Chapter 6

Small States' Services Trade: Enhancing Participation in the Multilateral Trading System and Beyond

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6.1 Introduction

Services are part and parcel of today's social and economic fabric, proving to be critical for small states' development and helping them overcome their inherent disadvantages of smallness and remoteness. Services such as health and education are vital to improving livelihoods; environmental services help to alleviate the impact of economic activities on the environment; and transport, telecommunications, financial and business services facilitate trade and reduce transaction costs, which are often exorbitant in the case of small states. Services such as tourism transform local communities and contribute to the preservation of culture and heritage, whereas developments in information and communication technology (ICT) transform business models, catalysing innovation and creating avenues for the diffusion of information and knowledge. Chapter 1 of this book highlighted the main trends in the services sector for Commonwealth small states. This chapter, although looking at a broader group of small states,[1] goes deeper into the analysis of services, outlining the key services sectors for small states, some areas of concern and developments at the multilateral level.

Services are defined by three inter-related characteristics.[2] First, services are intangible; while the multilateral trading system (MTS) through the World Trade Organization (WTO) has established rules that govern trade in services, in practice, most services are actually embodied in the conceptualisation, production, marketing, distribution and consumption of goods. Because of their intangible nature, services need to be packaged in a way that embodies the service rendered, such as an insurance policy document or architectural drawings. This need for packaging has implications for cross-border export. In the past, documents and discs had to be shipped to distributors and consumers using postal services, which was costly in both time and money, rendering distant suppliers uncompetitive. However, this competitive disadvantage has almost been obviated by developments in ICT, enabling distant suppliers, including small states, to compete in growing markets such as call centres and higher education, among others. Second, services such as entertainment and personal care derive their uniqueness and value from the person providing them. This personal aspect gives rise to heterogeneity, as a spa experience, for example, has the potential to deliver a variable experience, depending primarily on the therapist and the preference

Table 6.1 Economic indicators by country group

	Period	World	Low and middle income	Small states
Average annual GDP growth	2000–2010	2.8	6.4	3.9
Services trade (% of GDP)	2009	11.5	9	28.0
Workers' remittances and compensation of employees received (% of GDP)	2009	0.7	1.9	4.1
Inbound tourism expenditure (% of exports)	2009	6.4	6.3	33.1
Services (% of total exports)	2009	21.2	14.8	28.8

Notes: GDP, gross domestic product
Source: World Bank (2011)

of the consumer. Services are said to be perishable, in that a tourism experience, for example, is enjoyed in the moment and cannot be stored for future consumption. Of course, services are dynamic and therefore these characteristics do not apply across the board: legal and construction services have less potential for variability than personal, cultural and recreational services; the ability to codify and standardise is essential for the successful outsourcing of many business services. Nevertheless, these qualities create opportunities for service providers, industry groups and even countries to establish market presence. In particular, this inelasticity of substitution provides avenues for differentiation between small states that have similar characteristics and sources of comparative advantage. Thus, although the features of carnivals in Antigua and Barbuda and Belize are similar, the experience in each country is different, and appeals to different market segments.

The true value of services is notoriously difficult to estimate. World Bank figures indicate that the global share of services to gross domestic product (GDP) has grown from 55 per cent in 1980 to 70 per cent in 2013 (World Bank 2014a). Measuring services by value added indicates that around 45 per cent of the value of exports in the world economy comes from services (World Bank 2014a). Growth in services is often enabled and accompanied by investment in intangible assets, such as digitised information and intellectual property. The value of service intangibles (including data, branding and intellectual property) has even been known to outstrip investment in tangibles in the manufacturing sector (Low 2013).

The value of the service sector to small states in terms of its share in growth, employment, competitiveness, export and investment, among others, is significant and growing. In 2009, the world average of services trade as a share of GDP was 11.5 per cent, while the corresponding figure for small states was 28 per cent, rising to 30 per cent in 2013. Similarly, the share of services in total exports is higher in small states (28.8 per cent in 2009 compared with the world average of 21.2 per cent) (World Bank 2011). Table 6.1 shows selected indicators and highlights the relatively high importance of services trade for small states' economies.

6.2 Trends and key sectors in small states' services trade

Total world exports of services more than quadrupled between 1980 and 2002, from approximately US$400 billion to US$1.6 trillion.[3] Commonwealth small states saw a similar trend, with earnings from commercial services increasing from approximately US$4 billion to over US$16 billion in 2002.[4] Growth in services continued through the 2000s but was interrupted by the recession of 2009, when international trade in services fell by 12 per cent (UNCTAD 2011). WTO reports indicate that the impact of the recession was variable: transport, financial services and construction saw the sharpest decline, whereas computer and information services and royalties and licence fees were more resilient. Financial services in small states are largely driven by demand in the economies that were hard hit by the recession; therefore, the contraction in the USA and Europe had a concomitant effect in small states. The Caribbean region in particular saw the collapse of a regional insurance conglomerate with holdings in sectors including banking, real estate and media, among others. As regards tourism, world tourist arrivals decreased by 4 per cent, with the decline most pronounced in Europe (−13 per cent) and North America (−11 per cent). This decline in demand had an immediate and severe impact on small states: the travel exports of Mauritius and Seychelles fell by 23 per cent, with a similar pattern evident in Cape Verde (18 per cent), Maldives (10 per cent) and The Bahamas (10 per cent) (WTO 2010). However, the impact of the recession was less severe for the small states in the Pacific region. A study of Fiji, Kiribati, Samoa, Solomon Islands, Tonga and Vanuatu concluded that this was largely a result of the comparatively limited exposure of their financial systems and the relative stability in their main trading partners: Australia and New Zealand (Kida 2009). Similarly, small states in Africa suffered the indirect consequences of the slowdown, but the impact was not as severe as in the Caribbean.

The wide diversity of small states precludes meaningful generalisations, and growth in service trade has been concentrated in four economies.[5] A broad review of the main regions that are home to small states (Africa, Asia Pacific and the Caribbean) highlights a few differences. A comparative analysis of the economies of small states and larger countries in Africa suggests that key features of small states – such as their relative size disadvantage – are less significant in Africa, as the low purchasing power parity makes nearly all markets relatively small (Dömeland and Sander 2007). Furthermore, small states have a higher export diversification index than larger countries in Africa owing in part to their success in exporting services, notably tourism and financial services. African small states have better connectivity (roads and telecommunications) and the contribution of the services sector to GDP was higher than the average for Sub-Saharan Africa, particularly in Botswana, Cape Verde, Mauritius, Seychelles and São Tomé and Príncipe.

The Asia Pacific region represents some of the most remote and widely dispersed islands, resulting in significantly higher trading costs and undermining export competitiveness. Between 2005 and 2011, tourism accounted for close to 90 per cent of GDP in Maldives and 50 per cent in Palau, while remittances comprised about 30 per cent of GDP in Samoa and Tonga in the same period (Tumbarello et al. 2013). In the Pacific Island countries, tourist arrivals have been growing at an estimated 6 per cent per year since 2000, notably in Fiji, Samoa and Vanuatu (Chen et al. 2014).

The services sector has been the main driver of growth in the Caribbean over the past three decades. Services grew at an annual average rate of 5 per cent between 1978 and 2004, expanding the share in GDP from 61 to 68 per cent (Kida 2006). This was largely due to the rapid expansion of tourism: tourist arrivals doubled between 1980 and 1989, from 6.9 million to 12.4 million a year. To compete with neighbouring countries to attract more tourists and foreign investment, countries in the region invested heavily in infrastructure such as airports, ports, cruise facilities, hotels and tourist attractions (national parks, boardwalks, urban shopping centres, etc.). The resulting construction boom was a big factor in the growth of the industry sector in much of the region (Kida 2006). Currently, the services sector accounts for more than 60 per cent of employment in the small states in the Caribbean region, with the exception of St Kitts and Nevis. The true value of employment in services may be even greater than its impact on output, as tourism tends to be more labour intensive than industry or agriculture (World Bank 2014b).

With support from partners (including the Commonwealth Secretariat, the Caribbean Aid for Trade and Regional Integration Fund (CARTFUND), the European Commission and the Inter-American Development Bank), almost all small states in the Caribbean region have undertaken assessments to identify non-tourism services that can be harnessed for competitiveness and export growth. Emerging sectors include health and wellness, higher education, information technology (IT)-enabled services and selected professional services. The main drivers of competitiveness include proximity to large markets, ease of access relative to competitors, availability of skill and good infrastructure. In some sub-sectors, the recommended market strategy is to target the region and diaspora in selected countries, building capacity, exposure and linkages to build competitiveness in the longer term. Nonetheless, tourism and financial services continue to be important.

Despite regional variations, the importance of tourism, health services and IT-enabled services for small economies cannot be ignored. In seeking ways to enhance their competitiveness and improve their services exports in these three key service areas, small states are driven by the need to:

- add value to traditional tourism to overcome volatility;
- secure higher incomes and more employment opportunities for skilled professionals who are underemployed or unemployed at home;
- inject a new dynamism to counter economic stagnation or moving into higher value services;
- adapt to the changing global trade environment, in particular the expiry of preferential trade regimes and new and deeper regional trade agreements.

6.2.1 Tourism

Tourism is by far the most important sector for the vast majority of small states. Small island developing states in particular have been popular holiday destinations for many decades and have adapted to changing market needs, including the traditional (sun, sea and sand) holiday during the 1960s; special interest packages (sports, adventure, culture) in the 1980s; and luxurious, tailor-made holidays (spa tourism, 'wellness', honeymoons and weddings) and cruises, as well as eco-tourism, in recent years (Bishop 2010). Tourism also confers other non-economic benefits on small states, including a renewed interest in local arts and crafts; improvements in educational, leisure, communication, medical and other facilities in the host countries; a general awareness of the man-made and natural aesthetic assets; and a broadening in the outlook of the local population (Briguglio and Briguglio).

The World Economic Forum ranks countries' competitiveness in tourism and travel based on 14 variables[6] under the broad categories of regulatory framework, business environment and infrastructure, and human, cultural and natural resources. Of the 140 countries ranked in 2014, only 15 were small states. The best performing of these are Barbados and Cyprus. Although data problems preclude the inclusion of many small states, the index suggests that small states rank high on *prioritisation of travel and tourism* and *ground transport infrastructure*.

According to the World Travel & Tourism Council, the contribution of travel and tourism to GDP in the Caribbean (which is dominated by small states) was higher than the global average of 3.3 per cent of GDP in 2013 (World Travel & Tourism Council 2014). The direct contribution of travel and tourism to GDP in the Caribbean region in 2013 was US$15.3 billion (4.4 per cent of GDP) and is forecast to grow by 3.5 per cent per annum to US$22.3 billion (4.5 per cent of GDP) by 2024. This trend primarily reflects the economic activity generated by industries such as hotels, restaurants and other leisure services, travel agents, airlines and other passenger transportation services (excluding commuter transport). The total contribution of travel and tourism to employment (including wider effects from investment, the supply chain and induced income impacts) was over 1.9 million jobs in 2013 (11.3 per cent of total employment). This is expected to have reached 2.3 million in 2014. Investment in tourism and travel made up 11.3 per cent of all capital investment in the region in 2013. This is the highest across 12 sub-regions.[7]

Tourism has a wide range of backwards and forwards linkages and can therefore potentially contribute to poverty alleviation through agricultural transformation, and rural community, culture and social development. Tourism is a labour-intensive sector with high female participation; it provides a wide range of opportunities for work, both unskilled and skilled working full or part time; it creates opportunities for micro-enterprises and small enterprises, as start-up costs are often low; and it can also provide opportunities for minority communities. It has, for instance, been argued that tourism was a main factor behind the graduation of Botswana, Cape Verde and Maldives from the status of least-developed country (LDC) (DEVCO and UNWTO 2013).

Studies looking at the dynamic effects of tourism on growth suggest that, in some cases, tourism contributes more to growth than other sectors; for instance, increased air travel for tourism can reduce the cost of air freight to the destination, providing new transport routes for exporters of fresh products (Subramanian and Matthijs, as cited in Qureshi and D te Velde 2008). Tourism is an important catalyst for growth in other services including construction, personal care and transport, among others. Furthermore, tourism can potentially increase local demand and provides an outlet for produce that may not meet export standards.

However, small states need to be careful about the way in which they govern their tourism sectors to ensure that they are reaping the benefits and avoiding the potential risks. First, hotels and resorts require large capital investment to build and operate. The resources, linkages and expertise are, on the whole, not available in small states; therefore, a large part of the industry is in foreign ownership. This in itself is not problematic; however, the hotel and resort industry is highly concentrated and is becoming increasingly vertically integrated. In 2012, analysis by Ernst and Young suggested that the top six hotel groups represent approximately 46 per cent of the hotel supply globally (Clifton 2013). As larger hotel groups seek to standardise services as part of their business strategies and to preserve brand identity, many are sourcing goods and services in bulk. Because of their characteristics, small countries are effectively locked out of such supply chains. Small states have responded to this consolidation by putting in place measures to protect certain services. The impact of foreign investment and resort enclaves has further limited the opportunity for (1) traditional economic activity to expand; (2) innovative and entrepreneurial activities to develop sustainably; and (3) local people to compete beyond the 'niche market'. The export-oriented model of resort tourism could result in developments that are not in the long-term interest of small states (Briguglio and Briguglio).

Second, although tourism employs a large proportion of the workforce, the nature of employment (type of job, role and salary) is not necessarily equitable (Commonwealth Secretariat 2013). Typically, expatriate workers make up a high proportion of those employed in key positions, leaving many local employees in unskilled, low-paid jobs with little chance of career advancement.

Third, the potential linkages with agriculture have been difficult to realise in practice: '… there is little evidence to suggest that the international tourism industry has been successful in developing backward linkages to local agriculture sufficient to stimulate growth in the agrarian sector' (Momsen 1998). This is of particular importance to small states, where micro-enterprises and small and medium-sized enterprises may be unable to guarantee the volumes, quality and uniformity required by hotel operators. However, data limitations also come into play.

Fourth, tourism as an industry depends on the whims and fancies of foreign travellers, whose decision to visit a particular destination is influenced to a very large extent by conditions outside the control of the country (including, for example, economic conditions and reports in the popular press in the tourist's country). Other economic dangers often associated with tourism in any country (but which are especially important in small states because of their dependence on tourism) include seasonal unemployment and a rapid increase in the price of land, often accompanied by speculation (Briguglio and Briguglio).

Finally, tourism appears to have a high potential for 'leakage', arising from:

- import of materials and equipment for construction and consumables, such as food and drinks;

- repatriation of income and profits earned by foreigners and foreign businesses;
- interest payable on foreign loans;
- overseas promotional expenditure (Turner 2010; Cole and Morgan 2010).

6.2.2 Health

Health and wellness services include four distinct but inter-related types of services:

1. **Medical**: general treatment and surgery for improved health or cosmetic purposes.
2. **Wellness**: therapeutic packages that may not necessarily be curative, but are designed to improve well-being through the management of stress, weight or ageing.
3. **Care**: management of adverse health conditions; includes recuperation, palliative and elderly care.
4. **Research and diagnostic services**: development and trials for medical and cosmetic preparations.

Exports through Mode 1 (cross-border) are realised when health-care professionals use the internet and postal services to care for patients abroad for consultation, follow-up and treatment. With access to the requisite technology, 'telemedicine' can include the provision of real-time medical services. Mode 2 (consumption abroad) is by far the most common, with patients travelling from their home countries to seek health and medical services abroad. Commercial presence (Mode 3) can take various forms, ranging from the establishment of medical facilities in a foreign location to joint venture arrangements, licensing and management contracts. Exporting through Mode 4 occurs when health-care workers move abroad to provide their services on a temporary basis.

The main reasons for seeking health and wellness services abroad include comparable or better quality care at a lower cost; shorter waiting periods; ease of access to procedures or treatment that may be subject to controls at home; and availability of advanced technology for treatment and surgery.

Small states are exporting medical and wellness services primarily through Modes 2 and 4. Several small states, including Mauritius, Jamaica, Trinidad and Tobago and Cayman Islands have been successful in attracting investment in medical tourism, providing jobs and creating business opportunities in other sectors of the economy. Although strong development indicators such as the availability of infrastructure and a stable macro-economic and political environment are important, a number of additional factors come into play, including the factors outlined below.

Proximity and ease of travel from populous destinations: Patients travelling to consume health and wellness services aim to minimise the discomfort and time associated with travel. The Caribbean is within easy reach of clients based in the USA and Canada: flying time to Jamaica from Miami and Toronto takes less than two and four hours, respectively. Islands such as Barbados, Dominica and Jamaica share the same time zone as the east coast of the USA and Canada, minimising the effects of jet lag. Having a common language, being well attuned to the business culture, tastes and preferences of the American consumer, and familiarity with the American health insurance system also works in favour of the Caribbean.

Reputation as a holiday destination: A strong brand image in tourism acts as a lever for the health and wellness sector. Tour and travel operators can provide information and arrange flights much more quickly than to less well-known destinations. As prospective clients are already aware of the region's tourism products, the decision to travel to the same exotic location for a medical procedure or to combine it with tourism is relatively more easily made.

Availability of good facilities and skilled personnel: A recent McKinsey survey estimates that 40 per cent of all medical travellers travel in search of advanced technologies (Ehrbeck et al. 2008). Some countries in the Caribbean have made significant investments in training health personnel and equipping medical facilities.

In small states, exporting health services through Mode 4 is not a deliberate strategy; rather, it is a result of rising demand for health-care workers worldwide and the growth and diversity of international recruitment agencies. Exporting health care is part of a global trend. Nonetheless, studies suggest that, in some instances, small states are targeted by recruitment agencies or by employers directly. A 2007 study of the USA-based nurse recruitment industry identified 11 agencies working in the Caribbean (Pitmann et al. 2007). There is no doubt that the negative impact of the outflow of health-care professionals is relatively higher for small states (owing to smaller numbers of professionals and the higher public costs in training them). However, the experience across small states is variable, reflecting the specific conditions in different countries. Furthermore, the line between temporary movement (which falls under the General Agreement on Trade in Services (GATS)) and permanent migration (which is outside the remit of the WTO) is blurred, and the available data do not reflect this distinction. Evidence suggests high intra-regional flows of professionals among the small states in the Caribbean and Pacific region – Fijian nurses go to Palau and Marshall Islands; Guyanese nurses move to the British Virgin Islands and eventually to more developed countries such as the USA (Connel 2009).

Several proposals have been forwarded to control the movement of professionals to ensure that the migration is temporary, that they are treated fairly and that their home country reaps some benefit. These include the Commonwealth Code of Practice of International Recruitment of Health workers (2003) and national initiatives such as the UK Code of practice for international recruitment for National Health Service employers. However, the impact of global codes and protocols is limited, mainly because the codes are non-binding. A number of bilateral initiatives have yielded some positive results. These include an initiative in St Vincent where nurses were trained for the US market. At the time of hiring, US partners would reimburse the government for each nurse trained. In Jamaica, some nurses split their time between Miami and Jamaica (Salmon et al. 2007). Other long-term solutions include deepening and modernising the health sector to provide a wider range of opportunities for the professionals and improving the remuneration of health-care workers.

Where they succeed in attracting external investment in medical tourism, small states face challenges with regard to domestic regulation. The export orientation of the health care system can have the unintended result of creating a system in which foreign clients have access to high-quality services that are not readily available to nationals. The result is a tiered system arising from two major conditions. First, the profit motive of the private sector means that health-care providers will seek to service clients who can pay. Where resources are directed to caring for foreign clients to the exclusion of local patients, the result may be the alienation of the poor and other marginalised groups in society. Second, private providers tend to offer more attractive conditions of work. The consequence of this could be under-resourced public facilities on which the majority of the population relies.

A range of policy options can be used to address this inequality, including:

- charging a levy on foreign patients which is then used to subsidise local patients, either directly through treatment or indirectly by building or equipping public facilities;
- introducing a system for foreign specialists to tutor local professionals in various fields;
- bonding arrangements whereby health professionals can join the private sector only after serving in the public sector for a given period of time;
- requirements for facilities exporting their services to reserve a minimum percentage of beds, persons and equipment hours for local clients or disadvantaged groups.

Finally, small states need additional capacity to manage a globalised, dual health-care system. Challenges here include limited market knowledge, insufficient funds and inadequate technical and managerial expertise. A wide range of clinical issues need to be addressed, including control of unfamiliar and hospital-acquired infections, assurance of quality and ethical standards and use of unauthorised or counterfeit drugs, among others. Political questions also come into play: what role should the private sector play in health care? How far should the government go in opening the sector to foreign providers and patients? Strategic choices must be made on what niches to develop and markets to target, how best to mobilise investment and how to ensure the availability of the required human resources. A host of managerial issues need to be addressed, including human resource planning, ensuring value for money and dealing with foreign insurance providers, especially when malpractice claims arise.

6.2.3 IT-enabled services

Studies suggest that a well-developed ICT sector contributes to faster growth, because it helps households, firms and regulators to engage in activities more efficiently. In particular, ICT has facilitated access to knowledge and information, reduced transaction costs and enabled the closer integration of supply chains. Digital technologies and solutions have become key enablers for productivity, innovation and growth in the world economy. The internet accounts for 15–20 per cent of GDP growth in many countries, including developing ones, and its importance continues to grow (Pélissié du Rausas et al. 2011; Manyika et al. 2013; UNCTAD 2013). The internet continues to enable and inspire new business models that could have a disruptive impact. The peer-to-peer distribution model that began with music has morphed into the 'sharing economy', in which almost every possible commodity (e.g. rental cars, unused office space, accounting help) can be bought and sold on the internet, providing opportunities to monetise idle assets (Bughin et al. 2013). A direct consequence of this is 'servicification', where non-services sectors in the economy produce, buy and sell more services than before (Low 2013).

Four key drivers of this phenomenon are:

1. increasing geographical dispersion of supply chains with specialisation;
2. the drive to cut costs and improve efficiency;
3. the desire to deepen customer relationships by providing services related to their products and meeting consumer demands; and
4. the differentiation of products to acquire advantage through market segmentation (Rentzhog and Anér 2014).

This has led to rapid growth in IT-enabled services, which broadly comprise business process outsourcing (BPO) (such as contact centres and data entry services) and knowledge process outsourcing (analytics and research). It is estimated that the global spend on BPO increased by 4.9 per cent to reach US$1.9 trillion in 2012 (Parikh and Mukherji 2013). AT Kearney's Global Services Location Index (GSLI)[8] analyses and ranks the attractiveness of 51 locations for outsourcing. The index comprises the categories below:

1. **Financial attractiveness**: compensation costs, infrastructure costs, tax and regulatory costs.
2. **People skills and availability**: remote services sector experience and quality range, labour force availability, education and language, attrition risk.
3. **Business environment**: country environment, infrastructure, cultural exposure, security of intellectual property.

Mauritius (36) and Jamaica (45) are the only small states included in the 2014 report, but many small states (including Trinidad and Tobago, Grenada, Belize and Barbados) have an IT-enabled services sector, however nascent. With the exception of the small states that have established a global presence in IT-enabled services (Mauritius and Jamaica), further growth is likely to arise out of the continuing trend of outsourcing, not only in the private sector but also in government. More importantly, a rising number of companies are locating services closer to their markets or country of origin – 'nearshoring'. This is partly because of the need to counter the perception that outsourcing organisations were 'exporting jobs', a view that gained ground during the recession. An additional factor is customer driven. In some industries, clients have negative experiences with the quality of services delivered from abroad (language, accents, providing additional information, etc.). Other considerations

Table 6.2 Small states' average broadband cost and speed by region, 2013

Region	Broadband cost (% of GNI per capita)	Broadband speed (Mbit/s)
Africa	13.2	0.62
Asia	5.4	1.3
Caribbean	5.4	1.9
Pacific	83.3	2.2

Notes: GNI, gross national income.
Source: adapted from International Telecommunications Union (2014)

include regulatory processes, customer privacy and intellectual property.[9] Finally, organisations are increasingly building nearshoring into their global BPO strategies for greater flexibility, quicker resolution of issues and avoidance of the risks of over concentration in one location.

Many small states are well positioned to benefit from this trend owing to a number of factors:

- cultural affinity with the key markets, notably US proximity, which results in lower overhead costs for clients;
- a strong, customer-facing business culture;
- unemployment, especially among young people, and low attrition costs;
- government support (e.g. fiscal incentives, training).

Small states still face a number of challenges with regard to the provision of IT-enabled services. The cost of bandwidth in many of them is still comparatively high and speeds are comparatively low, most notably for Pacific small states (Table 6.2) (International Telecommunications Union 2014). This is partly a result of historical monopolies in telecommunications, the reform process of which has been lengthy. For instance, in the Caribbean region, Cable & Wireless's monopoly in telecommunications was guaranteed by local laws. In one case, its exclusivity licence ran as far into the future as 2020. Cable & Wireless's charges for international telephone service were well above those in other countries of similar size and geography; these high costs were a burden to individual consumers and companies alike (Favaro 2008). Other challenges relate to the sustainability of the sector, especially where it is exclusively dependent on a few clients based in the USA.

6.3 Negotiating services in the WTO: where do small states stand?

The importance of the WTO to small states derives from their defining characteristics: openness to international trade and the resultant vulnerability to changes in prices of imports and exports; small population sizes that prevent the realisation of economies of scale; and the lack of competitiveness owing to high production, transport and transaction costs, among others. The vast majority of small states became part of the WTO in 1995 and 1996, the exceptions being Cape Verde (2008), Samoa and Vanuatu (2012) and Seychelles (2015). Small states comprise about 20 per cent of the WTO's membership. Most are classified as developing countries, although there are a few developed countries (e.g. Malta) and LDCs (Lesotho, Maldives). Three small states (Bhutan, São Tomé and Príncipe and The Bahamas) are among the 21 countries in the process of WTO accession.

Arguably, the lead up to the Third WTO Ministerial Conference in Seattle (1999) marked the beginning of small states' engagement with the WTO. Small states' issues were initially raised by Bolivia and were subsequently re-echoed by Mauritius, Barbados, Sri Lanka and Trinidad and Tobago, as well as the World Bank and Commonwealth Secretariat. The key issues raised in submissions to the Intersessional Committee of the WTO General Council and the Committee on Trade and Development in the lead up to Seattle were the need:

- to avoid abrupt removal of preferential trade regimes, as they partly compensated for small states' lack of comparative advantage, and abrupt removal would make it difficult for small states to integrate into the MTS;
- to improve telecommunications linkages with small states;
- for arrangements to ease the high legal cost of the WTO Dispute Settlement procedures for small economies;
- to streamline and accelerate procedures for accession to the WTO;
- to reduce WTO subscription fees of small states (Commonwealth Secretariat and World Bank 2000).

A range of proposals were made to the Ministerial Conference, including enhanced market access, longer transition periods, assistance to modernise key sectors and fast tracking regional integration, among others. The Seattle Ministerial Conference collapsed, but the 2001 Doha Round saw agreement by the General Council that small economies would be a standing item on its agenda and that the Committee would hold dedicated sessions and report regularly on small state issues.[10] As regards services, subsequent proposals and reports reaffirm the overall objectives of the Doha Development Agenda (DDA), with a small states' focus in the overall pace of liberalisation, export diversification, market access and technical assistance. Specific reference was made to 'trade-related concerns of small states' in Annex C of the Hong Kong Ministerial Conference in 2005. Subsequently, the Small Vulnerable Economies (SVE) Working Party on Domestic Regulations made a range of proposals on qualification and licensing requirements and procedures, technical standards and transparency in access to relevant information on legislative, regulatory and administrative measures.[11] Post-2008, the SVE agenda focused on operationalising the ministerial decision of 2011,[12] which called for the dedicated session of the Committee to examine the effects of non-tariff measures (NTMs) on the exports of small economies. The WTO Secretariat was instructed to provide relevant information and factual analysis for discussion among members in the Committee's dedicated session on, among other things, the challenges and opportunities experienced by small economies when linking into global value chains for trade in goods and services. An early harvest of the 2011 ministerial decision was the decision to grant a waiver to LDC services exporters,[13] with a view to accelerating the process of securing meaningful preferences for LDCs' services. By the Bali Ministerial Conference in 2013, the waiver had not been effective. Among others, the Ministerial Conference mandated the General Council to initiate a process that aimed to promote the expeditious and effective operationalisation of the waiver, periodically review the progress and make recommendations on steps for its further enhancement. Developed and developing members in a position to do so were encouraged to indicate sectors and modes of supply where they intended to provide preferential treatment to LDC services and service suppliers.[14] A collective LDC request identifying the sectors and modes of supply of particular export interest was submitted in July 2014[15] comprising a wide range of proposals, including:

- horizontal and sector-specific requests to waive Article XVI, Market Access and Article XVII, National Treatment, restrictions on LDC services suppliers. The sectors of particular interest to the LDC small states are travel, hospitality and conferences; banking, non-bank and insurance; transport and logistics, education and training, ICT and BPO;
- waiving Mode 1, 3 and 4 restrictions on 74 services.

Operationalising this waiver has potential benefits for LDC small states such as Lesotho, Solomon Islands and Vanuatu.

LDCs have also emphasised the presence of NTBs in the services sector, which inhibit market access in services trade and requested preferential treatment for licensing/work permit/visa fees, recognition of qualification of LDC professionals and accreditation of LDC institutions (WTO 2014c). In response to the Collective Request of the LDCs, the Council for Trade in Services (CTS) convened a high level meeting in February 2015, in which over 25 members indicated services sectors and modes of supply to which they would give preferential treatment to the LDCs (WTO 2015). There was active engagement from developed and developing countries in a position to do so. The majority of the 74 services sectors in which LDCs requested preferences came under the purview of discussion. Some of these preferences include expanding access for the temporary movement of business people and professionals from LDCs for a range of services (Mode 4); waiving fees for business and employment visas; not imposing Economic Needs Tests (ENTs); and extending durations of stay of LDC professionals. These will be implemented once the members have completed their domestic processes. Members also mentioned various technical assistance initiatives to improve LDC services export capacity, such as training programmes for service suppliers and support to upgrade infrastructure (Rahman and Jahan 2015). The question that has recently been raised in certain development forums is whether or not a similar approach to the LDCs services waiver can be adopted for small states in the WTO to boost their services trade. Obviously, much will depend on the success in operationalising the LDCs waiver in the very first instance.

Since the launch of the DDA, significant progress has been made in raising the issues of small states in the WTO, as explained in Chapter 1. However, with the lack of progress of GATS negotiations, the issues remain largely unaddressed, with the exception of the LDC services waiver. At the same time, there is growing interest among the larger, more developed, economies in plurilateral negotiations such as:

- The Transatlantic Trade and Investment Partnership (TTIP) – a proposed Free Trade Agreement between the EU and the USA.
- The Trans-Pacific Partnership (TPP) – comprising 12 countries in the Asia Pacific region, with the aim of enhancing trade and investment, to promote innovation, economic growth and development, and to support the creation and retention of jobs.
- The Trade in Services Agreement (TiSA) – bringing together 23 parties, including the EU-28 and the USA, covering about 70 per cent of global services trade.

These initiatives are taking place on the side line of the MTS and now have a tendency to dominate the scene on trade in services to the extent that the goal of achieving international participation and consensus seems to have been replaced by the goals of regional harmonisation and integration, and enhanced state-to-state relationships.

It is difficult to assess the impact of TiSA on small states, as negotiations are ongoing. Nonetheless, the intention of maximising TiSA compatibility with GATS is encouraging, but it also raises concerns that TiSA could be similarly restricted. However, TiSA could effectively replace GATS, or provide an avenue for small states to pursue additional market access, alongside more robust regulatory disciplines and/or greater transparency and predictability. The mere declaration of intent to participate in TiSA would send a powerful signal from small states about their interests to play at the upper echelons of services rule-making and market opening. Ultimately a choice for governments to make, it would be essential to ensure that the far-reaching implications of joining TiSA are well understood and that the decision is based on a thorough understanding of the benefits and costs (of which there is ample potential for both) (Primack 2014).

The current MTS presents a number of obstacles for small states, one key area of which is their ability to influence negotiations (see Chapter 2). The issues here relate to the structure of the WTO, the strategic importance of small states and their export capacity. The all-member Ministerial Conference is the WTO's decision-making body and meets every two years. Oversight of GATS is provided by CTS under the guidance of the General Council. The work of the CTS is, in turn, executed through subsidiary bodies: the Committee on Financial Services, the Committee on Specific Commitments, the Working Party on GATS Rules and the Working Party on Domestic Regulation. WTO records indicate that, since 1995, Barbados has been the only small state to have chaired the CTS (in 2007) and any of the subsidiary bodies (Committee on Specific Commitments in 2010), making it impossible to draw meaningful insights on the advantages of occupying leadership committee positions.

The work of putting mandates and agreements into effect takes place in Geneva and requires close co-ordination and collaboration not only with like-minded members in Geneva, but also abroad. Maintaining an effective presence in Geneva is vital for keeping abreast of ongoing negotiations, let alone advancing positions (see Chapter 1). Effective negotiations require technical expertise, backstopping support in capitals, building strategic alliances and attendance of major meetings and events. Small states find the cost of participation prohibitively high. Consequently, many drop out of the process, attend only selected meetings or become heavily dependent on funding from multilateral financial institutions and bilateral donor agencies in developed countries, whose interests may not be aligned to those of small states (Bernal 2008). A further complication is that, when it comes to commitments and preferences, the WTO recognises developing countries and LDCs. No similar grouping exists for small states.

Although decision-making in the WTO is by consensus and all countries carry equal weight, some analysts maintain that, in practice, consensus is driven by powerful countries and their allies, and the level of influence a country can exert through the WTO mechanisms is largely determined by their share of world trade (Hartmann and Scherrer 2003). With their small domestic markets and insignificant share of world trade, small states have limited leverage in the world trading system. Although this weakness applies to all trade, it is more significant in services trade. This is because of the reciprocal nature of services negotiations, where exporters are granted better access to target markets in return for domestic reforms. Given the scale of their industries, small states' offensive interests are likely to be modest. Similarly, strong members do not have that much interest in small countries, owing to their limited market size. Some analysts argue that these factors combine to constrain the prospects of negotiating significant additional market access, slowing down overall progress in GATS.[16]

Does the problem lie with small states or with the MTS? To answer this, it is necessary to assess small states' performance in GATS negotiations. The services market access to negotiations in the WTO is based on a request and offer approach. From the information available, some 15 small states have submitted offers in the current round of multilateral trade negotiations. In total, 71 initial offers were made by WTO members. Some of the sectors in which offers were made by the small states include tourism, business services and telecommunications – sectors of strategic interest to small state members. However, GATS has effectively stalled. The apparent lack of interest and ambition of small states must be juxtaposed with the experience in other agreements, such as the Economic Partnership Agreement (EPA). In several regards, the Caribbean Forum (CARIFORUM) EPA goes beyond the commitments and rules governing services trade in the WTO and creates a detailed framework of rules on investment. The EPA also features many WTO-plus (i.e. improvements on existing rules and/or commitments) and GATS-X (i.e. new rules, sectors or commitments not covered by GATS provisions). These include, for instance, improvements in access to the EU market for commercial presence and especially the temporary entry of natural persons and the treatment of cultural industries. It also features a dedicated focus on tourism, with a set of disciplines targeting the potentially anti-competitive conduct of large tourism intermediaries. Still, the EPA is more limited as regards the depth of commitments scheduled in areas where GATS commitments already existed (Sauvé and Ward 2012). This suggests that the MTS needs tweaking if it is to fully serve the interests of small states.

With regard to services in WTO agreements, the key area of concern for small states appears to be policy space arising from the GATS provisions in market access and domestic regulation. The role of the government is arguably more critical in small states owing in part to the limited number of market players (which makes monopolies and oligopolies more prevalent) and the nature of the private sector (dominated by small and medium-sized enterprises). Some analysts argue that these factors necessitate greater state involvement to control the adverse effects of dominant market behaviour, and to support the enterprise sector in overcoming the inherent structural challenges it faces. By extending coverage of the Dispute Settlement Body (DSB) to tourism and small states in particular, GATS rules on market access 'have the potential to weaken the basic notions of protection, conservation, and the ability of local communities and national governments to regulate tourism and tourist behaviour' (Turner 2010; Cole and Morgan 2010). This arises when, for instance, government initiatives aiming to support micro enterprises and small and medium-sized enterprises are deemed restrictive and challenged by transnational corporations in the Dispute Settlement Body.

The efficacy of GATS in relation to tourism in small states has been questioned by some, who suggest that GATS does not address the major problems that small states face in promoting tourism, such as ease of access to passports and visas (Thakur 2008). Furthermore, it does not confer substantial added value in market access, as countries that have a comparative advantage in tourism were already taking steps to attract foreign investment outside GATS and have overcome any market access restrictions (Thakur 2008).

It is pertinent to ask whether GATS can support small states to maximise their opportunities and address the challenges of exporting health and wellness services. It appears that small states have covered significant ground in attracting investment and exporting professionals in the sector, in spite of the lack of progress of GATS in DDA.

Can the issues in the ICT sector mentioned in the previous section be addressed in GATS? Small states have raised the need for support to modernise their telecommunications infrastructure throughout the DDA. GATS Article IV contains the general obligation to increase participation of developing countries in world trade through 'negotiated specific commitments … relating to the:

- strengthening of their domestic services capacity and its efficiency and competitiveness, inter alia through access to technology on a commercial basis;
- improvement of their access to distribution channels and information networks; and
- liberalization of market access in sectors and modes of supply of export interest to them.'[17]

Developed country members also are required to establish contact points to facilitate access by developing country members' suppliers to information concerning the 'commercial and technical aspects of the supply of services; registration, recognition and obtaining of professional qualifications; and the availability of services technology'[18]. The intention certainly exists, but many of the issues, the resolution of which would benefit small states, remain unanswered to date.

6.4 Conclusion

In assessing the opportunities and challenges faced by small states in navigating the MTS, it is important to consider a number of key global trends. First is the impact of technology, particularly the internet, which continues to influence innovation and trade in a dynamic and sometimes disruptive way. Second is servicification, which has made it even more difficult to isolate, measure and value the contribution of services. Third is the emergence of mega-regional trade agreements, notably TiSA, initiated and driven mainly by large, developed economies.

The MTS is vital for small states because of their defining characteristics: openness to international trade and the resultant volatility; vulnerability to natural hazards and climate change; small population sizes that prevent the realisation of economies of scale; and lack of competitiveness owing to high production, transport and transaction costs, among others. Small states have been engaged in the WTO and GATS for more than 20 years, during which time their major interests have not changed: enhanced market access and assistance to modernise key sectors, particularly ICT. Small states such as Mauritius, Jamaica and Malta provide important lessons in using tourism and financial services as a platform to stimulate other sectors. Whether this can be replicated is questionable because of the specific circumstances prevailing in different small states. Nonetheless, identifying services with export potential, targeting specific countries, regions or states and addressing any emerging market entry challenges through relevant channels, including the MTS, appears to be a concrete approach.

Within this global context, it remains clear that, from the services waiver, there is the potential for huge gains for LDC small states in sectors of export interest, such as tourism or financial services, but the operationalisation of the waiver would need to be successfully implemented. Other small states can contemplate emulating a similar approach in the WTO DDA negotiations, a way to enhance their participation in the MTS through services trade. There are, nevertheless, a number of key challenges to be addressed for the benefits of services agreements to reach the population of small states, including the development of soft and hard infrastructure services and other elements of productive capacities, including human resource development. There also needs to be efforts to develop mutual recognition agreements. Strictly on the negotiations side, identifying strategic markets and making concerted efforts for market entry – continued lobbying, systematic recording of barriers, negotiations to relax entry requirements and promotion of joint ventures – will certainly help in the process. Such momentum is essential to unlock the potential for services development in small states. In this regard, the use of a market-driven approach to negotiate market access for sectors with proven competitive advantage in regional and bilateral agreements (EU–EPA, Caribbean–Canada) could be instructive.

Notes

1 This chapter looks at a broader collection of small states, as defined by the World Bank.
2 Trade in services are defined based on four modes of supply in the WTO General Agreement on Trade in Services. See Article 1 of the GATS (https://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm).
3 Estimated using data from UNCTAD stat (2015). http://unctadstat.unctad.org/EN/
4 Estimated using data from UNCTAD stat (2015). http://unctadstat.unctad.org/EN/
5 Cyprus, Jamaica, Malta and Mauritius. From Bora et al. (2004).
6 Policy rules and regulations; environmental sustainability; safety and security; health and hygiene; prioritisation of travel and tourism; air transport infrastructure; ground transport infrastructure; tourism infrastructure; ICT infrastructure; price competitiveness in the travel and tourism industry; human resources; affinity for travel and tourism; natural resources; and cultural resources.
7 World Travel & Tourism Council sub-regions: (1) North Africa, (2) Sub-Saharan Africa, (3) Caribbean, (4) Latin America, (5) North America, (6) North East Asia, (7) Oceania, (8) South Asia, (9) South East Asia, (10) European Union, (11) Other Europe and (12) Middle East.
8 https://www.atkearney.com/documents/10192/5082922/A+Wealth+of+Choices.pdf/61c80111-41b2-4411-ad1e-db4a3d6d5f0d
9 Ibid.
10 Doha Ministerial Declaration (WT/MIN(01)/DEC/1), p. 35, and the Work Programme on Small Economies Framework and Procedures (WT/L/447), paragraph 2.
11 JOB(06)/66/Rev.2.
12 WT/L/844.
13 WT/L/847.
14 WT/MIN(13)/W/15.
15 S/C/W/356.
16 Note that, in contrast to goods, there is no generalised system of preference for services. In other words, developing countries do not have non-reciprocal preferential access to developed country service markets.
17 GATS Article IV, available at: https://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm
18 See GATS Article IV (2), available at: https://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm.

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