important finding, which highlights that a concerted effort to develop this sector was not sufficient, probably because St Lucia was too late and not sufficiently competitive to enter this sector.

The regulatory framework for telecommunications has not been favourable for the economy in general. This is because after privatisation of the telecom sector, one firm – Cable and Wireless Ltd (C&W) – took monopoly control. There is now a regional regulatory authority at the OECS level with regulatory bodies in each country, which made an agreement with the incumbent firm and terminated its monopoly after negotiations. A two-phase transition to a liberalised telecommunications sector began in April 2001. During the first phase, licences were issued to Internet Service Providers (ISPs) and cellular mobile telephone operators. In the second phase, full liberalisation of the sector started and C&W was issued new non-exclusive operating licences in each of the five OECS states. One of the conditions for the second phase was that the tariffs charged by C&W had to be rebalanced. As a result of the new regulatory framework, mobile phone charges have decreased by up to 40 per cent due to increased competition between the new entrant Digicel Ltd and the incumbent C&W.

External conditions

St Lucia faces external conditions that affect the development and prospects of its service sectors. Favourable external commercial conditions include growing trends in the demand for tourism services in general and for those provided by St Lucia in particular. However, some external developments are conditioning the growth of the tourism sector as well. For example, air access to St Lucia is expensive. The Caribbean has recently seen a sharp price hike in regional air access, which may adversely affect the number of visitors in the future. Also, the structure of the tourism industry is changing worldwide. Tour operators and travel agencies in developing countries are calculating to become bigger players. This is increasing the competition pressure on local hotels to improve their performance, marketing strategies and health and safety standards.

International trade policies also affect trade in services. St Lucia is facing continuing trade preference erosion, which has already hit the exports of its main commodity – bananas – hard. Producers and exporters of agricultural and manufactured products are finding it increasingly difficult to compete with other suppliers, including the larger countries. There are few existing preferences for services, but now that St Lucia is losing its competitive edge due to preference erosion, the promotion of services is suggested as one of the ways forward.

St Lucia is a WTO member and has committed to a few sectors in the General Agreement on Trade in Services (GATS). While it is difficult to assess the precise links with increased investment, in theory appropriate commitments should provide for a more welcoming investment climate. So far, the committed sectors have not enjoyed a large increase in FDI because of GATS. This may be because these sectors were already quite liberalised before making the commitment. However, it is important to consider further commitments, which would show that the government takes the development of its services seriously. For instance, signalling greater openness to foreign education institutions (for example, offshore medical schools) might be helpful in the government's strategy to attract more exporters of education services.

The Caribbean Single Market and Economy includes services, covered by the revised Chaguaramas treaty of 2001 establishing the Caribbean Community: Chapter III on Establishment, Services, Capital and Movement of Community Nationals. The initiative on the free movement of skills originated in the 1989 Grand Anse Declaration (GAD) and found its way into 2001's revised Chaguaramas treaty establishing the Caribbean Community, including the CARICOM single market and economy. Article 45 states that 'Member States commit themselves to the goal of free movement of their nationals within the Community.' Article 46 of the GAD on movement of skilled community nationals states that 'as a first step certain categories of Community nationals should be accorded the right to seek employment in their jurisdictions.' Member states have enacted legislation to implement free movement of university graduates and of artists, media workers, musicians and sports persons from 1995 onwards. There are plans for further liberalisation of movement in other categories. These developments seem to have facilitated the movement of people and hence trade in services.[1]

Institutional support structure

St Lucia is at a critical juncture regarding the level of support and strategic direction it provides to its service industries. Strategic action is important for creating appropriate overall conditions for the development of trade in services. Appropriate public institutions need to have the right mandates and the right interpretation of those mandates. The National Development Corporation (NDC) – the island's principal development agency promoting investment and exports – would need to continue to focus its attention on promoting investment in services, and this needs to go hand in hand with the right incentives and proactive thinking as in the case of goods. Services benefit from appropriate skills, technology institutes, incubators and clustering initiatives, all of which could be implemented and facilitated by the NDC. In particular, it seems important to have a more integral approach to IT parks. The Ministries of Economic Affairs, Economic Planning and of Trade, Industry and Commerce need to co-operate on setting the right framework for the development of service industries and ensure that the objectives of the country and the service sectors coincide.

At the same time, it is important to obtain an adequate private sector representation in order to facilitate good state-business relations for the development of services. The St Lucia Chamber of Commerce is the main voice for the private sector, and it has many (voluntary) members, including some from the services economy. However, just as there is a manufacturers' association, the development of adequate associations to represent services is also important (see Box 8.3 on Barbados).

Box 8.3: Private sector associations in services: Barbados

Barbados is a key example of a small state (in the Caribbean) that has created a coalition of service industries, known as the Barbados Coalition of Service Industries (BCSI). The coalition was formed as a private-sector initiative in 2002 and consisted of 20 member associations initially. However, today it represents the interests of about 39 service associations comprising over 3,000 service providers in the private and public sectors.

The Government of Barbados fully supports the BCSI, providing funding for the secretariat and its projects. The BSCI has an independent board and is tasked to implement an export strategy, by improving the image of service providers and developing their capacity. The BCSI assists its service providers by continuing to educate its members on how to export successfully and on WTO rules. It lobbies government for changes in legislation, provision of incentives and financial assistance; helps service providers to access financial and technical assistance; and it sets up associations where none exist. The BCSI has organised seminars, procurement workshops and launched a website which has proven most valuable for its membership. It also sends out several learning pieces to members on issues such as GATS and external barriers to trade.

In addition, the BCSI is assisting other Caribbean countries such as St Lucia to develop a services coalition. It is envisioned that after national coalitions are formed in individual CARICOM states, they will jointly form a Caribbean Coalition of Service Industries.

Source: Barbados Coalition of Service Industries (http://www.bcsi.org.bb/ [accessed 29 May 2008])

Some of the service industries in St Lucia, for example, insurance, banking, tourism/hotel, engineering and medical services, already have well-organised associations that have been able to voice their concerns to the government successfully. A good example is the Insurance Council, which is mirrored only in Trinidad and Tobago and Barbados in the region. The membership of the Insurance Council has grown gradually over time to around 30 brokers and insurers. Its roles and responsibilities include:

- Communication with government and lobbying;
- Promoting codes of ethics through internal sub-committees;
- Receiving complaints and urging members to address them, thereby improving public trust and confidence;
- Facilitating projects to benefit all members;
- Ensuring the interests of the insurance industry by sitting on committees and boards of other sectors; and
- Imparting information about the insurance industry in educational institutions.

In the tourism sector, the St Lucia Hotel and Tourism Association is well-organised and helps local businesses to promote themselves. For example, the Association assists local hotels that lack adequate IT systems to market their services on the internet. The St Lucia Tourist Board is also supportive. It has offices abroad for international marketing and its budget allocation for further promoting tourism is increasing.

In addition, a host of smaller associations exist in the country, but they often lack the funds to operate strategically and lobby government or to raise the standards of individual members. To fill this gap, a Coalition of Service Industries was formed in 2005. The coalition aims to help set and raise standards and acts as a bureau of standards for the services sector. Discussions are also ongoing about the extent to which the coalition needs to be engaged in advocacy, for example, with respect to skills development in relation to IT parks or other service sectors.

Conclusions

The contribution of the services sector to the economy is substantial in St Lucia. The development of tourism has succeeded; while initially private-sector led, the government had the vision to provide the right framework for the development of tourism services.

In other instances, for example, in offshore banking services, government action failed to lead the sector into success, because the external environment was not right. This is a painful reminder that government interventions, if they are to be successful, need to be well thought out and all factors (domestic capabilities, regulatory frameworks and external conditions) need to be enabling.

In this regard, St Lucia is at a crucial juncture. In order to move beyond tourism services and promote exports of other services, it needs to move more strategically into certain key sectors (see Box 8.4 on the private sector's view towards adopting an integrated approach in this regard).

Box 8.4: An integrated approach to developing services: a private sector view

The government needs to co-ordinate action to support services. There are clear co-ordination failures that justify government involvement, such as a dearth of entrepreneurial people, high unemployment and social dislocation. An integrated approach is needed to move out of this situation, which would include:

- Provision of research know-how;
- Improving the culture of training;
- Identifying needs for infrastructure;
- Improving the entrepreneurial spirit;
- Improving access to credit; and
- Emphasising positive public action rather than incentives (which could be used as an excuse for failure in other areas).

Source: Interviews in St Lucia

IT-related activities are a prime candidate for further development. The fact that there are already some IT-enabled service exporters, coupled with a relatively well-organised finance and insurance sector suggests that the current interest in IT parks could be successful if supported by a well-educated and trained workforce, IT infrastructure, research centres, appropriate incentives and international promotion of the sector (including in trade agreements).

Another promising service sector for St Lucia relates to offshore medical schools and training of nurses. There are already some offshore medical schools in the country, which provide a foundation for developing this sector further.

Note

1. Source: Based on interviews conducted in St Lucia.

9

Singapore

Singapore is a high-income island located in the Pacific with real per capita GDP (PPP-adjusted) of US$26,763 and total population of 4.4 million in 2005. Singapore, with an average annual growth rate of 7 per cent since the 1990s, is a well-known economic success story. The services sector has played an important role in the economic development of this small island, contributing to 64 per cent of GDP and over 69 per cent of employment in 2005 (Chart 9.1). Its GDP and employment share is comparable to that of other high-income East Asian economies such as Japan, Taiwan and South Korea.[1]

The services sector has grown steadily in Singapore. In 2004 alone, the value added by services rose by 12.4 per cent. The contribution of trade in services to GDP has also increased significantly over the years (Chart 9.2). In 1990, trade in services accounted for 58 per cent of GDP, which increased to 76 per cent in 2004.

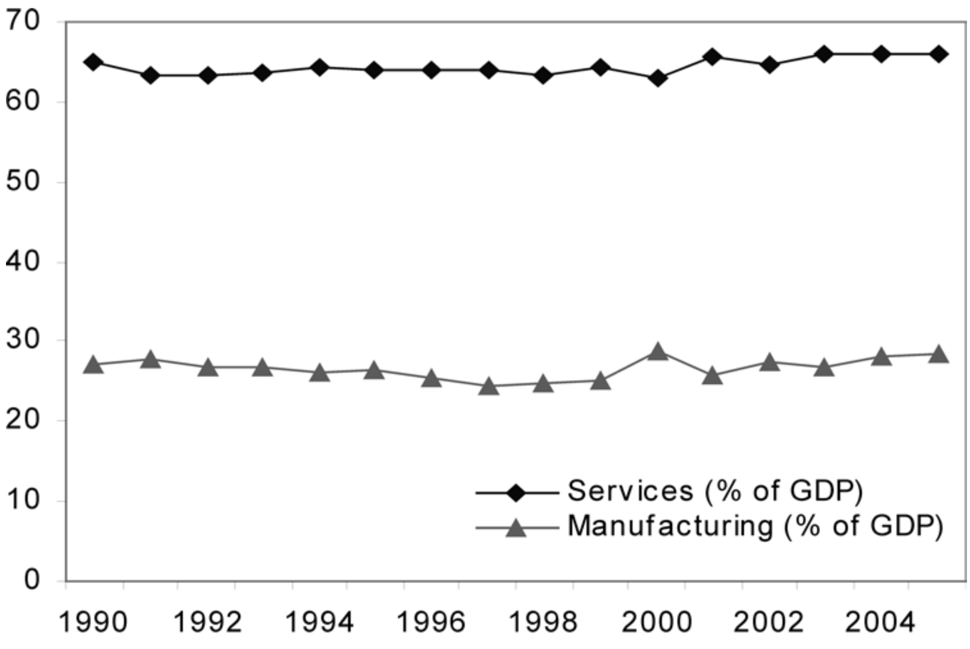


Chart 9.1: Contribution of services to GDP in Singapore (%)
Source: Based on World Bank (2006)

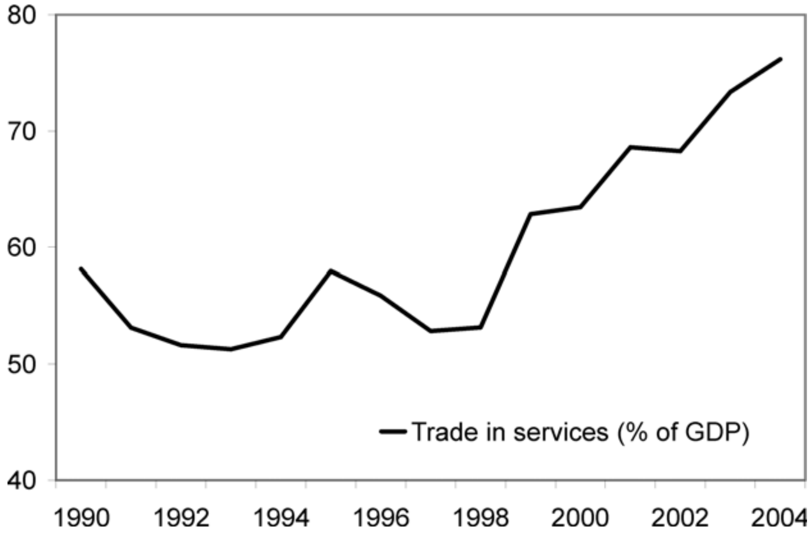


Chart 9.2: Contribution of trade in services to GDP in Singapore (%)
Source: Based on World Bank (2006)

Singapore has always been a net exporter of services.[2] The share of service exports in total trade of services has remained fairly constant at over 15 per cent since the mid-1980s (Chart 9.3). However, the import share has risen gradually, but especially since the late 1990s.

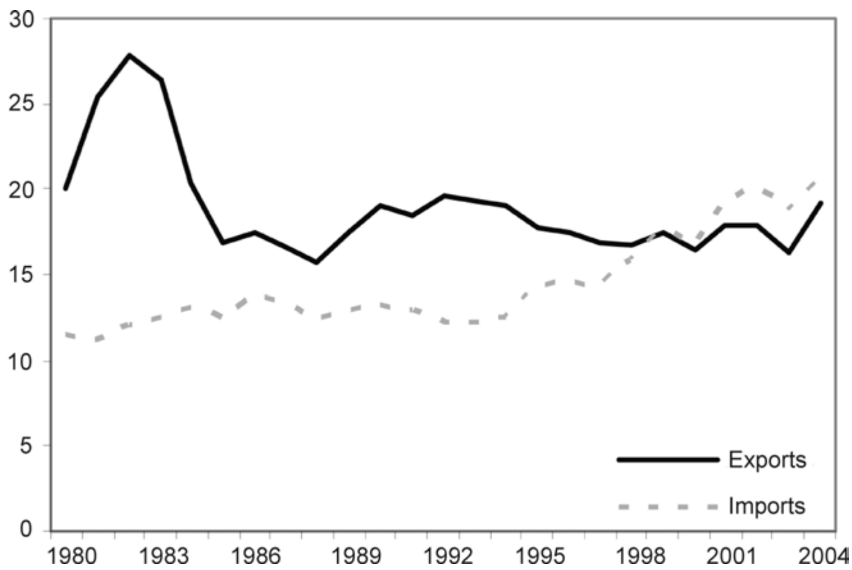


Chart 9.3: Exports and imports of services as a % of total trade of Singapore
Source: Based on UNCTAD (2005)

The main sub-sectors in services are the wholesale and retail trade; hotels and restaurants; transportation, storage, information and communications; financial and insurance services; real estate and business services; and community, social and personal services. The largest number of firms and workers are associated with the wholesale and retail trade sector, which is followed by the real estate and business services, and the community, social and personal services sectors (Chart 9.4).

Performance of selected services

Financial services

The financial services sector is one of the most important services sectors for the economy, contributing 5 per cent to total employment and 11 per cent to GDP. At the end of 2005, about 10,000 firms in Singapore were associated with the financial and insurance services sector; most of these were small firms (with less than 10 employees). According to Singapore's Department of Statistics, financial services had the highest profitability ratio (defined as the ratio of operating surplus to operating receipts) and value added per worker among the main service sub-sectors in 2003 and 2004. The sector is also the second largest recipient of foreign direct investment (FDI) in Singapore. FDI inflows into financial and insurance services were 34.7 per cent of the total FDI inflow in 2005.[3]

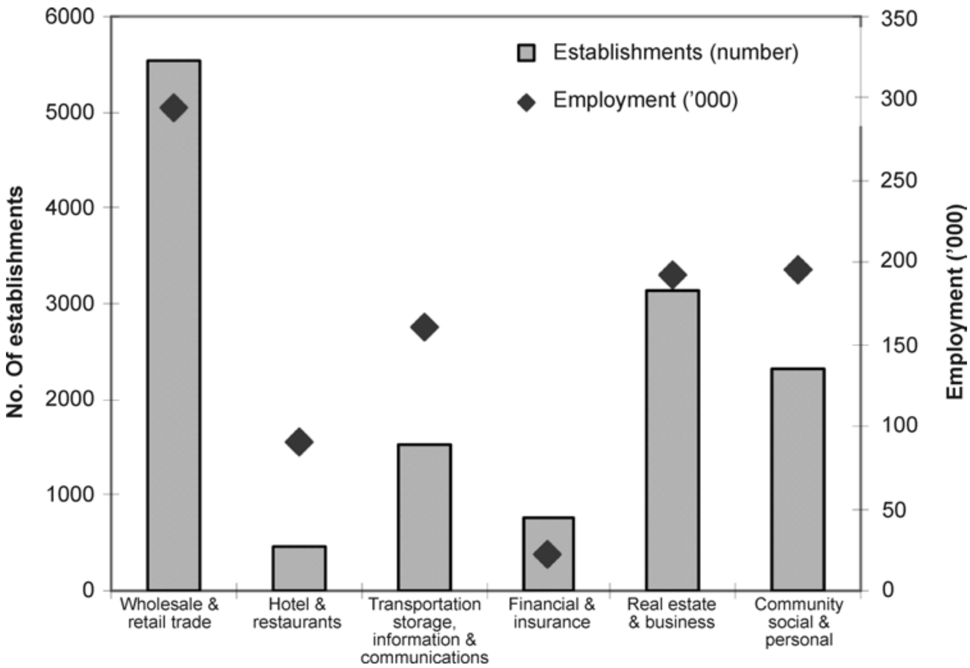


Chart 9.4: Establishments and employment in main services sectors in Singapore, 2004

Source: Economic Survey Series 2004, Department of Statistics, Government of Singapore

The sector is dominated by banks, which accounted for over 85 per cent of total financial sector assets in 2003 (IMF, 2004). There are five local banks, which account for 21 per cent of total financial assets, and 110 foreign banks, which constitute 64.6 per cent of total financial assets. In terms of sector dominance, banks are followed by the insurance sector, which comprises 6 per cent of the total financial assets in the economy.

Singapore is a net exporter of financial services (excluding the insurance sector) (Chart 9.5). The share of financial services in total services trade stood at 6 per cent in 2003. Exports have been going up in recent years, and increased by about 30 per cent in 2003.

In the insurance sector, Singapore is a net importer. The gap between the imports and exports has widened considerably over the years (see Chart 9.6). The average share of exports of insurance services in total trade of services during 2000–03 was about 2 per cent whereas that of imports was 6 per cent. However, insurance exports have picked up sharply since 2000 and increased by 15 per cent in 2003.

Tourism

The tourism sector, which primarily constitutes hotels and restaurants, contributed 2 per cent to GDP and over 5 per cent to total employment in Singapore in 2005. Singapore remained a net exporter of tourism services throughout the 1980s and 1990s, but became a net importer in 2001. Share of tourism exports in services trade also exhibits a declining trend and decreased from 36 per cent in 1990 to 13 per cent in 2003.

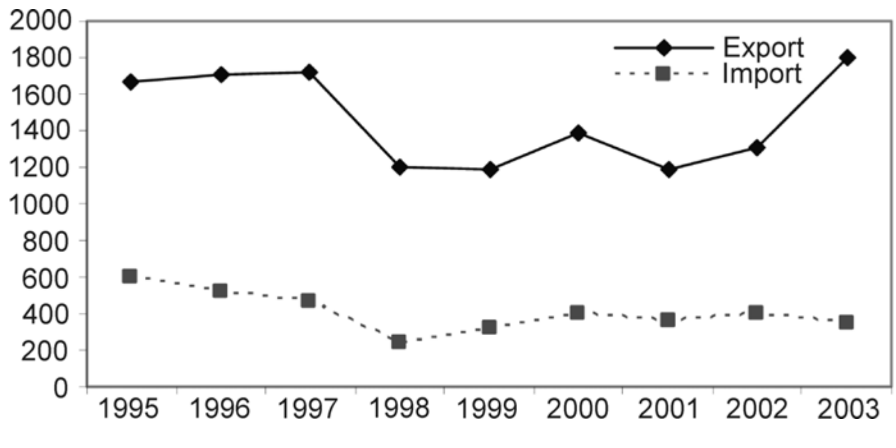


Chart 9.5: Exports and imports of financial services in Singapore (US$ million)
Source: UNCTAD (2005)

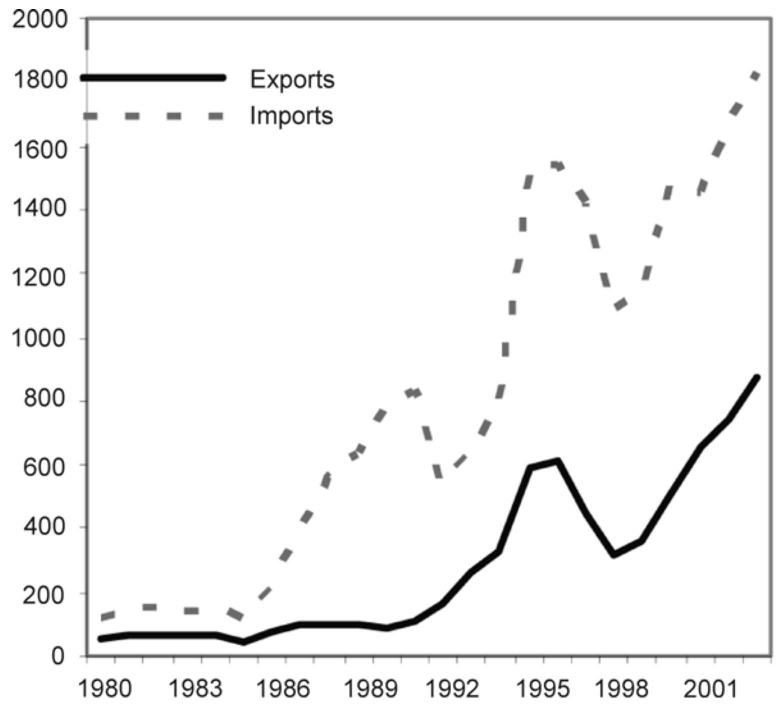


Chart 9.6: Exports and imports of insurance services in Singapore (US$ million)
Source: UNCTAD (2005)

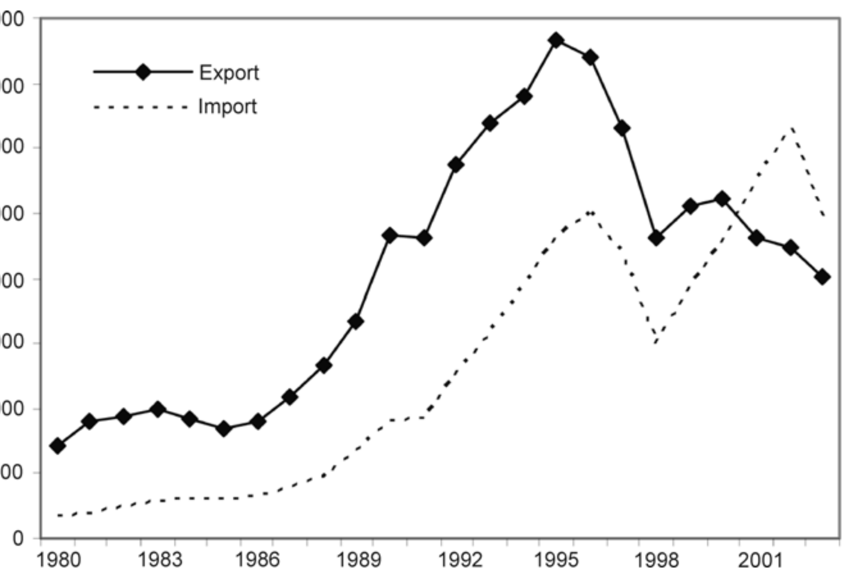


Chart 9.7: Exports and imports of travel services in Singapore (US$ million)
Source: UNCTAD (2005)

The number of visitors arriving in Singapore dipped sharply in 2003, falling by about 20 per cent. However, recent estimates of the Department of Statistics indicate that the number of visitors increased by 36 per cent and 7 per cent in 2004 and 2005, respectively.[4] A vast majority of the tourists visiting Singapore are from the Association of Southeast Asian Nations (ASEAN) region, followed by China, Japan, Australia and the United Kingdom.

Transport and information and communications technology

In 2005, the share of transport and storage in GDP stood at 11 per cent and that of information and communications was 4 per cent. Employment in these sectors constituted 11 per cent of total employment. Total value added by information and communications services grew by 3 per cent in 2004, and that of transport and storage services increased by 7 per cent.

Singapore has been a net importer of transport services since mid-1980s (Chart 9.8). However, the share of transport exports in total services trade has increased significantly from 17 per cent in 1990 to 38 per cent in 2003. It is also a net importer of communications services, which had exports that accounted for 2 per cent of total services trade in 2003.[5]

Table 9.1: Selected indicators of tourism for Singapore, 1990–2003

	Arrivals of visitors (thousands)	*Average length of stay (days)*	*Visitors' expenditures, excluding transport (millions of dollars)*
1990	4,842	3.30	4,937
1991	4,913	3.26	4,767
1992	5,446	3.14	6,081
1993	5,804	3.01	7,004
1994	6,268	2.95	7,811
1995	6,422	3.71	7,646
1996	6,608	3.29	7,402
1997	6,531	3.27	6,300
1998	5,631	3.43	4,602
1999	6,258	3.18	5,089
2000	6,917	3.16	5,229
2001	6,725	3.19	4,617
2002	6,997	3.08	4,463
2003	5,705	3.18	3,998

Source: UNCTAD (2005)

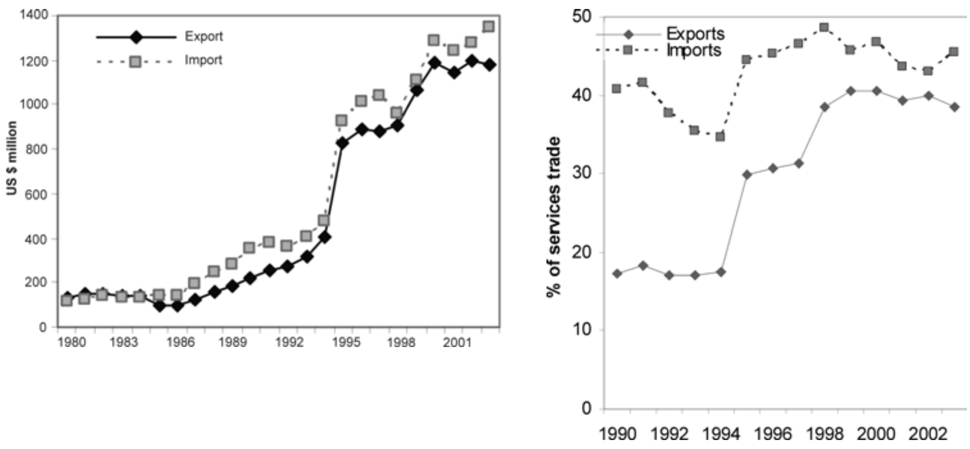


Chart 9.8: Exports and imports of transport services by Singapore
Source: UNCTAD (2005)

In computer and information services, Singapore is a net exporter (Chart 9.9). Its exports have increased and imports have declined sharply since 2001. However, despite the increase in exports, this services sub-sector still constitutes only 1 per cent of total services trade.

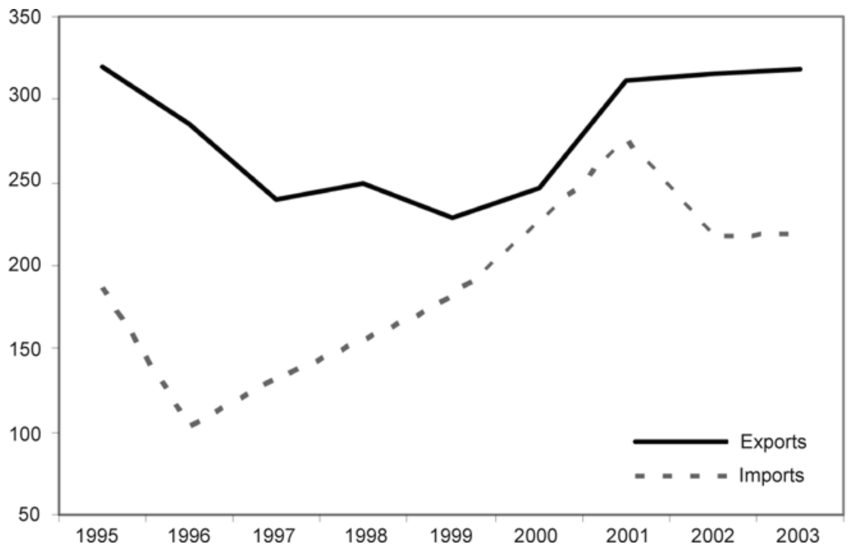


Chart 9.9: Trade in computer and information services for Singapore (US$ million)
Source: UNCTAD (2005)

Professional business services

Business services are an important part of Singapore's economy, contributing 12 per cent to GDP and 11 per cent to total employment. With over 31,000 establishments, the sector expanded by 10 per cent in 2004. Total FDI inflow into business services (including real estate) was 5.9 per cent of total FDI.

The country is a net exporter of business services (Chart 9.10). Exports (in nominal terms) increased sharply from the mid-1980s to early-1990s, before plunging sharply. However, they have recovered since the late 1990s and accounted for about 35 per cent of total services trade in 2003.

Educational services

According to statistics from 2004, the education services industry comprises of about 50,000 workers; this accounts for around 5 per cent of total employment and 3 per cent of GDP. Value added by the education services industry increased by 0.3 per cent in 2004. In 2004, about 2,900 establishments were affiliated with education services, of which over 80 per cent were small. Larger institutions are often more profitable in Singapore and also have higher value added per worker.[6]

Since the mid-1980s, the government has embarked upon an ambitious programme of making the education sector one of the country's key sectors and Singapore the centre

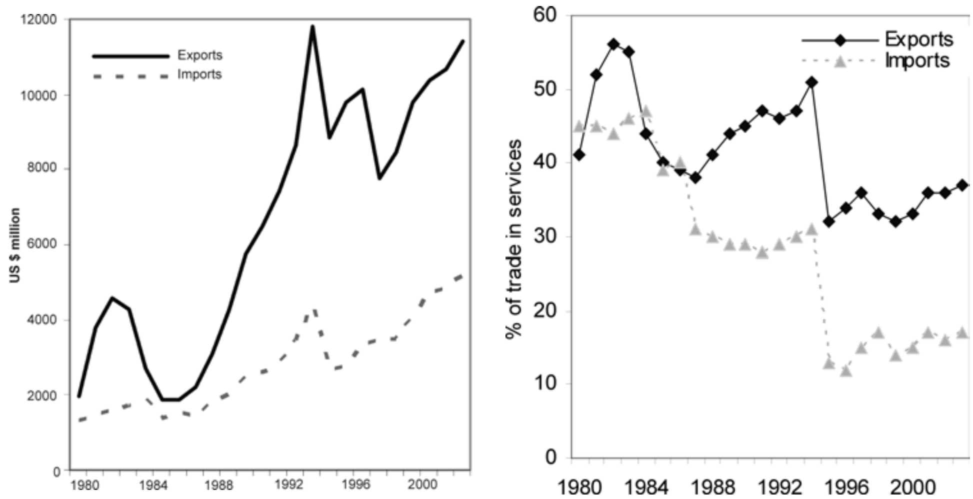


Chart 9.10: Exports and imports of other business services of Singapore, 1980–2003*

Note: * includes merchanting and other trade-related services; operational leasing services; and miscellaneous business, professional and technical services.

Source: UNCTAD (2005)

of education for regional and international students. Well-designed policies and strategic efforts have resulted in attracting overseas students, and as of 2005 more than 70,000 foreign students were studying in Singapore.[7] Campuses of 16 well-known international institutions from the USA, UK and Australia are operating in Singapore.

Supporting factors

Domestic capacity and skills

The domestic environment of Singapore is ideal for further development of the private sector. It ranks fifth out of 124 countries in the Global Competitiveness Index, compiled by the World Economic Forum, which is a composite measure of the state of institutions, infrastructure, macroeconomic performance, health and primary education, higher education and training, market efficiency, technological adaptability, business sophistication, and innovation.

In terms of skills, Singapore has a comparative advantage over its regional competitors because of its highly-competitive, skilled, English-speaking workforce. Its total adult literacy in 2005 was 93 per cent. The net secondary and gross tertiary school enrolment ratios in 1999 were 76 and 39 per cent respectively.[8]

Singapore has well-developed information and communications technology (ICT) systems. A comparison of the access, quality and affordability of its ICT with high-income countries indicates that its performance is better than an average high-income country in the three respects (Table 9.2).

Table 9.2: ICT indicators for Singapore (2005)

	Singapore	*High-income group*
Access		
Tel. main lines per 1,000 people	425	503
International voice traffic (min. per person)	646*	171
Mobile subscribers per 1,000 people	1,010	835
Population covered by mobile telephony (%)	100	99
Internet users (per 1,000 people)	571	527
Personal computers (per 1,000 people)	621	579
Quality		
International Internet bandwidth (bits per person)	5,826	4,537
Affordability		
Price basket for fixed line (US$ per month, residential)	6.7	27.6
Price basket for mobile (US$ per month)	6.1	17.8
Price basket for internet (US$ per month)	20.5	19.9
Price of call to United States (US$ per 3 minutes)	0.69	0.76

Note: * value is for the year 2000.

Source: World Bank (2006) Information and Communications for Development 2006: Global Trends and Policies. *Washington DC: World Bank*

Transport infrastructure in Singapore is also of a high standard and 100 per cent of the total road network (3,165kms) is paved. Singapore's main airport (Changi airport) is ranked one of the best in the world and has a network of over 70 airlines. In terms of shipping, Singapore has a highly-modernised and efficient infrastructure and is ranked in the top ten most important maritime nations in the world. Its location and investment-friendly climate (including incentives) has attracted over 40 multinational shipping companies to base their regional headquarters in Singapore.

The financial sector has developed substantially due to an efficient legal system, high accounting standards and good corporate governance (IMF, 2004). Singapore has a highly-developed payment infrastructure, which is one of the best in the world. The infrastructure for clearing and settlement of securities and derivatives is also well developed. In addition, the country has conducive legal, judicial and regulatory environments, which are crucial for private sector development.

Policy and institutional framework

The government has been actively managing Singapore's economy. To provide incentives for investment and innovation, the Pioneer Industries Ordinance of 1959, one of several tax incentives, reduced corporation tax for a fixed period of time provided that firms, both foreign and domestic, developed new products. The Ordinance was part of an industrial strategy that focused on attracting employment-generating multinationals in the 1960s and early 1970s. After an increase in the wages and improvements in the skills of the workforce, the focus shifted to targeting capital-intensive projects in the 1980s and knowledge-intensive sectors in the 1990s. Currently, Singapore's skills base is an important factor in attracting foreign investment to the country.

The country has also been developing its services sector actively since mid-1980s. This was upon the recommendations of its Economic Committee, which was set up by the government to review economic performance and suggest new directions and strategies for accelerating growth and development. To do so, it has improved its infrastructure, improved the regulatory and institutional environment, and has devised well-planned strategies that helped increase domestic as well as foreign investment in the country. Singapore ranks very high in terms of the World Bank's governance indicators and outperforms other small states, the rest of East Asia and an average high-income country (Table 9.3).

In the financial services sector, all financial institutions, securities and insurance companies are under the purview of the Monetary Authority of Singapore (MAS), which is Singapore's central bank. MAS also oversees the regulatory responsibilities of the stock exchange, Singapore Exchange. During 1999–2003, MAS undertook key reforms to liberalise the financial sector and develop its regulatory framework. In 2002, the Financial Advisors Act was implemented to consolidate the different regulations governing financial advisory services and to set high standards of business conduct. The Securities and Financial Services Act was also enacted to integrate supervision of financial firms in the securities and future markets (IMF, 2004).

Table 9.3: Governance indicators for Singapore, 2000–05

	2005	*Average 2000–05*	*High-income group*	*East Asia*	*Small states*
Political stability	1.08	1.12	0.81	0.39	0.40
Government effectiveness	2.14	2.28	1.27	–0.05	0.25
Regulatory quality	1.79	1.90	1.23	–0.11	0.27
Rule of law	1.83	1.81	1.26	0.16	0.32
Control of corruption	2.24	2.37	1.36	–0.13	0.30

Note: Units of measures range from about –2.5 to 2.5, with higher values corresponding to better governance outcomes.
Source: World Bank (2006)

To improve corporate governance, the Council of Corporate Disclosure and Governance was established in 2002. In 2003, the Code of Corporate Governance, which requires all companies to disclose their governance practices in their annual reports, took effect. Further, listed companies with market capitalisation of at least 75 million Singapore dollars (S$) are required to issue quarterly reports.

In the tourism sector, the Singapore Tourist Promotion Board (STB) was established in 1964 to promote and develop the tourism industry in Singapore. Since its establishment, STB has actively encouraged investment and infrastructure in hotels and restaurants, tourist attractions and tourist facilities. STB has 22 regional offices across the world, to promote the image of Singapore as a tourist destination abroad.

External conditions

Singapore has been a member of the WTO since 1995 and a member of the Asia–Pacific Economic Cooperation (APEC), which seeks to liberalise trade and investment in the Asia–Pacific region by 2020, since 1994. In addition, it has negotiated free trade agreements (FTAs) with several trading partners, for example, USA, Japan, South Korea, Australia, New Zealand, India, Jordan, Panama, the European Free Trade Association and the Trans-Pacific Strategic Economic Partnership (comprising Brunei, Chile, New Zealand and Singapore). At the time of writing, it was negotiating FTAs with Canada, the Cooperation Council for the Arab States of the Gulf, China, Mexico, Pakistan and Peru.

In the context of the GATS, Singapore has made specific commitments in various sectors including tourism and travel, communications, financial services and professional business services. However, these commitments are subject to certain limitations in modes 1 to 3. For example, financial services are subject to the entry requirements, domestic laws, guidelines, rules and regulations, and terms and conditions of MAS. In terms of telecommunications, fixed-line and mobile networks, and value-added telecom services, are all subject to restrictions on entrance and competition in addition to the horizontal commitments.

Institutional support structure

In Singapore, the Economic Development Board (EDB) is the principle and highly efficient government agency responsible for planning and implementing economic strategies and finding new directions and prospects for growth. It places special emphasis on developing capital and innovation-intensive activities so as to make Singapore the hub of international investment.

The EDB supports the operations of both local and foreign investors in the manufacturing and services sectors. It is a highly pro-active organisation, which is also playing an important role in expanding existing industry clusters. It has an investment body, EDB Investments Pte Ltd (EDBI), established for the purpose of equity investments that are geared towards the growth of industry clusters and emergent technologies and innovations. The EDBI invests into projects in partnership with local and multinational companies to further develop key industries.

In the private sector, the Singapore Business Federation is the most important body for assisting businesses in strengthening their trade, investment and networking relations. It facilitates interaction between the public and privates sectors in Singapore and represents the private sector internationally. It has over 15,000 members, which include over 20 per cent of the country's top companies.

Conclusions

The emergence of Singapore as a regional and international hub for services is due to the close co-operation and partnership between the public and private sectors in the country and the combined initiatives of those sectors. The government reviews the economic performance of the economy, identifies niche markets with growth potential, sets targets for medium- and long-term growth, and devises and implements strategic plans to achieve those targets. The private sector builds on the services and facilities provided by the government and makes full use of its potential. A classic example of this is the development of Singapore's education sector. The Economic Committee of Singapore stressed the need for developing a strong tertiary education sector in the mid-1980s and reaffirmed that need in 2001. Since then, the government has undertaken numerous initiatives to promote tertiary education in the country. Besides establishing three world-class public universities, the EDB embarked upon an ambitious plan to attract renowned foreign academic institutions and bring in more specialised programmes through tie-ups with local private educational institutions. A recent important initiative in promoting educational services further is 'Singapore Education' – described in Box 9.1.

Box 9.1: A Singapore government initiative in tertiary education: 'Singapore Education'

In 2003, a multi-government agency initiative, Singapore Education, was launched by the EDB with the support of the Singapore Tourism Board (STB), the Standards, Productivity and Innovation Board (SPRING), International Enterprise (IE) and the Ministry of Education (MoE).

Each agency has been assigned specific tasks to promote Singapore's educational sector and attract more foreign students to the country. The EDB conducts negotiations with foreign academic institutions, providing them with incentives and information to open campuses in Singapore. The STB is responsible for marketing educational services overseas and provision of information on facilities to foreign students in Singapore. SPRING, meanwhile, administers quality accreditation for private education organisations in the country, and IE helps good schools in Singapore to develop their businesses and set up campuses overseas. Finally, the MoE is responsible for overseeing the local school system.

Notes

1. In 2004, the GDP share of services in Japan, Taiwan and South Korea was 69, 69 and 56 per cent, respectively, and the employment share of services was 68, 66 and 64 per cent, respectively.
2. Source: World Bank (2006) and UNCTAD (2005).
3. The largest recipient was the manufacturing sector, with 35.2 percent of total FDI inflow.
4. Source: http://www.singstat.gov.sg/stats/stats.html#latestdata [accessed 11 June 2008]
5. Source: http://www.singstat.gov.sg/stats/stats.html#latestdata [accessed 11 June 2008]
6. Source: Singapore's Department of Statistics.
7. Source: http://www.edb.gov.sg/edb/sg/en_uk/index/industry_sectors/education_services.html [accessed 11 June 2008]
8. Source: World Resources Institute (2003) *Population, health and human well-being – Singapore*. Also available at: http://earthtrends.wri.org/pdf_library/country_profiles/pop_cou_702.pdf [accessed 2 June 2008]

10

United Arab Emirates

United Arab Emirates (UAE) is a Middle Eastern federation comprising seven states – Abu Dhabi, Ajman, Dubai, Fujairah, Ras-al-Khaimah, Sharjah and Umm-al-Quwain. Abu Dhabi, Dubai and Sharjah are the three largest states in terms of population as well as the size of their economies. UAE is an oil rich country, with 9 per cent of total world reserves of crude oil and 5 per cent of world reserves of natural gas. In 2004, it had a real per capita GDP (PPP-adjusted) of US$22,000 and a population of 4.3 million. With an average annual growth rate of over 7 per cent since 2000, the UAE economy is one of the fastest growing in the world.

The importance of trade of goods and services to the country is substantial, and trade constituted 145 per cent of GDP in 2004. The country maintains a trade surplus, primarily because of its large oil and gas exports. Foreign direct investment (FDI) inflows to UAE increased rapidly in the last few years (Chart 10.2). They stood at US$10 billion in 2004 and inched up to US$12 billion in 2005 (UNCTAD, 2005).

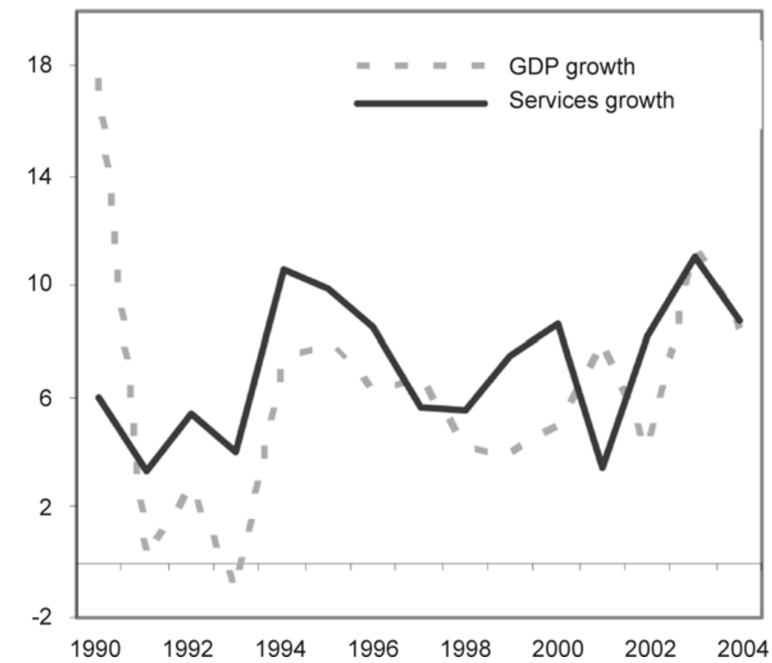


Chart 10.1: Annual GDP and services growth rates for UAE (%)
Source: World Bank (2006)

The leading sectors for FDI are oil- and gas-field machinery and services, power and water, computers, medical equipment and supplies, airport development and ground equipment, telecommunications and franchising.

Although the importance of manufacturing has increased since the late-1990s, the services sector continues to be the main contributor to the economy with shares of over 40 and 50 per cent in GDP and total employment respectively (Chart 10.3). Since 1990, the services sector has recorded impressive growth and has expanded at an average rate of more than 7 per cent. The main services sub-sectors contributing to GDP are trade (external trade [transshipment and re-export]), wholesale and retail trade, real estate and construction activities, and transport storage communications; these sub-sectors had a combined share of 35 per cent of GDP in 2004.

Performance of services

The share of the financial services sector in GDP was about 6 per cent in 2004. The sector grew at an average rate of 8 per cent during 1999–2004 (Table 10.1). In the financial and insurance services sector in 2004, there were 46 commercial banks (21 national and 25 foreign), 50 representative offices of foreign banks, two investment banks, seven financial investment companies, seven finance companies, 12 financial consultancies and 46 insurance companies (50 per cent local). The country's banking sector is in general efficient, competitive and profitable.

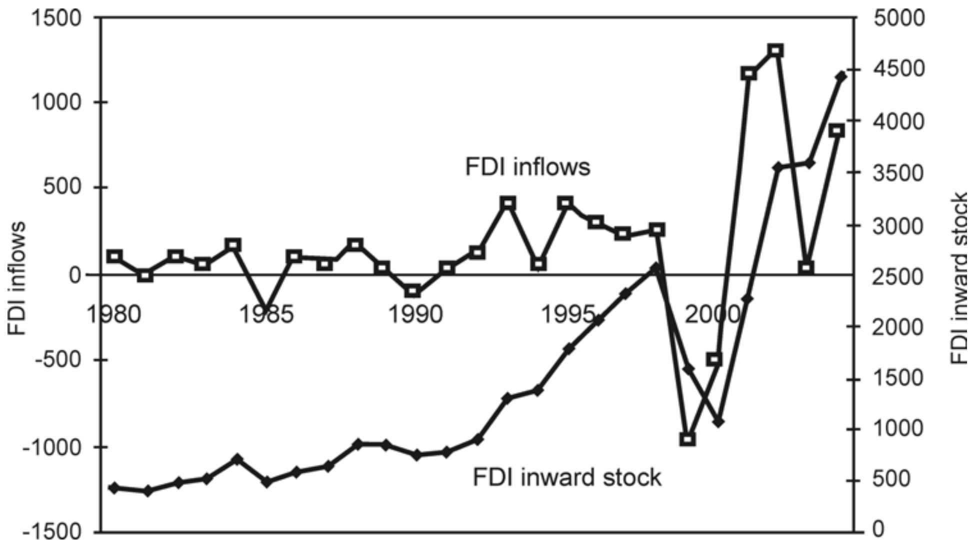


Chart 10.2: FDI inflow and FDI inward stock for UAE (US$ million)
Source: UNCTAD (2005)

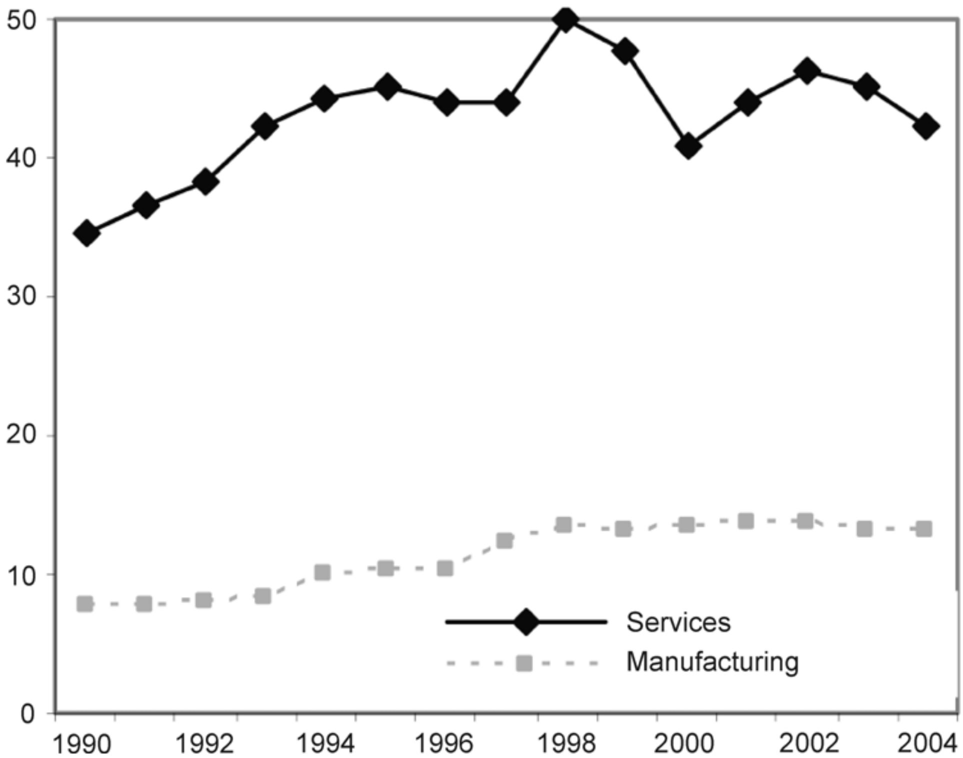


Chart 10.3: Share of manufacturing and services in GDP for UAE (%)
Source: World Bank (2006)

Real estate services accounted for 10.0 per cent of GDP in 1995, but this share decreased to 7.8 per cent in 2004. On average, the sector has been growing at a slower rate as compared to other services (see Table 10.1).

Table 10.1: Growth in real terms for selected services (%)

	1999	*2000*	*2001*	*2002*	*2003*	*2004*	*Average (1999–2004)*
Trade, restaurants & hotels	4.0	3.4	1.2	17.3	17.3	6.2	8.2
Transport & communications	9.9	14.3	6.1	7.1	7.8	10.1	9.2
Finance & insurance	5.2	7.6	12.1	0.9	8.1	15.9	8.3
Real estate	3.8	0.9	1.6	11.2	8.1	14.1	6.6
Other services	6.0	7.2	7.0	22.7	9.9	4.8	9.6

Source: WTO (2006)

The share of transport, storage and communications in GDP increased from 6.7 to 7.2 per cent from 1995 to 2004. With an average annual growth rate of 9 per cent in recent years, it is one of the fastest growing services sectors in UAE. Sea transport benefits from highly-developed ports. UAE's merchant fleet consists of 180 ships and ranked 31st in the world in 2001 (WTO, 2006). The government of UAE owns Emirates airlines, which is world's fastest growing airline with an annual average growth rate of 20 per cent. The share of exports of this sector in trade of services was 4 per cent in 2004. However, the country is a net importer of transport services and its trade deficit in transport was estimated to be US$0.5 billion in 2004 (Chart 10.4).

The UAE government is putting more and more emphasis on increasing revenues from the tourism sector. It has undertaken numerous initiatives in this regard, with the result that tourism is growing very fast – almost three times more than world tourism – and constituted 12 per cent of GDP in 2003.[1] Dubai, the second largest state in terms of its economic size, has emerged as a major tourist destination in recent years. With over 270 hotels and 30 shopping malls, 5 million tourists visited Dubai and 16 million passengers used its airport in 2007.

Tourism exports for UAE account for 6 per cent of the country's total trade in services. UAE remained a net importer of travel services throughout the last decade. However, the trend may reverse considering the rapid growth of the sector (see Table 10.2). In 2002, Dubai was ranked as the fastest growing tourist destination by the World Tourism Organisation.

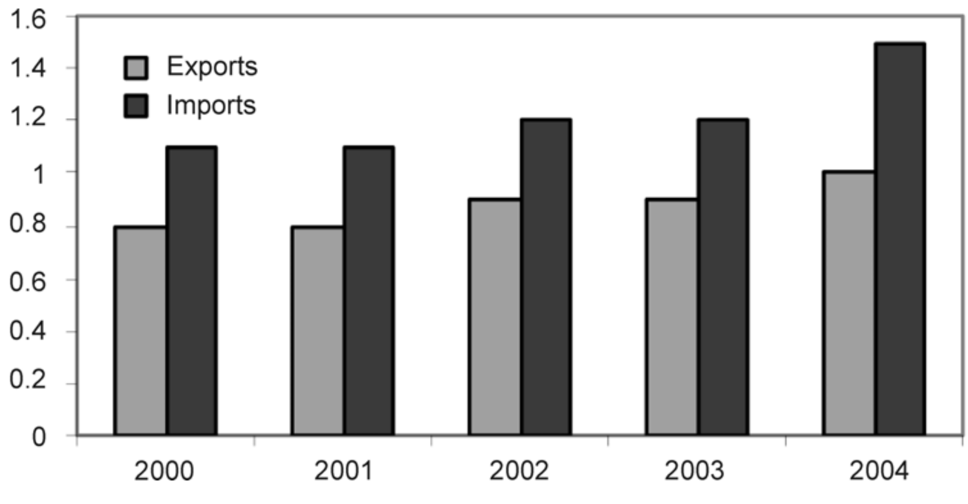


Chart 10.4: Trade in transport, storage and communications for UAE (US$ million)
Source: UNCTAD (2005)

Table 10.2: Selected indicators of tourism for UAE

				Growth rate (%)	
	1995	*2000*	*2003*	*1995–2000*	*2000–03*
Hotels (number)					
Dubai	229	265	271	3.0	0.7
Abu Dhabi	39	49	52	4.7	2.0
Other emirates	29	39	43	6.1	3.3
Hotel revenues (US$ million)					
Dubai	389.3	714.8	1,093.5	12.9	15.2
Abu Dhabi	184.8	234.1	271.2	4.8	5.0
Other emirates	57.0	62.2	111.4	1.8	21.4

Supporting factors

Domestic capacity and skills

The total adult literacy rate in UAE in 2005 was 76 per cent, while the gross tertiary enrolment ratio in 2002 was 23 per cent (13 per cent for males and 40 per cent for females). The United Nations Development Programme (UNDP) (2005) ranked UAE as 49th out of 177 countries in terms of its human development indicators. However, despite its relatively strong position in terms of human development, the country lacks local skilled labour and most of the skilled workforce in the country comprises expatriates and foreigners. UAE has a relatively open labour market; hence lack of availability of foreign skilled workers is not a major impediment to private-sector development (more than 90 per cent of the total workforce in UAE is foreign).

The ICT infrastructure of UAE is well developed, especially in terms of access and affordability (Table 10.3). Telecommunications services have been modernised in recent years, with the result that the rate of mobile telephony coverage is 100 per cent. The number of fixed lines has been growing steadily; however, telephone density has fallen in recent years because of population growth exceeding that of telephone lines (WTO, 2006).

In terms of transport, infrastructure for all modes of transportation – by air, sea and road – is excellent in UAE. Roads connect all major cities of the country and are in good condition. Almost the entire road network (4,000kms) is paved. Sea transport benefits from the presence of 15 large commercial ports with a total capacity of over 70 million tonnes. Dubai's Jebel Ali Port is the world's largest manufactured port. There are six international airports in UAE, which serve as major connecting points for the region with the rest of the world. Dubai airport is ranked 16th in the world in international passenger throughput and 17th in cargo tonnage (WTO, 2006). The country also has various 'cargo villages' that offer world-class cargo, storage and re-export services.

Table 10.3: ICT indicators for UAE (2005)

	UAE	*High-income group*
Access		
Tel. main lines per 1,000 people	273	503
Mobile subscribers per 1,000 people	1,000	835
Population covered by mobile telephony (%)	100	99
Internet users (per 1,000 people)	308	527
Personal computers (per 1,000 people)	197	579
Quality		
International internet bandwidth (bits per person)	923	4,537
Affordability		
Price basket for fixed line (US$ per month, residential)	17.4	27.6
Price basket for mobile (US$ per month)	4.1	17.8
Price basket for Internet (US$ per month)	13.1	19.9
Price of call to United States (US$ per 3 minutes)	1.73	0.76

Note: * value is for the year 2000

Source: World Bank (2006) Information and Communications for Development 2006: Global Trends and Policies. *Washington DC: World Bank*

Policy and institutional framework

The government of UAE has played a critical role in the private-sector development of the economy. Through infrastructure development, political stability, increased transparency, updating of laws and regulations according to international requirements, and streamlining administrative requirements, it has created a favourable business investment climate. This has attracted domestic and foreign investment in various services such as in oil and gas-field services, cargo and shipping, telecommunications and finance. UAE fares well in the World Bank's governance indicators, especially in comparison to the average of small states and the regional average. However, its performance lags behind that of the high-income group (Table 10.4).

Table 10.4: Governance indicators for UAE, 2005

	2005	*Average 2000–05*	*High-income group (2005)*	*Middle East & North Africa (2005)*	*Small states (2005)*
Political stability	0.61	0.79	0.81	–0.51	0.40
Government effectiveness	0.55	0.76	1.27	–0.21	0.25
Regulatory quality	0.44	0.74	1.23	–0.28	0.27
Rule of law	0.58	0.92	1.26	–0.04	0.32
Control of corruption	1.13	1.08	1.36	–0.01	0.30

Notes: Units of measures range from about –2.5 to 2.5, with higher values corresponding to better governance outcomes

Source: World Bank (2006)

The government has provided various incentives to foreign investment in the services sector. For example, creation of a free zone in Dubai provides incentives to foreign financial companies to enter the market, expand their businesses in the region, and benefit from the no taxation policy of the government.

The Central Bank of UAE (CBU) is the premier monetary institution that oversees the operations of most financial institutions in the economy.[2] Insurance services are regulated by the Ministry of Economy and Planning. Trade policy is also formulated by the Ministry of Economy and Planning, with assistance from other relevant departments and trade bodies. Investment policy is implemented through a licensing scheme that requires all business to obtain a licence (WTO, 2006). Although, UAE has an investment-friendly climate, its regulatory and judicial frameworks continue to discriminate between locals and foreign investors and the latter cannot own businesses except in the free zones. This also holds for land ownership, albeit laws vary across the emirates. Recently Dubai allowed foreigners to own properties in three government-owned housing projects. Abu Dhabi also has a law, which permits leasing of properties in investment areas to foreigners for a limited duration.

In terms of transport, regulation of shipping services is carried out by the Ministry of Commerce (which oversees security, communications, seaworthiness and ensures quality control) and the port authorities of individual emirates (which oversee port handling services such as lifting, loading, discharging, storage and warehousing, and pilotage). Civil aviation is the responsibility of individual emirates; however, the General Civil Aviation Authority, which is a federal organisation, oversees activities related to civil aviation.

Telecommunications services are regulated by the Supreme Committee for the Supervision of the Telecommunications Sector, which is responsible for drafting and implementing the telecoms policy as well as for issuing licences. In 2004, the Telecommunication Regulatory Authority was also set up to improve ICT infrastructure and services. In the tourism sector, individual emirates are responsible for formulating and implementing policies.

External conditions

UAE became one of the original members of the WTO in 1996. Alongside this multilateral initiative, it has signed bilateral free trade agreements (FTAs) with Syria, Iraq, Jordan, Lebanon and Morocco. The country is also negotiating FTAs with Australia, the USA, EU and China. Since it is a member of the Arab Gulf Cooperation Council, it is required to harmonize its trade legislation with that of other member states (WTO, 2006).

UAE committed to GATS in certain areas, although with certain limitations. For example, in the financial services sector restrictions relate to discrimination in investments and shareholding between nationals and non-nationals. The country made no commitments in insurance services; cross-border supply of insurance services cannot be carried out by firms located abroad and foreign ownership restrictions apply. Similarly, the following are limited to UAE nationals: real estate services; rental/leasing services related to road transportation; services related to agriculture, hunting and forestry, and fishing; placement, investigation and security services; and passenger and freight road transport (WTO, 2006).

For various professional and business services such as auditing, accounting, taxation, architectural services, engineering, urban planning and veterinary services, UAE has bound commitments in modes 1 to 3. In the tourism sector, provision of hotel and restaurant services is bound, without limitations through modes 1 and 2. However, in mode 3 (commercial presence) a restriction on foreign ownership (which can be up to a maximum of 49 per cent) exists. In the construction services sector, UAE has not made any commitment under GATS; however, it is not a protected sector and numerous foreign contractors are working in the country. Nor has the country made any commitments in the transport and telecommunications sectors. Here, large state-owned enterprises are the major players in the market and majority foreign ownership is prohibited.

Institutional support

In the UAE, each emirate has a chamber of commerce and industry. The Federation of UAE Chambers of Commerce and Industry is the umbrella organisation, which consists of the seven emirates chambers of commerce as its members. The Abu Dhabi Chamber of Commerce and Industry (ADCCI), which was set up in 1969, has grown to become the largest Chamber of Commerce and Industry in the Arab Gulf Cooperation Council (AGCC). It has over 55,000 members and represents the manufacturing and services activities of the private sector in national and international forums. ADCCI also provides technical and financial support to small and medium enterprises, promotes UAE's private sector in international markets, and provides regulatory, policy and commercial information to domestic and foreign producers and investors.

In addition, government investment development offices/authorities exist in all emirates to identify new investment opportunities and facilitate investment processes to create a business-friendly climate and attract investors.

Conclusions

The rapid development of the United Arab Emirates has been made possible by the pro-active attitude of the government and co-operation between the public and private sectors. An example is the setting up of a one-stop-shop at Abu Dhabi Municipality through collaboration between different government agencies and the ADCCI to facilitate the issuance of trade licences and make the procedure simpler and quicker. The public sector took the lead and provided the right incentives for industry to develop in the country. A diverse range of initiatives have been undertaken to make the most of the country's endowments and promote growth, trade and investment.

One of the most significant steps in this regard was the development of airport and seaport facilities during the 1960s and 1970s, which led UAE to become a leading transhipment and re-export centre. The government developed transportation infrastructure and established efficient state-owned enterprises. In both shipping and air transport services, most companies including the largest and most-profitable ones are government owned.

Capitalising on Dubai's strategic location and good infrastructure, the UAE government initiated an 'open skies policy', which has made the country, especially Dubai, the regional hub of trade and commercial activities (see Box 10.1).

Box 10.1: Dubai's Open Skies Policy

Dubai operates an 'open skies' policy by allowing over 100 airlines other than its national carrier, Emirates airlines, to operate from the airport of Dubai and utilise its airport and refuelling services. This has made UAE a land-bridge between continents and has increased Dubai's interconnection regionally as well as globally, making it a hub for tourism traffic. In 2004 alone, 16 million passengers passed through Dubai airport and the number is expected to increase four-fold by the end of the decade.

The open skies policy has caused tremendous growth in Dubai's civil aviation sector and has benefited the overall development of the economy. It has boosted the demand for Dubai's goods and services, causing a boom in the travel and tourism industry. The competitive environment has also had a beneficial effect on its own airline, and has enhanced its efficiency and profitability. Dubai is now taking the lead in the drive of liberalising civil aviation services in the entire Gulf region.

Other important initiatives include massive public investments in parks, sports facilities, international conference centres, the organisation of high-profile sporting and shopping events and so on to develop the tourism industry. Dubai's government has been leading the drive to develop tourism (see Box 10.2 for some projects started in Dubai).

To facilitate foreign investment, a simple but very useful initiative was the initiation of a 24-hour telephone and fax hotline at the Dubai Naturalization and Residency Department, which provides information regarding different types of visa, various documents required for opening a company file at the department, court appointments, changing visas and departure certificates. Another recent and major step to make Dubai the regional financial centre and to attract foreign investment is the creation of the Dubai International Financial Center (DIFC) (see Box 10.3).

With the co-operation of the public sector, the private sector is also taking initiatives for further development. An example is the setting up of a one-stop-shop at Abu Dhabi Municipality, the result of a collaboration between different government agencies and

Box 10.2: Selected projects in Dubai

In 2004, **Dubai Healthcare City**, a newly created free zone, began providing specialised medical and healthcare services with the help of partners and investors from regional and international clinics. The project targets customers from the Gulf Cooperation Council (GCC), the Indian subcontinent, East Africa and Central Asia. A turnover of US$1 billion was expected in 2005.

The US$3 billion **Palm Island** project for the construction of two artificial, palm-shaped islands off Dubai's coast is a by-product of the Jebel Ali harbour expansion. Each island will have around 60km of coastline. The islands will house residential homes and hotels, as well as entertainment and retail outlets. Infrastructure work on the first island was completed in 2004. In addition, there are plans to build a similar group of 200 artificial islands in the shape of the world map.

With a total investment of almost US$6 billion and an assigned space of 4 billion square feet (372 million square metres), **Dubailand** is one of the world's largest self-contained tourism projects, offering leisure, sport, retail and entertainment attractions. The launch phase, covering initial infrastructure like road works and utility provision, was intended to extend from 2004 to 2006. The main construction phase will be completed by 2010. Financing is mostly from the private sector, both domestic and foreign.

Other projects include the construction of the world's first luxury underwater hotel, as well as the only indoor skiing centre in the Gulf region, **Dubai Snow World**. In 2004, Dubai Holding was established as a Dubai government-owned organisation charged with running some of the emirate's major ventures. They include Dubailand, Dubai Internet City and Jumeirah Beach Residence.

Source: WTO (2006)

Box 10.3: Dubai International Financial Center (DIFC)

DIFC was created in 2004 as a financial hub for the Middle Eastern region by the government. It aims to develop the financial services sector of UAE and attract investment for growth, infrastructure and overall economic development of the country and the wider region. DIFC focuses on banking services, capital markets, asset management and fund registration, reinsurance, Islamic finance, and back office operations.

DIFC is a project with immense potential. It has already attracted global firms and is expected to further boost employment, investment, and growth. It consists of a capital market which is a financial free zone. Financial institutions benefit from a zero income tax rate, 100 percent foreign ownership, dollar denominated environment, and no restrictions on foreign exchange or capital outflow. The Dubai International Financial Exchange was set up in 2005 as a subsidiary of DIFC.

ADCCI to facilitate the issuance of trade licences and make the whole procedure faster and easier.

UAE is also promoting trade in education services. A notable example in this regard is the investment in Dubai Knowledge Village (see Box 10.4).

Box 10.4: Dubai and promoting trade in education services

To promote secondary and tertiary educational services, UAE has liberalised its economy to educational institutions. At the time of writing there were 40 accredited universities, colleges and academies in addition to three federal higher education institutions. There are least 16 institutions in free zones, such as the Dubai Knowledge Village (DKV). The UAE's open door policy to new universities allows institutions to determine the programmes that they offer, based on student demand and willingness to pay.

The DKV emerged as recently as 2003 as part of the free zone. The establishment of a free zone required a lot of investment, but it has had various benefits including significant job creation. During 2001–2004, the free zone created 1,800 companies, 21,000 knowledge workers and 15 universities, with US$2 billion of investment. The DKV includes foreign branches of universities, colleges or schools providing accredited academic programmes and degrees. The Village offers a one-stop-shop for all educational and business needs: enabling physical infrastructure and high-performing technology infrastructure, networking opportunities, access to a large pool of knowledge workers, simplified laws and regulations, student visas made easy, 100 per cent foreign ownership and a tax-free environment.

Notes

1. Source: WTO (2006).
2. An exception to this is the Dubai International Financial Centre, which was established by the government to create a regional capital market. It is regulated by the Dubai Financial Services Authority.

11

Vanuatu

Vanuatu is a middle-income small island state comprising 83 islands located in the South Pacific Ocean. In 2005, it had a real per capita GDP (PPP-adjusted) of US$3,041 and a total population of about 220,000. The country has experienced modest annual growth rates in recent years and the annual GDP growth has averaged about 3 per cent since 1990 (Chart 11.1). Most of the population is engaged in small-scale agricultural activities, which constitute about 20 per cent of GDP. Domestic exports are mainly primary goods, with copra being the most important cash crop for the economy. Other leading exports include beef, cocoa, kava, coffee and timber.

Services are a very important part of the economy, contributing about 74 per cent to the GDP since 1990, but the average growth rate of the services sector has remained modest since the mid-1990s (Chart 11.1).

However, despite the modest growth, the share of services in GDP has risen steadily from 67 per cent in 1990 to 76 per cent in 2003 (Chart 11.2). The most important services sector in Vanuatu is wholesale and retail trade, followed by government services, transport and communications, and financial and insurance services (Table 11.1). The government has brought tourism to the forefront of the policy agenda and it is the fastest growing sector in the economy.

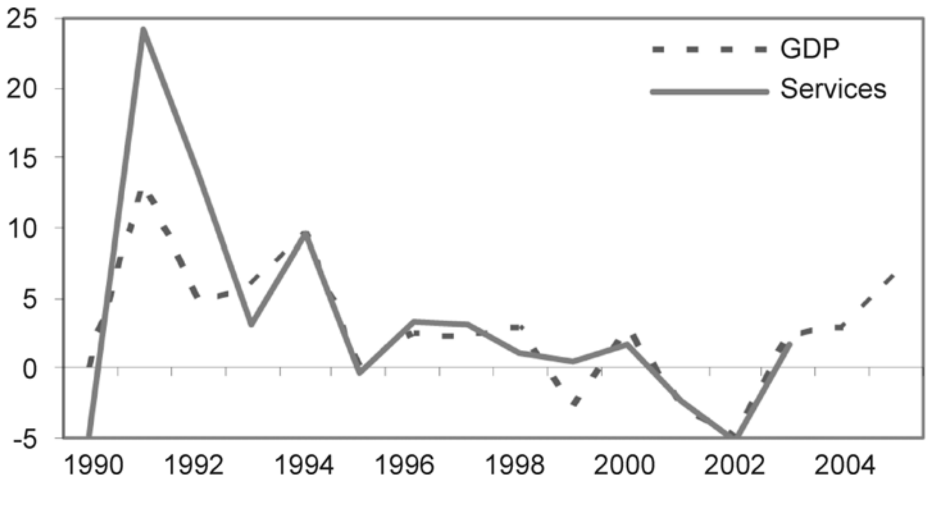


Chart 11.1: Annual growth of GDP and services in Vanuatu (%)
Source: Based on World Bank (2006)

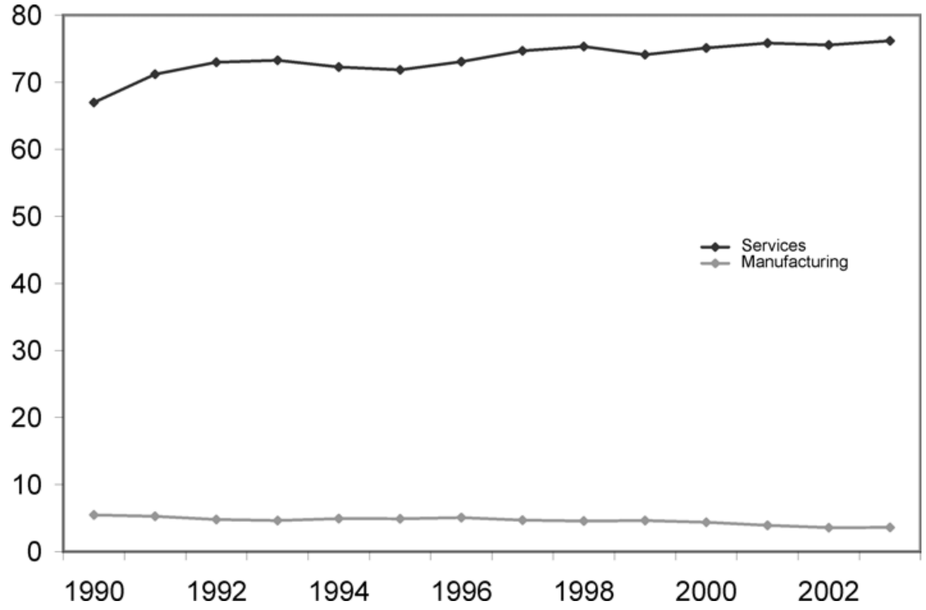


Chart 11.2: Contribution of services to GDP in Vanuatu (%)
Source: Based on World Bank (2006)

Table 11.1: GDP composition for services in Vanuatu (in millions of vatu)*

Services	*1999*	*2000*	*2001*	*2002*	*2003*
Wholesale and retail trade	5,611	5,773	5,490	5,149	5,283
Hotels and restaurants	958	1,042	987	892	894
Transport and communications	1,731	1,738	1,719	1,544	1,530
Finance and insurance	918	995	1,211	1,162	1,157
Real estate and other services	1,077	1,105	1,083	1,039	1,062
Government services	2,362	2,175	2,117	2,131	2,207
Personal services	150	160	140	124	109

Note: * Values are computed at constant 1983 prices
Source: IMF (2005)

Trade in services is an important part of total trade in Vanuatu. Exports of services account for about 80 per cent of total trade, whereas imports of services are about 40 per cent of total trade (Chart 11.3). The importance of service exports in total trade is higher in Vanuatu as compared to most countries in the region, for example, Fiji, Papua New Guinea, Tonga and Solomon Islands (Chart 11.4).

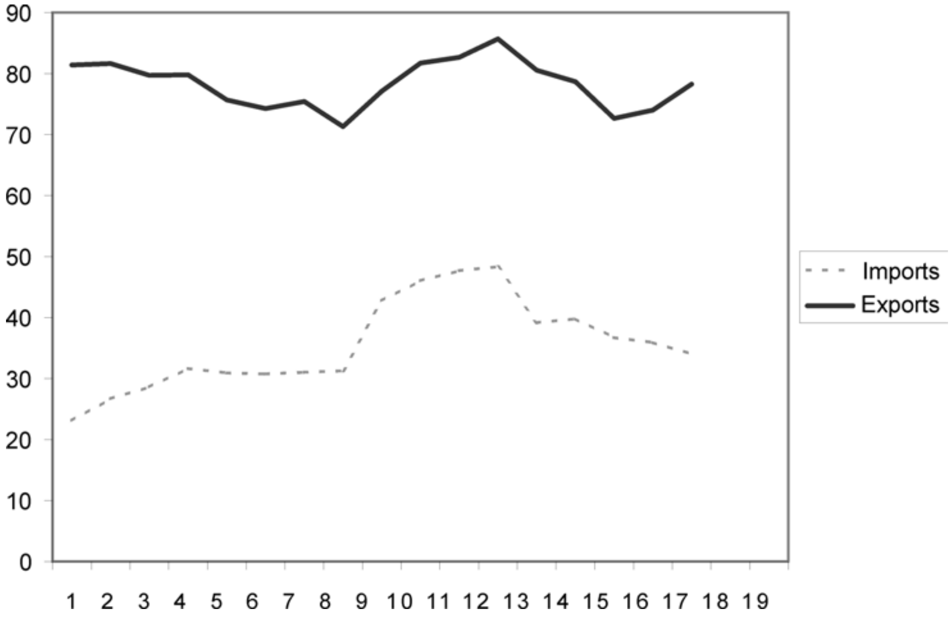


Chart 11.3: Exports and imports of services in Vanuatu (% of total trade)
Source: UNCTAD (2005)

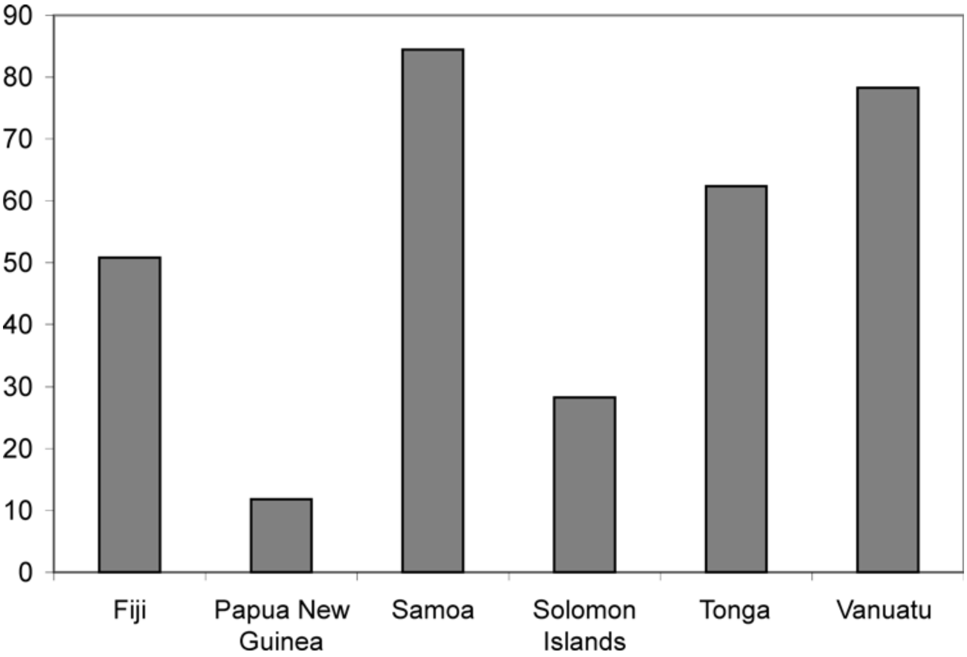


Chart 11.4: Exports of services in Pacific small states (% of total trade) in 1990–2005
Source: UNCTAD (2005)

Performance of selected services

Financial services

The financial and insurance sector contributes over 7 per cent to GDP in Vanuatu and consists of onshore operations (comprising banks and some non-bank financial institutions) and offshore operations, which consist of an offshore financial centre (OFC) that has offshore banks, non-banks and a shipping registry (IMF, 2005).

The domestic banking system consists of the Reserve Bank of Vanuatu and three commercial banks (two foreign-owned and one state-owned), whereas the non-bank system includes a provident fund, insurance companies, credit union, microfinance schemes and money changers. The total assets of the onshore financial system in 2003 represented about 173 per cent of Vanuatu's GDP, whereas the assets of the offshore financial sector were about 125 per cent of GDP.

Vanuatu is a net importer of insurance services and a net exporter of other financial services. The exports of financial services have expanded fast in recent years and the gap in exports and imports of financial services has widened considerably (Chart 11.5). The combined share of insurance and financial services in total commercial services exports has also increased, rising to about 12 per cent in 2005 from about 5 per cent in 1998 (Chart 11.6).

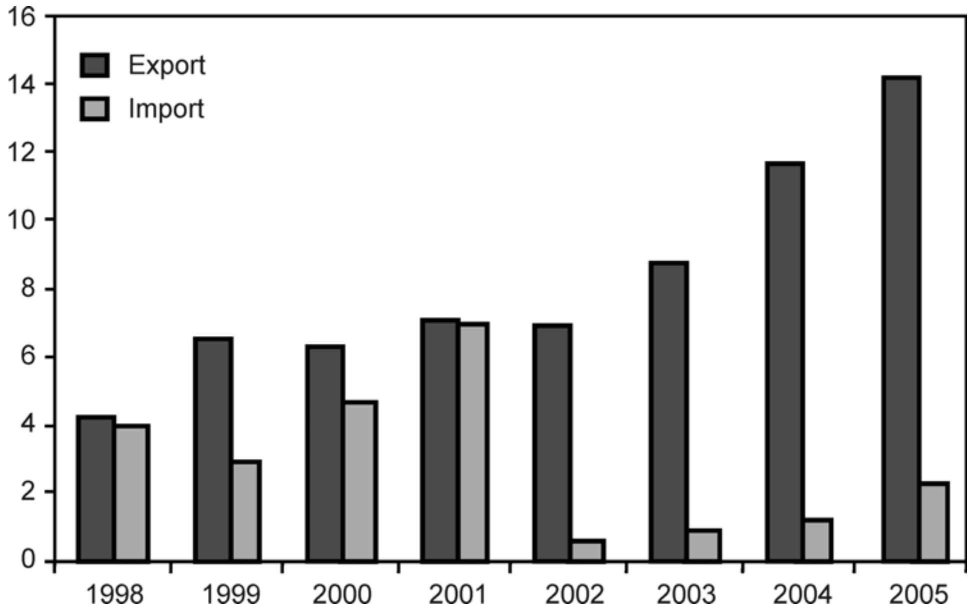


Chart 11.5: Exports and imports of financial services in Vanuatu (in million US$)*
Note: Insurance services not included
Source: UNCTAD (2005)

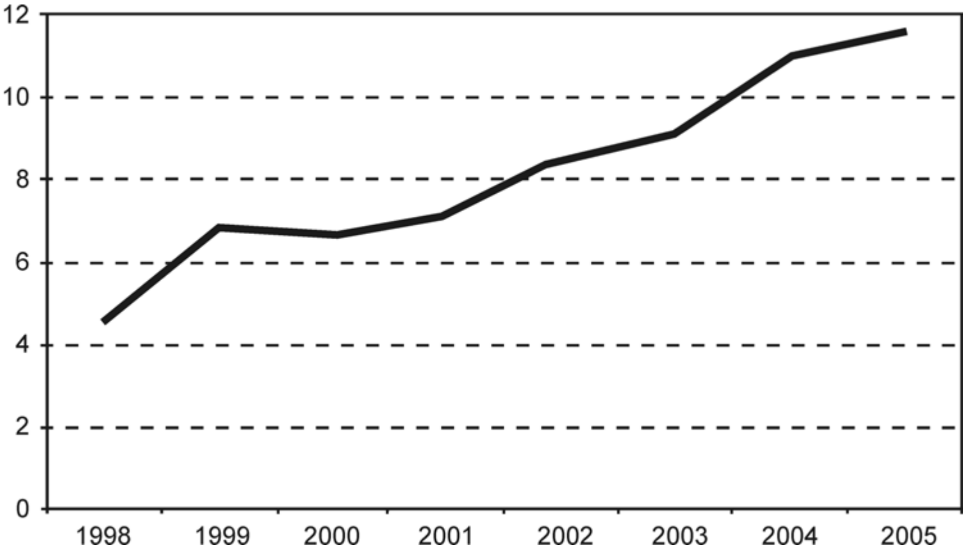


Chart 11.6: Insurance and financial services (% of commercial services exports)
Source: World Bank (2006)

Educational and health services

The gross secondary and tertiary enrolment ratios in Vanuatu are considerably less than the regional average (Table 11.2). The gross tertiary enrolment ratio in 2002 was only 5 per cent, as compared to the regional average of over 20 per cent. About 75 per cent of children between the ages of six and 16 attend school, but attendance drops significantly from the age of 12 onwards because of lack of schools and high school fees (Hughes, 2004).

Table 11.2: Gross secondary and tertiary enrolment ratios in Vanuatu (%)

		1991	*1999*	*2002*	*Regional Average (2005)*
Secondary	Total	18	30	38	74
	Male	20	32	39	74
	Female	16	28	37	74
Tertiary	Total	N/A	4	5	24
	Male	N/A	N/A	6	25
	Female	N/A	N/A	4	23

Source: UNESCO Institute for Statistics

Several reforms have been introduced in the education sector as part of the Comprehensive Reform Programme introduced in 1997, which aims to have all children complete school education by 2010 (Haberkorn, 1998). The Ministry of Education is guided by three documents: the Education Master Plan, the Ministry of Education Youth and Sport Corporate Plan 2002–2006, and the Education for All Vanuatu: National Plan of Action 2002–2006. Budget allocation to the education sector has increased and during 2000–03, it was significantly higher than in most neighbouring countries (Table 11.3). As a result, expenditure per student is also higher than other south Pacific small states, but the student-teacher ratio is the same as the regional average.

According to IMF (2005), the performance of the education sector is weak and requires reforms in order to set clear objectives and improve the quality of teaching and cost structure. Schoolteachers are mostly trained to certificate level, but 22 per cent receive no training at all (Hughes, 2004).

Tertiary education facilities in the country include a branch of the University of the South Pacific, which has its main campus in Suva, Fiji Islands. The Malapoa Teachers' Training College and Tagabe Agricultural School also provide tertiary education, and there is a school of nursing in Port Vila.[1] The Vanuatu Institute of Technology is a vocational and technical education institute, which offers certificate courses in various areas such as electricity, mechanical engineering, building and construction, tourism, hospitality, business studies, and financial management and accountancy. A few scholarships for tertiary education abroad are also offered annually, but most study is undertaken in the Pacific with the University of the South Pacific being the largest recipient of scholarship awardees (Strachan, 2004).

Tourism

Tourism contributes substantially to the economy in Vanuatu, both directly as well as indirectly by stimulating other sectors. The sector has been highly promoted in recent years and visitor arrivals have risen to over 50,000 visitors annually (Table 11.4). A majority of the visitors are from Australia followed by New Zealand and New Caledonia.

Table 11.3: Educational spending in Vanuatu and other Pacific small states, 2000–03

	Vanuatu	*PNG*	*Samoa*	*Fiji*	*East Asia & Pacific*	*Low & middle income*
Education spending (% of total expenditures)	28.8	N/A	14.4	23.7	N/A	N/A
Expenditure per student	16	12	11	14	6	N/A
Student-teacher ratio, primary	22	36	25	28	22	27

Source: IMF (2005)

Table 11.4: Tourism activity in Vanuatu (1999–2003)

	1999	*2000*	*2001*	*2002*	*2003*
Total visitor arrivals	50,746	57,591	53,304	49,462	50,400
(annual percentage change)	–2.6	13.5	–7.4	–7.2	1.9
Tourists	37,725	44,992	41,612	38,740	38,924
(annual percentage change)	–4.4	19.3	–7.5	–6.9	0.5
Australia	30,769	36,805	33,667	29,730	29,492
New Zealand	6,487	8,024	7,512	7,263	7,729
New Caledonia	5,037	4,124	4,039	4,704	5,050
Other Pacific countries	2,317	2,039	2,182	1,828	2,034
Europe	3,063	3,401	2,687	2,948	3,003
North America	1,343	1,547	1,413	1,438	1,625
Japan	915	811	834	731	571
Other countries	815	840	970	820	896
Average length of stay (in days)	7.2	7.6	8.3	8.9	9.5
Room-night capacity (in thousands)	254.9	364.1	371.3	367.6	328.9
Capacity utilisation (%)	51.9	52	49.8	44.2	46.5
Cruise-ship passengers	44,853	47,644	52,758	50,027	51,995
(annual percentage change)	78.6	6.2	10.7	–5.2	3.9

Source: IMF (2005)

Vanuatu is a net exporter of tourism services (Chart 11.7). Total exports of tourism-related services were valued at about US$55 million in 2005 as compared to US$11 million worth of imports. Exports of tourism services are a major foreign exchange earner for the economy and constitute about 60 per cent of total commercial services exports for the economy (Chart 11.8)

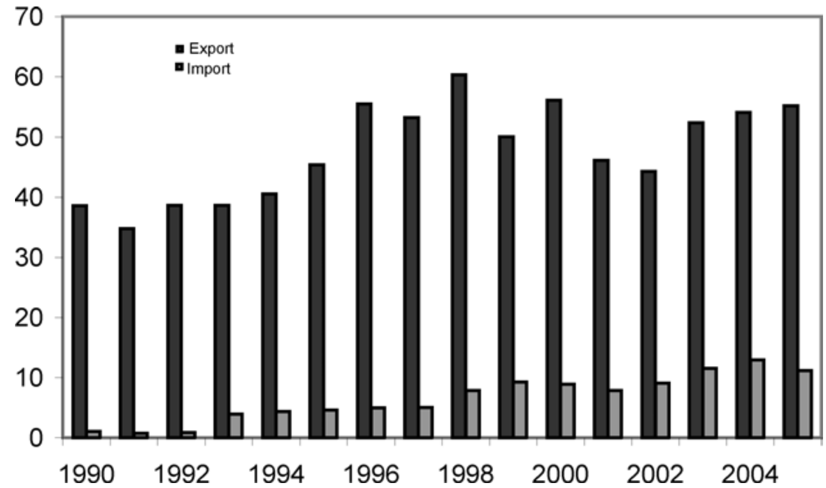


Chart 11.7: Exports and imports of travel services in Vanuatu (millions of US$)
Source: UNCTAD (2006)

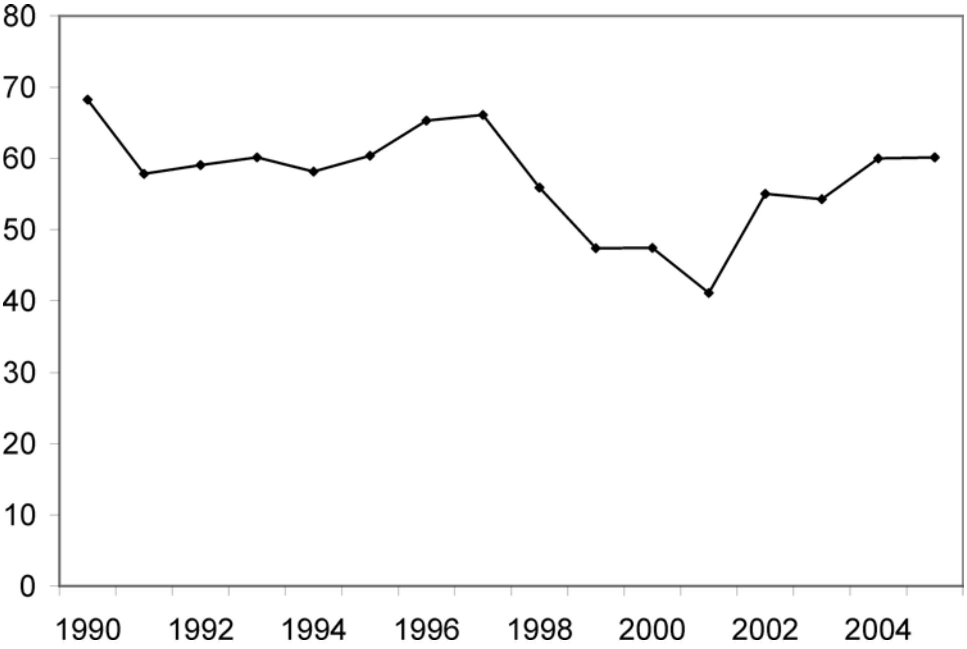


Chart 11.8: Exports of travel in Vanuatu (% of commercial services exports)
Source: UNCTAD (2006)

Transport, information technology and communications services

Transport and communications constitute about 10 per cent of Vanuatu's GDP. There is one local international airline, Air Vanuatu, which operates to Australia, New Zealand, countries in the South Pacific as well as local destinations. However, several international airlines of other Pacific countries also serve Vanuatu, for example, Aircalin (New Caledonia), Virgin Blue (Australia) and Air Pacific (Fiji).

Vanuatu is a net importer of transport services (Chart 11.9). In 2005, the exports and imports of transportation services were about US$26 million and US$42 million respectively. The country's exports of transport services constituted about 20 per cent of total commercial services exports in 2005. This share has doubled since 1990, rising sharply in the late-1990s.

Communications services play a relatively smaller role in the economy and their share in commercial services exports have declined from 20 per cent in 1990 to about 5 per cent in 2005.[2] However, Vanuatu is a net exporter of communications services and exports of communications services are almost twice the country's equivalent imports (Chart 11.10).

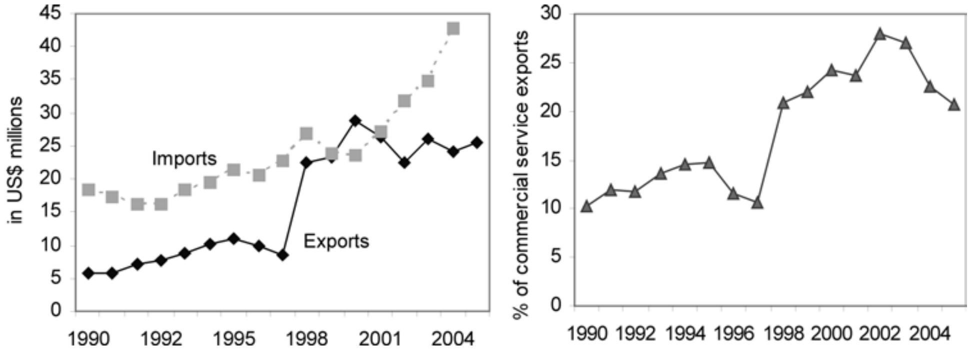


Chart 11.9: Trade of transportation services in Vanuatu, 1990–2004
Source: World Bank (2006)

Professional business services

Exports of other business services such as merchanting and other trade-related services, operational leasing services, and miscellaneous business, professional and technical services, constituted a significant part of services trade for Vanuatu up until 1995. For example, in 1980–95, the share of other business service exports in total services trade was about 27 per cent. However, this dropped to about 18 per cent during 1996–2001, falling further to 6 per cent in 2002–2005.[3]

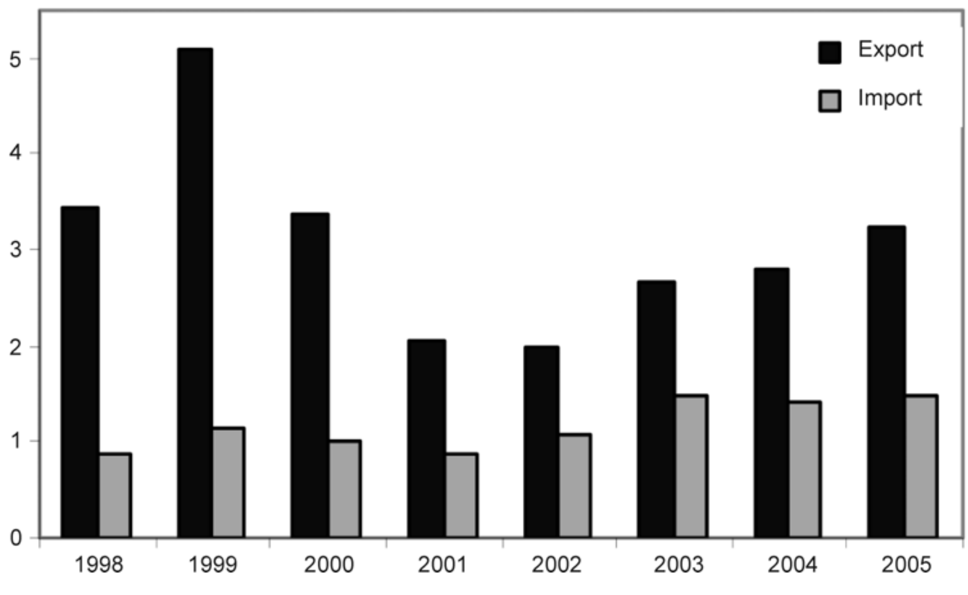


Chart 11.10: Exports and imports of communication services in Vanuatu (US$ millions)
Source: UNCTAD (2006)

Vanuatu remained a net exporter of other business services until the late-1990s (Chart 11.11). The average exports of other business services during 1980–1998 were about US$17 million as compared to about US$8 million of imports. However, since 1998 the country has mostly been a net importer of other business services.

Supporting factors

Domestic capacity and skills

The International Monetary Fund (IMF, 2007) indicates substantial barriers to private-sector development in Vanuatu, such as political uncertainty, the high cost of doing business, poor infrastructure and weak land and property rights. These factors have deterred foreign investment in the country, reducing Vanuatu's external competitiveness, and have reduced employment and income opportunities in the economy.[4]

Vanuatu has witnessed considerable political instability, especially during the 1990s, and this has had a substantial adverse impact on economic growth. For example, during 1995 to 2004, Vanuatu had nine different governments (Gay, 2005). According to World Bank's governance indicators for 2006, Vanuatu is particularly weak in terms of government effectiveness and regulatory quality (Table 11.5). However, the country's overall performance in recent years has been better as compared to other small states in the region, for example, Papua New Guinea, Fiji and Solomon Islands.

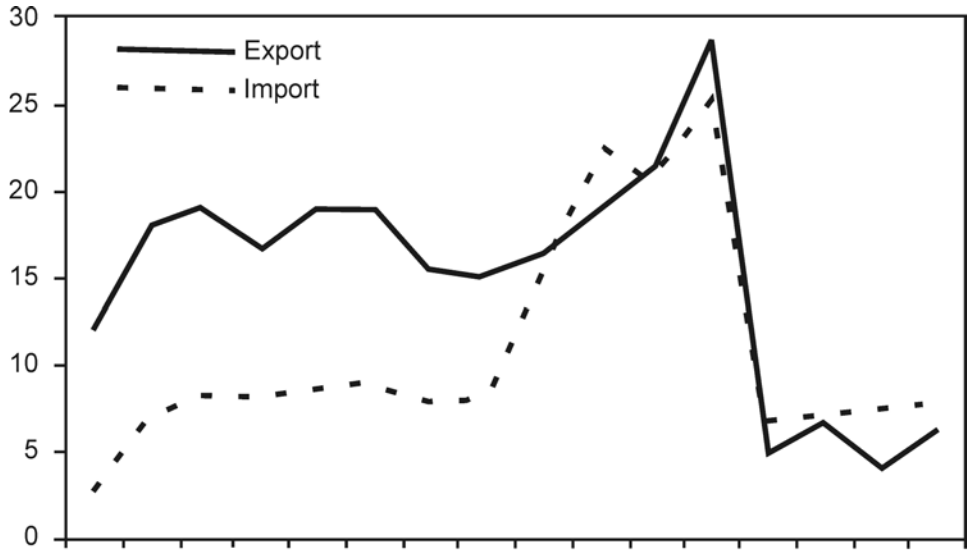


Chart 11.11: Exports and imports of other business services in Vanuatu (US$ millions)
Source: UNCTAD (2005)

There are only two towns in the country, Port Vila and Luganville, and public utilities and infrastructural facilities are concentrated in these areas. However, both towns are facing various socio-economic problems due to rapid migration from rural areas (Hughes, 2004).

Transport infrastructure in Vanuatu is not well developed in all parts of the country. Islands are separated by large distances, and some are remote and isolated due to lack of air or sea transportation. There is no rail network in the country. The total road network is 1,100 km, of which 22 per cent is paved. The country has one international airport at Port Vila, which is the centre for the local international airline, Air Vanuatu, and three important ports at Forari, Port Vila and Luganville. The ports at Port Vila and Luganville are well developed and can handle standard and refrigerated shipping containers of 20-feet (6.1m). International container and cargo services are provided by seven overseas shipping lines operating in Vanuatu, which stop at various Pacific island ports en route to Australia or South East Asia.[5]

The lack of availability of a skilled labour force is a major concern. According to statistics provided by the Ministry of Education, Youth and Sport, about 7,500 students are enrolled in the first year of education. However, by the 13th year of education, only about 100 remain (Chart 11.12).

Telecommunications services are monopolised by Telecom Vanuatu Ltd, a company in which the government is the majority shareholder. ICT services are very weak in terms of access, quality and affordability as compared to both the region and to an average lower-middle income country (Table 11.6). For example, internet facilities are extremely expensive and cost about US$60 per month. The same is true for fixed-line and mobile rentals, which are three to five times higher than the regional average.

Domestic regulatory and institutional framework

Planning and policy development in Vanuatu has mostly been ad hoc (Hindson, 1995). The reasons for this include lack of financial and human resources, and the unavail-

Table 11.5: Governance indicators for Vanuatu (2006)

	Vanuatu	*Tonga*	*Fiji*	*Papua New Guinea*	*Samoa*	*Solomon Islands*
Political stability	1.39	0.70	0.13	−0.80	1.15	0.15
Government effectiveness	−0.39	−0.64	−0.10	−0.84	0.07	−0.92
Regulatory quality	−0.12	−0.78	−0.38	−0.70	−0.03	−1.13
Rule of law	0.46	0.54	−0.08	−0.94	0.92	−0.90
Control of corruption	0.20	−1.29	−0.35	−1.13	0.02	−0.29

Notes: Units of measures range from about −2.5 to 2.5, with higher values corresponding to better governance outcomes

Source: World Bank (2007).

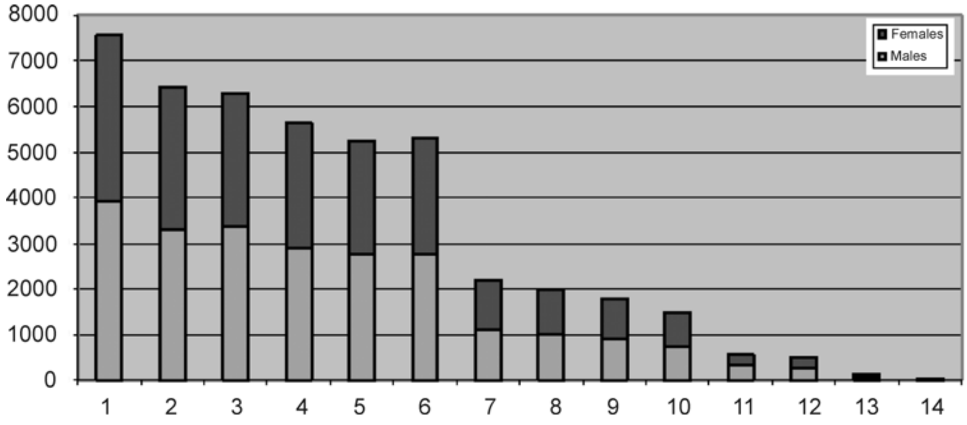


Chart 11.12: Pupil enrolment by year and gender in Vanuatu, 2001
Source: Strachan (2004)

ability and inaccessibility of comprehensive and reliable data. The government introduced a three-year Comprehensive Reform Programme (CRP), funded by the Asian Development Bank, in 1997 aimed at improving governance, private-sector development, economic growth and liberalisation of the economy. However, the CRP did not meet many of the set objectives for various reasons including high political instability and poor standards of governance.

Table 11.6: ICT indicators for Vanuatu (2005)

	Vanuatu	*East Asia and Pacific*	*Average for lower-middle income country*
Access			
Telephone main lines per 1,000 people	33	214	205
International voice traffic (min. per person)	N/A	6	14
Mobile subscribers per 1,000 people	60	282	306
Population covered by mobile telephony (%)	20	N/A	N/A
Internet users (per 1,000 people)	38	89	95
Personal computers (per 1,000 people)	14	38	45
Quality			
International internet bandwidth (bits per person)	19	97	116
Affordability			
Price basket for fixed line (US$ per month, residential)	31.6	5.9	8.5
Price basket for mobile (US$ per month)	18.1	5.0	10.2
Price basket for internet (US$ per month)	58.2	10.7	16.8
Price of call to United States (US$ per 3 minutes)	7.5*	2.08	1.2

Note: * Value for 2000; *Source*: World Bank (2006).

In 2006, Vanuatu finalised a national development strategy for 2006–2015, known as the Priorities and Action Agenda (PAA). The PAA builds on the CRP and aims at private-sector development and employment creation, macroeconomic stability and equitable growth, good governance and public-sector reform, better provision of basic services, human-resource development, improved economic infrastructure and support services (Hosea, 2006). The PAA also includes various performance indicators, including the Millennium Development Goal (MDG) indicators, to facilitate the monitoring of development progress.

Vanuatu has various legislations and institutions in place to govern different services sectors and promote investment. For example, to promote foreign investment in the country, Vanuatu passed a Foreign Investment Act in 1998, which was amended in 2001. The Act simplified regulatory procedures for investment and laid the basis for creating an investment-promotion body. Vanuatu also has the International Companies Act (1993) and the Companies Act (1986) based on English law under which foreign and domestic companies are incorporated. Overall, the services sector, especially financial services, is largely liberalised and offers unrestricted access to foreign investors.

In the financial services sector, the Reserve Bank of Vanuatu (RBV) plays a central role in ensuring a sound financial system, maintaining monetary stability and monitoring onshore and offshore (banking) financial operations (IMF, 2005).[6] The Reserve Bank's role and responsibilities are governed by the Reserve Bank Act of 1980, the Financial Institutions Act of 1999 and the International Banking Act of 2002.

In the tourism sector, national tourism policy is based on the Tourism Master Plan, which was drafted in 1995 and updated in 2003. The Vanuatu Tourism Office (VTO) was established by a Parliamentary Act, which defines its functions, structure and funding. The main function of the VTO is to promote sustainable development of the tourism industry by building public–private sector co-operation, marketing in domestic and international markets, and encouraging ni-Vanuatu participation in the tourism industry.

External conditions

Vanuatu has an observer status at the WTO. The Government of Vanuatu initiated the accession process in 1995, but suspended it in 2001 just before the Doha Minsiterial Conference. However, as part of the accession negotiations, Vanuatu had agreed to include ten areas with 50 specific commitments in the final schedule of commitments on services (Gay, 2005). The number of commitments was greater than those made by most neighbouring economies. For example, Fiji and Solomon Islands have made GATS commitments in two and nine areas respectively.

Vanuatu has a number of regional trade agreements in place. It is a member of the Melanesian Spearhead Group (MSG), which is a trade treaty between Fiji, New Caledonia, Papua New Guinea, Solomon Islands and Vanuatu to eliminate tariffs and foster economic development by improving trade relations. Vanuatu is also a member of the Pacific Islands Forum (PIF), an organisation aimed at enhancing co-operation between Pacific countries to promote their socio-economic development.[7] The Pacific Islands Forum Secretariat (PIFS) based in Fiji is the administrative body of the Forum, which holds PIF events, implements decisions taken by the PIF and facilitates the delivery of development assistance to member states. The PIF also started a Representative Office in Geneva in 2004 to increase the participation and representation of member states in WTO negotiations. The PIF endorsed a 'Pacific Plan' in 2005 to further strengthen regional integration and co-operation with the goal of promoting growth, sustainable development, governance and security (see Box 11.1 for some immediate implementation priorities to achieve economic growth).

Vanuatu ratified the Pacific Islands Countries Trade Agreement (PICTA) in 2005, under which PIF member countries aim to create a free trade area over the next decade. Vanuatu also has preferential access to the Australian and New Zealand markets under the South Pacific Agreement on Regional Trade and Economic Co-operation (SPARTECA), and goods imported from Vanuatu are allowed to enter these markets duty-free. It is currently negotiating an economic partnership agreement (EPA) with the EU through the African, Caribbean and Pacific (ACP) configuration.

In terms of bilateral trade agreements, Vanuatu benefits from a non-reciprocal trade arrangement with Fiji and the generalised system of preference schemes of Australia,

Box 11.1: Economic growth implementation priorities in the Pacific Islands Forum's Pacific Plan (2006-2008)

1. Expansion of market for trade in goods under the SPARTECA, PICTA, Pacific Agreement on Closer Economic Relations (PACER) and with non-Forum trading partners
2. Integration of trade in services, including temporary movement of labour, into the PICTA and the EPAs
3. Timely and effective implementation of the Regional Trade Facilitation Programme (RTFP)
4. Investigation of the potential impacts under the PACER of a move towards a comprehensive framework for trade (including services) and economic co-operation between Australia, New Zealand and the PIF countries
5. Intensified development of proposals/strategies for regional bulk purchasing, storage and distribution of petroleum
6. Implementation of the Forum Principles on Regional Transport Services including development of the Pacific Aviation Safety Office and intensify focus on enhancing shipping services for smaller island states
7. Intensified implementation of a regional digital strategy for improving information and communication technology
8. Support of private-sector mechanisms, including through the Pacific Islands Private Sector Organisation

Source: The Pacific Islands Forum Secretariat http://forumsec.org/pages.cfm/economic-growth/ [accessed 3 June 2008]

Austria, Bulgaria, Canada, Czechoslovakia, EC, Finland, Hungary, Japan, New Zealand, Norway, Poland, Switzerland and the US.

Institutional support structure

The Vanuatu Investment Promotion Agency (VIPA) is the main public-sector body promoting investment in the country. It provides different services to foreign investors, including information and advice on investment opportunities, procedures and incentives. Foreign investors cannot operate businesses in Vanuatu until an approval has been given by the government through the VIPA Board.

In the private sector, the Vanuatu Chamber of Commerce and Industry (VCCI) was established in 1995. It has over 5,000 members belonging to different business categories. The VCCI offers a range of services to its members, for example, assistance in building networks, providing local and national policy representation, advisory services, training and development activities and e-commerce development.

Conclusion

Vanuatu has suffered from political instability and various natural calamities since it gained independence from the British and French administrations in 1980. Economic activity seems to have improved since 2004, and the country has achieved positive growth rates averaging over 5 per cent in three consecutive years. Initiatives to improve the services sector appear to have been taken mainly in the financial services and tourism sectors. An OFC offering various legal and regulatory incentives to investors was established in the country as early as 1970 (Box 11.2). This gives Vanuatu a

Box 11.2: The offshore financial centre (OFC) in Vanuatu

An offshore finance centre (OFC) was established in 1970 at Port Vila under the Banking Act 1970 to promote the financial services sector and reduce reliance on agriculture. The OFC comprises bank and non-bank institutions such as insurance companies, trusts, business services providers and the shipping registry. The OFC is a tax haven and offers various fiscal incentives to operating firms, including exemption from paying income, capital gains, withholding and estate taxes. It also offers simple and fast registration procedures to international companies.

The establishment of the OFC has contributed significantly to the development of English and French financial, investment, banking, accounting and legal expertise in the country. At the end of 2006, over 5,000 firms – most of which were foreign companies – were registered with the Vanuatu Financial Services Commission. The OFC also has an international shipping registry, in which about 500 local shipping vessels are registered. The OFC accounts for about 4 per cent of Vanuatu's GDP and contributes about 3 per cent to government revenue in the form of registration fees paid to the government.

Sources: IMF (2005); the Offshore Financial Services Centre Port Vila www.financial.com.vu [accessed 3 June 2008]; and the Pacific Islands Trade and Investment Commission www.pitic.org.au [accessed 3 June 2008].

competitive edge over neighbouring economies in attracting foreign investment. However, considerable scope remains to develop the financial services sector further, which requires improvement of ICT and financial infrastructure and appropriate training of the country's labour force.

The government of Vanuatu has been actively promoting tourism in recent years and the contribution of tourism-related activities, hotels and restaurants to the economy is rapidly expanding (see Box 11.3). The tourism industry is still small relative to that in Fiji, but it is larger than other neighbouring island states such as Solomon Islands.

The small state economies of the Pacific are some of the most disadvantaged countries in the world in terms of economic and environmental vulnerabilities. Services can play an important role in the development of these economies and considerable potential exists for expanding these sectors. However, their development requires strategic planning and concerted efforts at both national and international levels. Regional and international co-operation in building domestic capacity to improve physical and human infrastructure is crucial for these states. Initiatives already undertaken or envisaged to be undertaken by the PIF to meet the goals set out in the Pacific Plan are a step in the right direction.

Box 11.3: Promoting tourism in Vanuatu

Tourism has been widely promoted in Vanuatu since the late 1990s to take advantage of its cultural diversity, the tropical climate and scenic beaches. Tourist facilities have improved, especially in urban areas, and different cultural and other festivals are organised on various islands to attract tourists. The years 2005 and 2006 were declared the years of tourism and budgetary allocations to the tourism sector were increased. As a result, tourist arrivals have almost doubled in the last 20 years. International connectivity has improved considerably and Vanuatu is well connected with other Pacific countries such as Australia, New Zealand, Fiji and New Caledonia. The national airline has plans to further increase its services to Australia and New Zealand to meet the anticipated increase in demand for tourism-related air travel.

Cruise tourism represents a large part of the tourism industry and has gained tremendous importance in recent years. About four large cruise ships, one carrying 600 passengers and others 1,500, and smaller ships carrying about 100 passengers visit Vanuatu regularly. These ships stop at Port Vila, Mystery island, Pentecost, Vala island, Champagne Beach, Luganville and Lauren Bay, creating income opportunities for the locals as well as for the government (for example, through docking fees paid to local administrative authorities).

Vanuatu's national tourism policy is informed by the Tourism Master Plan, which was developed in 1995 and updated in 2003. Tourism is promoted by the Vanuatu Tourism Office (VTO), which was established by the Parliament as a government statutory body. The VTO is governed by a Board of Directors, which includes representatives from the Vanuatu Hotels and Resorts Association, Vanuatu Chamber of Commerce and Industry, Vanuatu Island Bungalows Association, Vanuatu Tour Operators Association, Vanuatu Scuba Operators Association, Vanuatu Land Transport Association, Air Vanuatu (Operations) Ltd, Vanair Limited, Tafea Tourism Council and Santo Tourism Association.

Sources: Vanuatu Tourism Office http://www.vanuatutourism.com [accessed 3 June 2008]; and Slatter (2006)

Notes

1. Source: Commonwealth Secretariat www.thecommonwealth.org/YearbookInternal/139633/society/ [accessed 2 June 2008]
2. The statistics for communications also include IT-related services, which are not reported separately.
3. Source: UNCTAD (2005).
4. According to Vanuatu Labour Market Survey, the formal sector in Vanuatu employs about 14,272 people only (Vanuatu Statistics Office, 2000).
5. Source: Pacific Islands Trade and Investment Commission www.pitic.org.au [accessed 11 June 2008]
6. Offshore non-bank institutions are monitored by the Vanuatu Financial Services Commission.
7. PIF has 16 member countries: Australia, the Cook Islands, the Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, New Zealand, Niue, Palau, Papua New Guinea (PNG), Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. Five (Australia, Fiji, New Zealand, Papua New Guinea and Solomon Islands) out of the 16 PIF members are members of the WTO.

PART III

Conclusions and Implications

12

Conclusions and implications

The small states agenda proposed in the Commonwealth/World Bank Joint Task Force Report of April 2000 and the review of this agenda, 'Toward an outward-oriented development strategy for small states: issues, opportunities and resilience building', of August 2006 both identify serious challenges for development in small states due to their small size, remoteness and vulnerability. The review suggests that over the past few years, the prospects for small states have deteriorated further due to preference erosion and the emergence of new, large competitors. It proposes that small states need to reposition themselves in the global economy and move into knowledge-based and other service industries. This book discusses the challenges faced in doing this and how they might be overcome. Growth strategies in the new competitive environment will increasingly rely on the promotion of knowledge-based and service industries.

Small states differ – some are landlocked while others are islands or coastal states, some are remote to key markets, others have the benefit of large neighbours and income levels vary. Services are already an important contributor to income and employment in small states. The poorest small states face severe constraints to services development, but even they are heavily dependent on the services sector. The small states in the middle and particularly the high-income group have already moved significantly into services, and some have specialised in highly-skilled, knowledge-based services more than their large state peers.

For many small states, trade in services, especially tourism-related services, is already an important foreign exchange earner. Tourism is highly important for low- and middle-income small states due to their relatively less diversified services sectors as compared to those in high-income states. A major challenge is to move up the value-added chain towards knowledge-intensive services. Generally, the more developed a country, the more it is engaged in knowledge-based services. This finding is reiterated by the six case studies, where the authors observe that tourism typically accounts for over 50 per cent of service exports for the middle-income countries (Botswana, Mauritius, St Lucia and Vanuatu); this is also the case (although to a lesser extent) in Singapore and United Arab Emirates (UAE). Singapore's service exports are skill intensive, and include education services, financial services and other professional business services such as information technology (IT). UAE's major service is trade (external, wholesale and retail), which has developed due to its excellent transport infrastructure facilities; however, the country is rapidly developing its financial, educational and tourism services as well.

Developing trade in knowledge-intensive services is a complicated process and many countries do not have an explicit trade-in-services policy or a detailed overall plan to develop trade in services. The constraints to trade in services are complex and go beyond traditional trade constraints. A policy-relevant approach distinguishes amongst three types of constraints. These include:

- supply-side or domestic capacity constraints;
- the domestic regulatory and institutional framework; and
- external constraints (for example, international trade in services agreements or pressures due to competition).

This approach is particularly useful in the services context for several reasons. It provides an analytical lens to developing trade in services – trying to make sense of the myriad of constraints to trade in services. It also delineates clear responsibilities for different actors in different sectors, ministries and among other stakeholders. That said, trade in services, which is a catalyst to promote economic diversification away from traditional sectors, involves a fundamental shift in mindset throughout the whole economy and necessitates different types of actions to overcome these constraints. For this to be successful, leadership or co-ordination from the top is crucial. Small countries might be at an advantage because they may have more flexibility to introduce changes than their larger peers.

A review of the experiences of small states that have either developed or are in the process of developing a strong services sector, in the context of these constraints, shows how appropriate public support may help to build vibrant private services sectors. The small states studied – Botswana, Mauritius, St Lucia, Singapore, United Arab Emirates and Vanuatu – belong to different geographical locations and income groups. The studies covered the performance and supporting factors in five promising services: financial, information and communications technology (ICT), education, professional business and tourism.

Botswana

Botswana, a landlocked country in Africa with foreign exchange earnings heavily dependent on diamonds and beef, has tried actively to move into financial services by establishing an International Financial Services Centre (IFSC). This has had some success as some IT and financial firms have moved in, but further progress seems arrested by weak IT systems and lack of appropriate skills. Call centres and the regional headquarters of some financial firms have already moved to Johannesburg instead. Banks list Botswana's lack of skilled labour as one of their primary concerns, an issue worsened through the strict immigration regime that affects not only unskilled but also skilled workers. The country has undertaken some important public-private initiatives to improve tertiary education, as in the Botswana Accountancy College: here an initiative has reduced dependence on imports of education services by training registered accountants, such that numbers have increased from four in 1996 to 400 a decade later. However, there are still too few efforts to improve ICT infrastructure and the availability and quality of local skills to make Botswana the regional hub of financial services and increase the net export of services. Perhaps the current plans for an IT hub could improve this.

Mauritius

Mauritius has managed the development of its services sector by gradually adding tourism, financial services and EPZs to the two traditional pillars of the economy, sugar and textiles. It has now embarked on a plan to provide an integrated competitive platform, linking the various pillars of economic development. The rapid expansion of services has already absorbed (employment) losses stemming from agriculture and textiles that were previously dependent on preferences, although there will still be painful losses in the adjustment process. The tourism sector has developed well and has set very ambitious new targets. The government is encouraging and adopting innovative ways to develop new types of tourism activities and attract foreign investment. Mauritius is also successfully developing its IT and financial services, benefiting from useful government involvement such as forward planning in terms of infrastructure, as well as from external technical and financial support. However, a cause of concern is the low supply of appropriately trained labour needed for the knowledge-based service economy. Increasing relevant tertiary enrolment rates is one of the country's national priorities.

St Lucia

St Lucia is currently at a critical juncture, as trade preferences are being eroded and competition with bigger countries such as Brazil, India and China is intensifying in international markets. The country has already realised a limited diversification of its export base by successfully promoting tourism, which it has done by using a proactive supply of infrastructure as well as organising successful one-off events such as St Lucia Jazz and the St Lucia Carnival. However, its performance in other, more knowledge-based services remains weak and while there are signs of other emerging sectors (IT-enabled services and offshore education), they are not yet receiving the same integral support and strategic planning as the tourism sector. To actively move trade in services beyond tourism, St Lucia will need to provide the emerging sectors with at least the same level of support (for example, improved infrastructure, promotion of service associations and effective state-business relations, and appropriate and well targeted investment incentives) and strategic direction as it did to tourism. In addition, there is still a lack a focus on developing a strong human resource skills base in order to move into a knowledge-based service industry.

Singapore

Singapore is an important success story for small states striving to build a strong services sector. The public sector created the right environment (a business-friendly climate, an export-oriented economic policy framework, improved regulatory and legal systems and state-led investments in strategic sectors through proactive supply of infrastructure, planning of clusters and skill upgrading schemes) for the services sector to develop. The case study shows that a successful approach needs the ability to respond flexibly as well as long-term engagement. The support framework has evolved gradually over time from one that stimulated manufacturing in the 1960s to one that promoted a knowledge economy in the 1990s and beyond. Singapore has a competitive advantage over many large countries in terms of its excellent transport and ICT infrastructure and availability of a skilled labour force. The government is attaching particular emphasis on promoting the education sector even further to make Singapore the regional hub for educational services. This would further strengthen other knowledge-based services such as ICT and financial services.

United Arab Emirates

United Arab Emirates (UAE), particularly the emirates of Dubai and Abu Dhabi, is a rapidly emerging success story. Like Singapore, the public sector in UAE, backed by oil revenues that one day will run out, took the lead to identify services with potential and development opportunities, planned strategically and created an investment-friendly climate to attract foreign investment. One of the successful initiatives was that of an open skies policy liberalising air transport, which strengthened the tourism sector and stimulated the demand for other goods and services as well. A more recent and sudden change has been the increased focus on developing knowledge-based services, with Dubai leading the other states in this regard. Important initiatives include the Dubai Financial Centre, Dubai Knowledge Village and Dubai Internet City. Dubai and Singapore have in common a strong focus on attracting (foreign) talents and foreign business schools and universities.

Vanuatu

Vanuatu, classified as a least-developed country (LDC) because of its high economic and environmental vulnerabilities, has an economy that is highly dependent on the services sector, yet exports of services have remained low and stagnant. The country continues to rely on primary agricultural products for foreign exchange. An offshore financial services sector was established as early as 1971 at Port Vila, which has attracted considerable foreign investment – in part because of extensive fiscal and legal incentives. However, considering increasing international competition to attract foreign investment in financial services, Vanuatu needs to be more proactive beyond incentives. Development of ICT infrastructure and human capital, as well as international marketing, are important in attracting more investment, especially from Asia. The government has actively promoted tourism in recent years and the contribution of tourism-related activities to the economy is rapidly expanding. Considering that Vanuatu is one of the most disadvantaged economies in the world in terms of its geographic location and susceptibility to natural disasters, and that it relies heavily on official development assistance, the development of a sound services sector requires strategic planning at the national level, as well as international technical and financial assistance to build domestic capacity.

Strategic and practical implications

The book includes a number of important strategic and practical implications:

- It makes economic sense for small states to concentrate on the development of knowledge-intensive services. Such services are less sensitive to high transport costs when compared to goods, help diversify the economic base, reduce vulnerability to macro shocks, are less sensitive to hurricanes (compare a call centre with a plantation) and reduce reliance on agriculture and manufacturing, which depend on eroding trade preferences and scale. With good telecommunication systems, IT-enabled services in small states can obtain direct access to large markets.
- The reality is that while many small states already depend on services for income, exports and jobs, this is often due to tourism, and less so because of the development of other services.
- Successful examples show that **leadership** is required to create a vision for the development of the services sector in a country. This may lead to a **change in the mind-set** throughout the whole economy towards a competitive, service-dependent economy and away from preference-dependent and protected sectors.
- Small states that have successfully developed knowledge-based services have supported these sectors **consistently over a period of years and decades**, while at the same time remaining **flexible to adjust** to new internal and external challenges.
- Technical and financial assistance could help to enable small states to adjust to a higher value-added economy and away from preference-dependent economies, especially 'Aid for Trade'. Many small states are amongst the most disadvantaged countries in the world in terms of their economic and environmental vulnerabilities. Regional and international co-operation to devise appropriate plans to build domestic capacity and improve physical and human infrastructure is crucial for these states. There also exists a large gap between small states in the low-income group and other small states in terms of their capacity to embrace service industries.
- There are various supporting factors (domestic capabilities, regulatory frameworks, external conditions etc.) across countries and sectors:

Different sectors

- **Tourism activity** is often private-sector driven initially, but the public sector can support tourism by building infrastructure and co-ordinating the activities of different private sector agents (for example, as in St Lucia). The design of appropriate international trade-related policies can be instrumental in this regard. The success of the open skies policy of Dubai (UAE) demonstrates how such liberalisation tends to work well.

- Some small states, especially middle and high income, are moving fast into **knowledge-based services** beyond tourism services. For example, Mauritius has already experienced a rapid rise in the number of IT companies operating in the country. However, in other small states the government needs to consider following an active approach to support services, as even a small expansion requires an increase in domestic capabilities such as skills and improved IT networks. If a deliberate attempt is not supported on all fronts, IT companies may decide to move elsewhere (see, for example, Botswana).
- Some small states have been successful at becoming regional **financial hubs** (for example, Singapore, Dubai and Mauritius). Others have long been engaged in offshore finance (for example, the Bahamas, Barbados and Vanuatu). However, many small states have struggled. It is important to realise that an adequate regulatory framework is not sufficient to succeed, as late entrants find it difficult to beat the competition.
- **Offshore education and training** is another emerging service. Caribbean states have already been successful in attracting offshore medical schools and they can contribute significantly to gross domestic product (GDP). Small states could approach this sector more strategically and create 'sticky' places where investors invest in education (for example, training local and foreign nurses), which would improve exports of services and at the same time upgrade the skills of the local workforce appropriate for the development of the services sector.
- There are many **other exports of services** from small states, including professional services, but often there are no systematic data. The lack of available data suggests that such services may not receive priority policy support. A first step would be to compile data and assess the export capacity of these sectors. Considering the increase in global demand for business services, such sectors can play an important role in diversifying the economies of small states.

Different supporting factors

- Building an appropriate and flexible **supply capacity** is crucial. Although this is part of normal development policies (skills enhancement, infrastructure, ICT etc.), the situation is different for small states, which face stark choices because of their small size and limited resources. Diverting resources from traditional sectors such as agriculture and manufacturing to supporting key services may involve adjustment costs for the economy, which will cause political repercussions and economic costs for some. Agreement on priority sectors is required within the country and careful planning as well as execution of policies to minimise the adjustment costs and maximise the advantages of diversification.

- The **regulatory framework** is very important for services. In some cases, bad frameworks can stifle development (for example, lack of regulation of monopolies in the utilities sector in the Caribbean). In other cases, a change in the rules can enable new service activities (attraction of offshore schools, film sets etc.).
- Small states need to embrace globalisation and use **international trade negotiations** to signal openness and their forward-looking approach. None of the countries studied have experienced negative consequences from taking part in trade in services negotiations, which have actually caused the private sector to take competition seriously. Creating a transparent framework for the non-discriminatory treatment of domestic and foreign investors is important if small states are to attract significant foreign (and local) investment in services. Successful small states tend to be more active in regional service negotiations, trying to gain access for their services providers in mode 4 negotiations on temporary migration.
- Governments have also considered the **institutional support structure** of both the private and public sectors. Private sector organisations can be assisted, perhaps with initial endowments or continued project support. Coalitions of service industries can also play a useful role in small states through, for example, educating their members about international service conditions and policies; promoting the adoption of standards and codes of conduct of their members to prepare for competition; lobbying government on the importance of an appropriate environment for services; and assessing the capacity of the sector and identifying areas with market potential.

Overall, the development of services involves leadership that can signal a fundamental shift in economic thinking in small states, which have traditionally relied on preferences and protection of goods. Changes in policy might be required at all levels: trade negotiations, the development of an appropriate supply capacity and building an appropriate domestic regulatory framework. State-business relations need to be strengthened so that the private sector benefits further from initiatives undertaken by the government. Engagement with the international economy is crucial, so that important lessons can be learned from the experiences of other countries in general and successful small states in particular. In addition, the international community can help by supporting such initiatives and assisting small states technically as well as financially to build the domestic capacity that supports a strong services sector crucial for future growth prospects in small states. Small states need to be proactive and consistent, yet flexible in their approach. 'Aid for Trade' can support this.

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Appendix

Table 1A: List of small states*

Commonwealth Sec/World Bank Joint Task Force Report		*Commonwealth Secretariat (2007)*
Antigua and Barbados	Lesotho	All states in Commonwealth Sec/ World Bank Report
Bahamas, The	Maldives	Central African Republic
Bahrain	Malta	Congo, Republic
Barbados	Marshall Islands	Costa Rica
Belize	Micronesia, Federal States	Iceland
Bhutan	Palau	Ireland
Botswana	Mauritius	Kuwait
Brunei	Namibia	Liberia
Cape Verde	Qatar	Luxembourg
Comoros	Samoa	Mauritania
Cyprus	Sao Tome & Principe	New Zealand
Djibouti	Seychelles	Norway
Dominica	Solomon Islands	Oman
Equatorial Guinea	St Kitts and Nevis	Panama
Estonia	St Lucia	Papa New Guinea
Fiji	St Vincent & the Grenadines	Singapore
Gabon	Suriname	United Arab Emirates
Gambia, The	Swaziland	
Grenada	Timor-Leste	
Guinea-Bissau	Tonga	
Guyana	Trinidad & Tobago	
Jamaica	Vanuatu	
Kiribati		

Notes: This represents a list of all small states identified in Commonwealth Secretariat/World Bank Joint Task Force Report (2000) and the Commonwealth Secretariat (2007). In the analysis the authors include countries based on their data availability.

Small states face serious challenges for development due to their size, remoteness and vulnerability. In recent years, the prospects for small states have deteriorated further due to preference erosion and the emergence of larger competitors such as India and China. *Working Smart and Small* suggests how small states can reposition themselves in the global economy and move into knowledge-based and service industries.

Part I provides an overview of general factors stimulating or constraining the development of services sector and trade in services. It also identifies key trends and provides analysis.

Part II gives six case study examples of how some small states have promoted knowledge-based and service industries in their economies. The small states studied, from different regions and income groups, are Botswana, Mauritius, St. Lucia, Singapore, United Arab Emirates and Vanuatu. The studies cover the performance and supporting factors in five promising service sectors: the financial sector, information and communication technologies, education, professional services and tourism.

Part III considers the policy implications.

This book will be of particular interest to economic policy-makers and researchers working on issues of concern to small states.

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