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An Investigation into Services Trade in the Bahamas

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Abstract: **The importance of the services industry as a share of overall production and employment in any country increases with growth and development. This expansion in the service-intensity of economies is driven by a number of forces including: final demand factors and basic structural changes in production linked to development. This paper delves into the literature available on the services industry in an effort to uncover the importance of services in an economy. It then examines the Bahamian economy to give readers insight into the small country's economic climate and composition. It then hones in on the major services offered in the country and identifies flaws in the country's sole reliance on tourism.**

Keywords: **services, trade, tourism, economic growth, economic development.**

I. INTRODUCTION

The importance of the services industry as a share of overall production and employment in any country increases with growth and development. This expansion in the service-intensity of economies is driven by a number of forces, including final demand factors and basic structural changes in production linked to development. Moreover, international exchange is increasingly taking the form of trade in tasks as opposed to trade in products, as the production process is sliced into different parts that are performed in different locations (Grossman and Rossi-Hansberg, 2008). From the aforementioned statements, one can say with assurance that services play a momentous role in all modern economies. A resilient tertiary service sector, coupled with an increased availability of services, may propel economic growth and enhance industrial performance. In an increasingly globalized world, services such as: finance, insurance, transport, logistics and communications deliver vital intermediate inputs and thereby provide critical sustenance to the rest of the economy. To further justify this assertion, according to the World Trade Organization (WTO), the global value of cross-border services exports in 2007 was $3.3 trillion, or some 20 percent of world trade in goods and services. However, the share of services rose to almost 50 percent if transactions are measured in terms of direct and indirect value added content – that is, if trade is measured in terms of the value that is added by processing of imported components into final products for export as opposed to measuring trade flows on the basis of the gross value of goods crossing the border (Escaith, 2008).

The discourse about services trade is an important one especially since the global marketplace is becoming virtually borderless. The focal point of this paper is the small archipelagic nation, The Bahamas. The Bahamas has a service-based economy and one of the highest income countries in the Caribbean. The economy of the Bahamas is characterized by tourism and financial services which are its two major income-generating sectors. As its dominant sector, tourism contributes to approximately 60% of the GDP. Construction driven by tourism adds another 20% to The Bahamas' aggregate output. The second largest sector is financial services, which contributes to around 15% of the economy, a large portion of which is from off-shore banking since the Bahamas is considered a tax haven. Apart from tourism and financial services, other activities include oil, maritime transshipment, salt, rum, aragonite, and pharmaceuticals industries. However, collectively, they only account for about 7% of the GDP. Agriculture accounts for 2.1% of GDP. In terms of space, more than 99% of the land is used for other purposes like tourism-related construction. Since services trade accounts for such a large percentage of the Bahamian economy, it is important to understand all of the key players involved and how such reliance affects other important parts of the economy such as unemployment. When assessing this situation logically, such a heavy dependence upon one industry- which is based solely on the dependence upon *other* countries' patronage and investment- is a very dangerous strategy to take when trying to develop a country. The rationale being, when unforeseen events occur around the world, and their people stop visiting The Bahamas, the result is the Bahamian economy contracts. Similarly, when multi-million dollar projects go bad, because of the great dependence on these ventures, the fallout has adverse effects on the country.

Hence the main focus of this paper is to delve into the literature available on services trade which will aid readers in understanding its importance and presence in a nation's economy. Then, to give readers a better understanding of the Bahamian economy, a brief overview will be shared on the makeup of the country's imports and exports and the breakdown of the composition of its services industry. Finally, the paper will discuss the Bahamian services trade industry and some of the problems associated with the country's sole reliance on this sector and the effects it has had on unemployment.

II. LITERATURE REVIEW

The intended focal point of this paper is services trade and the contribution its components make to the economy of The Bahamas. Before exploring the actual services that are specific to The Bahamas, it is important to first discuss services trade by looking at the literature available on the subject matter.

What is Services Trade?

Standard trade theory predicts that if markets are perfectly competitive, then a country will always gain from trade, in the sense that the country as a whole can consume more goods and services after trading than before. (Sapir, A. and C. Winter 1994) Therefore, the logic here relies on the simple premise that if markets are perfectly competitive, then profit maximizing firms will end up maximizing the value of national income. This is one of the major advantages of capitalism- a major economic theory. With this being said, it is important to lay the foundation of differentiating service trade from goods. *Service* trade differs from *goods* trade in two major ways. First, while the majority of goods traded involve shipping goods from one country to another, cross border trade accounts for less than half of trade in services. For services which require personal contact between customers and clients, trade is possible only via sales through a foreign affiliate or if either the customer or producer travels across borders. While foreign investment and labor mobility are also issues affecting goods trade, they are fundamental aspects of trade for some services. Second, services tend to be highly regulated. Many types of services are publicly provided or are produced by regulated monopolies. In contrast to goods, relatively few services are subject to simple discriminatory taxes on trade. Instead barriers to trade in services arise from domestic regulations that often serve the dual purpose of responding to market failures (such as ensuring quality standards for medical practitioners) and protecting local suppliers from foreign competition.

Over the past 20 years, trade in services has become the most dynamic segment of world trade, growing more quickly than trade in goods. Developing countries and transition economies have played an increasingly important role in this area, increasing their share in exports of world services from a quarter to one-third over this period. According to WTO-UNCTAD-ITC trade in services dataset

Regulation

The WTO's General Agreement on Trade in Services (GATS) was put into force in 1995. It remains the only set of multilateral rules covering international trade in services. The Agreement outlines the steady transfer of responsibility for many services from government-owned suppliers to the private sector and the increased potential for trade in services brought about by development in information and communication technology. The GATS recognizes that in many instances suppliers and consumers have to be in physical vicinity for services to be traded and highlights four different ways, or "modes", of supplying services.

How are services traded?

According to the GATS, trade in services is defined in terms of modes of supply:

• Mode 1 covers services supplied from one country to another (for example, call centre services).

• Mode 2 covers consumers or firms making use of a service in another country (for example, through international tourism).

• Mode 3 covers a foreign company setting up subsidiaries or branches to provide services in another country (such as a bank setting up a branch overseas).

• Mode 4 covers individuals travelling from their own country to supply services in another (for example, a consultant travelling abroad to provide an IT service).

When analyzing these various modes, one can assert Mode 2 is by far the most liberalized mode in terms of commitments by WTO members. This is mostly due to governments being less likely to restrict the movements of citizens outside domestic borders (e.g. tourists). Mode 1 is not often committed because it is impossible for many services to be supplied remotely (e.g. construction services), conversely mode 3 is more open, reflecting its vital role in driving the international supply of services, transferring knowledge and improving the capacity of economies to participate in global value chains. However, Mode 4 has the lowest depth of commitments, probably due to a number of sensitivities involved with the movement of foreign workers. In 2014, trade in services totalled USD 4,800 billion, representing 21 per cent of world trade in goods and services. However, this total does not cover services delivered via foreign affiliates.

The Role of Services

Modern economies are increasingly dominated by services. According to the WTO, over the last three decades, services have grown from roughly 58 percent of GDP to almost 75 percent. This sector is also important by other measures, including employment provision, cost shares for industry, and sector share of overall foreign direct investment. In the case of the industrialized countries, this is a trend that actually began much earlier, linked to fundamental changes in the structure of the economy that were already underway in the late 19th and early 20th century (Francois 1990a; Broadberry and Ghosal 2005). It is also a trend reflected in changes across the global economy. Services are very heterogeneous, and span a wide range of economic activities. Theoretically, this variety masks a fundamental function that many services perform in relation to overall economic growth and economic development; they are inputs into production. One dimension of this 'input function' is that services facilitate transactions through space (transport, telecommunications) or time (financial services) (Melvin, 1989). Another dimension is that services are frequently direct inputs into economic activities, and thus determinants of the productivity of the 'fundamental' factors of production – labor and capital – that generate knowledge, goods and other services. Education, R&D and health services are examples of inputs into the production of human capital.

Evidence from the literature strongly suggests that services play a critical role in productivity growth and can contribute greatly to a nation's economy. This brings us to the next part of the discussion- the analysis of these principles within the Bahamian economy.

III. THE BAHAMIAN ECONOMY OVERVIEW

Size and Location

The Bahamas is a small archipelagic chain of islands in the Caribbean spanning some 100,000 square miles. The country lies about 80 miles off the east coast of the United States of America, and its unique geographic positioning is a direct testament of its current economic system, which will be alluded to later. The Bahamas is one of the wealthiest nations in the Caribbean, with respect to gross national income (GNI) per capita. The country is heavily dependent on tourism which is the country's number one industry. As mentioned earlier, the country's close proximity to the United States of America, makes it an obvious choice for tourists from that nation, who comprise more than 80% of total visitor arrivals to the Bahamas. Tourism, being the major industry in The Bahamas, not only accounts for direct employment in the hotel sector, but also largely accounts for many offshoot industries such as construction, restaurants, retail trade, entertainment, *inter alia.* The Bahamas' second pillar to its economy is that of financial services, and along with tourism these comprise more than 70% of the country's gross domestic product. The small size of the economy and its geographic location contribute to the Bahamas' growth. Like most small island economies, the Bahamas has limited capacity for economic expansion and is highly reliant on foreign markets. Any negative shift in the foreign market can be detrimental. In the case of the Bahamas, there is a large dependence on foreign markets, namely the US to contribute to its tourism sector. Moreover, given the geographic and climate traits of the region, the island is subjected to extreme floods, hurricanes, and other natural disasters which cause substantial damage and have negative economic repercussions. HDI, GDP per capita, and Annual GDP Growth The Bahamas is a high-income country with an HDI of 0.789 showing a good standing in the social development front. HDI is a measure of a nation's quality of life. It is comprised of life expectancy, level of education, and gross national income (GNI). Barbados, Trinidad and Tobago, Jamaica, Suriname, and Guyana which are neighboring Caribbean countries have lower indices than the Bahamas.

Economic performance

Despite The Bahamas holding its position as one of the higher per-capita income countries in its neighborhood, much like other small economies in the region, the Bahamas experienced stagnant economic growth in recent years. The first major catastrophe that immensely affected tourism in The Bahamas was the terrorist attacks in America on 9th September, 2001. This devastating event created a rippling effect that nearly crippled the Bahamian economy due to Americans' fear of travelling, stringent border controls from America, and people's general disinterest in travelling at the time. After some time, the Bahamas exerted more effort into attracting other countries and was able to lure other people to visit. Fast-forward a few years, following the global financial crisis in 2008, the Bahamas, experienced negative growth rates in GDP. According to the OEC website, while GDP has grown since 2010, the average annual GDP growth is only 1.08%. This is due to multiple factors, namely its size, location, and policies all of which intensify its dependency on foreign markets and significantly increases its vulnerability to external shock.

Furthermore, it is important to note that generally, the Bahamas annual GDP growth rates follow U.S. trends of fluctuation. This may seem surprising but as aforementioned, The Bahamas is heavily dependent upon America so usually when consumers become richer, they travel more hence this benefits The Bahamas positively. Where there is a rise in US GDP growth, there is also a rise in the Bahamas growth, mostly because economic success translates to luxury and hence tourism in the Bahamas by US citizen as well as investments from their rich population. On average, these growth rates have been positive. Growth rates started to boom with policies, hotel acts, non-taxed income, and other attractive undertakings that were put in place after World War II. During this time, there was the initiation of the late Sir Stafford Stands who was the chair of the Development Board in 1949. He played a pivotal role in transforming the Bahamas into a massive tourist resort in just a few short years. During the 1960s, the Bahamas recorded great economic growth averaging to about 9% annually during the entire decade. For the past 15 years, the country has experienced instability in the growth of the economy due to disturbances and financial crises around the world. Nevertheless the present and near future years are expected to highlight an increase in the pace of growth.

As aforementioned, following the 9/11 events in America, the Bahamian GDP growth rates became negative because US citizens grew wary of travelling as a consequence of political unsafety. More recently, the Bahamas experienced negative growth rates after the 2008 world financial crisis. In 2009, the country experienced a GDP growth of negative 4.2%. While a negative growth rate is no longer the case – in 2010 the country had a 1.5% GDP growth – the growth is still listless. Due to its slowly progressive economy and high dependency on U.S. tourism the GDP growth dropped to less than 1 percent in 2013 but increased to 1.8% in 2014. However, the strength of the U.S. economy recently and the substantial decline in oil prices is expected to continue to boost tourism as a result of a stronger economy and reduced airfare. The dependency on the U.S. will reap its benefits at the present time; however, given its sensitivity to such shocks, it is my view that The Bahamas needs to find other revenue generating solutions to balance the effect of shocks via fiscal and monetary policy. It is important to mention that the government decided to implement Value Added Tax (VAT) as a source of revenue however, due its lack of transparency, the people of the country cannot be sure that all of the funds are used for its intended purpose.

Tourism Service and Unemployment

As aforementioned, tourism has been the driving force of the Bahamian economy since the end of the World War II. Contributing to about two thirds of the economy, it is the sector that sustains the Bahamas since the country lacks diversity of income generating sources. This is a major gamble because it undoubtedly leaves the Bahamas extremely vulnerable. Examples of this include US market demand drops, unforeseen delays of development projects, global recessions and storm damage. Also more recent, the Baha Mar resort deal is a quintessential example of being susceptible to negative effects due to dependence on others which has a spill-over effect on the people of the country. In 2014, the government put a lot of hope into the Baha Mar project, a multibillion dollar hotel resort which was intended to attract a wide spectrum of elite tourists to The Bahamas which promised to provide over 5,000 jobs and the prospect of a boost in tourism. However, the process turned into a major debacle as the investors had to declare bankruptcy, the work on the hotel was shoddy and major discrepancies over the use of money to build the resort arose. This was a major economic shock to the country because not only did it bring bad press but it also affected unemployment because some people quit their jobs to work for Baha Mar and they later had to be laid off.

IV. SERVICES TRADE IN THE BAHAMAS

The travel and tourism sector accounts for four-fifths of the Bahamas' foreign exchange earnings. The World Travel and Tourism Council (WTTC) estimates that in 2013 the tourism industry accounted directly for 20.4% of GDP and 28.5% of total employment in the Bahamas, and that in 2014 its direct contributions to GDP and employment will rise to 28.2% and 34.3% respectively. If indirect contributions are also considered, the industry contributed 46% of GDP in 2013 and 54.5% of total employment (around 102,500 jobs) in 2011. Forecasts for the sector are positive, as the WTTC expects sustained average annual growth of 3.3% in the tourism industry in the period to 2024 and projects that the number of people employed in the sector will grow to about 125,000 by that year. The tourism sector is dominated by large resort hotels, which had an average occupancy rate of 51.9% in 2013, and by other hotels catering to international tourists. Small hostels and bed-and-breakfast venues mainly serve domestic tourists. Cruise-ship visitors and daily visitors account for around two-thirds of arrivals on average but for only 11% of total tourist spending, meaning that there is a reliance on stop-over tourism. According to an IMF study on stop-over expenditure, economic conditions in tourists' countries of origin explain 45% of the variation in tourism expenditure in the Bahamas, while the relative level of local prices explains less than 6% of the variation. According to data for 2011, the travel and tourism sector makes greater contributions to GDP and employment in the Bahamas than in regional comparator countries such as Antigua and Barbuda, Barbados and Jamaica, thereby rendering the Bahamas particularly vulnerable to any fall in the number of arrivals. The tourism industry is closely linked to the construction and related engineering services sector. Over the past decade, hotel construction projects across the Bahamian archipelago have boosted economic growth and raised employment. For instance, the construction of the Atlantis Resort and Casino on Paradise Island continues to boost tourism and other activities on New Providence. Meanwhile, as previously discussed, the construction of the BahaMar resort project on New Providence was intended to drive construction growth and positively impact the Bahamian economy with the US$2.6bn facility, the project was never completed.

Essentially, it is important to note that The Bahamian economy features a high dependence upon other countries for its growth and sustainability. It has found a way to capitalize on its natural resources and close proximity to the United States and offer it as a service package to visitors in order to sustain its economic development. However, as stated many times throughout this paper, I think this is a very huge gamble and an unwise plan of action because with such heavy reliance upon others, The Bahamas is essentially not in charge of forging its own path rather at the mercy of others.

V. CONCLUSION

The literature on trade in services has grown significantly over the years. The factors that affect trade and investment flows, the effects of such flows, their importance and the types of policies that affect them are now much better understood. Services can be an engine of export growth for some countries – India may be an example – but more important is that they are a key determinant of the competitiveness of all firms in open economies, no matter what they produce or what types of activities and tasks that they have a comparative advantage in.

As for The Bahamas, as stated in this paper, it is the wealthiest country in the Caribbean, yielding above par performance in key sectors compared to the rest of the region. Nonetheless, having a less than half-million population size, being prone and vulnerable to natural disasters, having high dependency on the U.S. for imports, investments, and tourism, there is still much need growth for the Bahamas. While it is strategic to develop its natural resources in such a unique way to provide excellent service, evidently the country's reliance on this sole industry is not a very advantageous strategy for economic growth. The Bahamas is a very small country and as such there is still much development that needs to take place hence increasing FDI and forging meaningful relationships with key world players like, The Bahamas will be able to sustain itself.

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