

# **THE OFFSHORE SERVICES INDUSTRY IN THE CARIBBEAN: A CONCEPTUAL AND SUB-REGIONAL ANALYSIS**

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*The proliferation of Caribbean offshore centers within the ambit of the offshore services industry appear to be providing recourse for the precipitate decline of the agricultural sector and in particular a key commodity export, namely bananas in the case of the Windward Islands, in national revenue generation. The article contends, therefore, that the development of offshore sector frameworks constitute deliberate public policy-making aimed at crafting a revised national development dynamic as well as economic diversification imperatives in the region. At a time when there are continued and significant declines in terms-of-trade for Caribbean primary commodity exporting nations this revised approach to economic growth is not a juxtaposition of policies but rather represents an important shift in approaches to national development planning – especially amongst emerging offshore jurisdictions like Grenada and the Commonwealth of Dominica. However, the article argues that while islands especially in the Organization of Eastern Caribbean States (OECS) sub-region are attempting to harness a strategic growth industry as a principle agent in national and sub-regional economic transformation it is premature for policy-makers to view the offshore sector as replacing the agricultural sector at least in the short- to medium-term. This argument is advanced through an explicit review of the banking and international business companies (IBC) sub-sectors of Dominica's offshore services regime.*

## **1. An Introductory Analysis of the Offshore Sector Modality**

An offshore sector makes reference to financial services and non-financial services frameworks in a country/territory. Clientele who make use of these services are non-residents of the given jurisdiction. In these service frameworks assets can be diverted to and business/financial affairs conducted in an environment where a package of favorable regulatory incentives are in place to benefit clients who would ordinarily not be privy to such regulatory regimes in onshore jurisdictions. These regulatory incentives typically comprise incorporation mechanisms as regards commercial holding companies or overseas subsidiaries in client friendly fiscal and exchange control environments.

Offshore frameworks are not new to the Caribbean; some island offshore jurisdictions have been in place, in one form or another, for over 50 years. The sector has proven to be very important economically as a major revenue generating agent, especially in the first tier jurisdictions, in the Caribbean.<sup>2</sup> There are approximately 70 offshore financial centers worldwide; the size of the global offshore services industry ranges from between \$5 to \$6 trillion and the offshore centers of the Caribbean command approximately a third of this money (Commonwealth Secretariat, 2000).<sup>3</sup>

Offshore financial services are offered within the ambit of offshore financial centers that function as financial market intermediaries.<sup>4</sup> These centers are categorized as either (1.) primary; (2.) secondary; and, (3.) booking centers. This typology reflects the degree to which value-added activities take place at the level of a given offshore jurisdiction itself. The low-end of the value-added chain encompasses booking activity, for example, those related to IBC registration/incorporation. Offshore booking centers, in this regard, serve as platforms where 'shell branches' of international financial institutions record their financial transactions. However, in addition to low-end market transactions, activities in these centers also extend to those in the high-end of the market such as international banking and insurance companies.

The principle international offshore financial center is London that, relatively speaking, offers a full-service environment and in this regard the most advanced array of services. The distinguishing features of such an offshore sector are sophisticated settlement and payments systems, typically not in place in secondary offshore centers - that principally intermediate funds and employ limited financial activities that are very specialized - because of the absence of financial autonomy. These jurisdictions are found in Central America (e.g. Panama), the Middle East (e.g. Bahrain) and South East Asia (e.g. Singapore and Hong Kong) for example. The Caribbean is where offshore booking centers are typically based and they serve as registries for financial transactions conducted and managed in other jurisdictions.<sup>5</sup> However, offshore booking centers are most widely recognized for their anonymity and tax planning uses where certain accounting procedures are employed to minimize tax burdens, 'legally', through *tax avoidance*. This is accomplished through flexible tax regulatory regimes not otherwise provided in onshore financial systems. A center typically provides "reduced regulatory environments and [...provides...] favorable treatment of tax, with the possibility of lower taxes. The tax aspects may be governed entirely by domestic legislation or a combination of such legislation and tax treaties. The tax benefits include reduced tax, low tax or special tax privileges. Sometimes there is no tax at all, usually in relation to foreign income or in respect of certain specified business activities" (Bourque, 1994: 68). Tax regimes, in this context, also work to minimize tax liabilities and advance the confidentiality imperatives typically provided by a *tax haven*.<sup>6</sup>

It is precisely because of the perceived need for flexible tax frameworks that the offshore concept was born. However, the emergence of offshore financial centers was also a response to bottlenecks to international commerce emerging from industrialized countries' fiscal/financial policies, of the 1960s, that hindered efficacy in the intermediation of funds as well as the conduct of business affairs across but also within jurisdictions. The central issue in this regard was one of high taxation but also stringent financial regulations in onshore financial systems. As relates to the latter, the existence of capital controls (e.g. the United States' Interest Equalization Tax and Voluntary Foreign Credit Restraints programmes of the 1960s), reserve requirements, interest rate ceilings, limits on financial products offered and government imposed quotas on the volume of cross-border financial flows and liquidity requirements catalyzed the need for the establishment of flexible offshore financial frameworks. The offshore sector, then, emerged as a response to what were viewed as restrictive fiscal regimes and systems of supervision as well as conservative banking laws and financial regulations, aggressively pursued by industrialized countries mainly to reverse desperate balance-of-payments situations, at a time when transnational corporations (TNCs) - towards the latter part of the last century - aggressively sought an enabling regulatory environment for the effective and efficient functioning of international commerce.

## 2. The OECS Sub-Regional Offshore Industry

As regards the rationale for putting in place offshore sectors in the Organization of Eastern Caribbean States (OECS) sub-region, this has historically been based on the perceived merits of this lucrative industry in lieu of restrictive tax regimes and financial regulations in industrialized countries. An offshore jurisdiction, for predominantly commodity-based economies of the developing countries in this sub-region, brings with it very important spill-overs, the most important of which is economic diversification. Other benefits for these economies include financial contributions to civil society, at large, for example through contributions to communities, sports and culture. In Grenada, for example, offshore banks continue to make significant financial contributions in this regard and expenditure increased from EC\$70,000 in 1998 to EC\$250,000 in 1999 with a further EC\$3 million targeted for spending by December 2000. Additional benefits include employment generation, both directly from the industry (for example back-office operations, as relates to settlement work, that depends on labor intensive activities) and also in an ancillary fashion as foreign capital and expertise are attracted to jurisdictions bringing associated labor market and technology spill-overs. For example in Grenada, according to the Grenada International Financial Services Authority, the expansion of the offshore sector in 1999 has contributed to reductions in the unemployment rate from 15.2% in 1998 to 12.5% in 1999 (see Table 1). Over 200 jobs were created directly, while additional

employment was indirectly created through linkages with the other sectors of the economy. An anticipated expansion in the offshore sector, combined with growth and development in other sectors, is expected to further reduce the national unemployment rate below 10% by December 2000.

*Table 1 – Direct and Indirect Employment Generated in Grenada through the Offshore Sector*

	1998		1999	
	<i>Employed</i>	<i>Unemployed</i>	<i>Employed</i>	<i>Unemployed</i>
<i>Offshore sector</i>	70	-	200	-
<i>Other sectors</i>	34,717	6,228	36,988	5,312
<i>Allsectors</i>	34,787	6,228	37,188	5,312
	<i>Unemployment Rate: 15.2%</i>		<i>Unemployment Rate: 12.5%</i>	

Source: Adapted from Departmental data provided by Office of the Executive Director of the Grenada International Financial Services Authority (October 2000).

St. Lucia was the last of the OECS Member States to adopt an offshore framework. As of 2000 all Member States had an offshore regime in place.<sup>1</sup> In the past two decades offshore jurisdictions have mushroomed in the sub-region; many of these offshore jurisdictions offer relatively similar offshore services (see Box 1).

*Box 1 – Offshore Service Provision in Second Tier Jurisdictions*

<p><u>Anguilla</u> International Business Companies Limited Liability Companies Limited Partnerships Offshore Banks Trust Companies Company Management</p>	<p><u>Antigua &amp; Barbuda</u> International Business Companies Offshore Banks International Trusts International Insurance Ship Registration</p>
<p><u>Dominica</u> International Business Companies Offshore Banks International Trusts International Insurance Ship Registration Offshore Banks International Business Companies International Exempt Trusts Exempt Insurance Economic Citizenship Internet Gaming</p>	<p><u>Grenada</u> International Business Companies Offshore Banks International Insurance International Trusts Economic Citizenship International Betting Companies Management</p>
<p><u>Montserrat</u> Offshore Banking International Banking Companies</p>	<p><u>St Lucia</u> International Business Companies International Trusts International Mutual Funds International Insurance Companies International Banks</p>

<p><u>St Kitts</u></p> <p>Exempt Limited Partnerships Exempt Trusts Exempt Companies</p>	<p><u>Nevis</u></p> <p>Offshore Banks International Business Companies Limited Liability Companies International Exempt Trusts</p>
<p><u>St Vincent and the Grenadines</u></p> <p>Offshore Banks International Business Companies Mutual Funds International Trusts Ship Registration International Insurance</p>	

Source: Adapted from ECCB, Departmental data provided by Bank Supervision Department, Eastern Caribbean Central Bank (October 2000).

Second tier offshore jurisdictions are attempting to develop unique offshore sector frameworks to build comparative advantages. In St. Lucia's offshore jurisdiction, for example, the private sector and Government partnership developed to operate the offshore framework resulted in the creation of the Financial Center Corporation and the International Financial and World Investment Center (IFWIC) – otherwise known as PINNACLE St. Lucia - which is aggressively promoting the use of advanced information technology to build on the jurisdiction's comparative advantage. At the time of its inception St. Lucia's offshore sector was the only one in the Caribbean region to offer online IBC registration. In addition, the St. Lucian offshore framework is a melange of the best features of legislation in well established and performing Caribbean offshore jurisdictions. So not only does the countries' legislative and regulatory framework – adapted from the best features of other regional offshore jurisdictions – serve to build the jurisdiction's comparative advantage but so does the use of advanced information technologies making the island the Caribbean's only public online IBC registry.

### 3. Offshore Industry Sub-Sectoral Bottlenecks in Emerging Offshore Jurisdictions

Despite the proliferation of the offshore industry within the OECS sub-region, it would be premature to view the pursuit of an offshore policy in such a fashion that would warrant an acute re-calibration of national development planning modalities. While the motivations for establishing offshore jurisdictions more so between banana-based countries, in the Windward Islands, and non-banana-based economies in OECS proper, vary and understandably so public policy-making aimed at crafting a revised national development dynamic with the offshore sector at its center would be flawed. Fundamentally, the performance of certain component parts of the sector in many of the second tier jurisdictions, especially in some of the emerging jurisdictions of the 1990s, have just not been dynamic enough. In Dominica, for example, offshore banking performance in revenue generation has not been dynamic.

Offshore banking is a recent phenomenon in Dominica and follows on the heels of similar initiatives pursued, for example, by the governments of Antigua & Barbuda and St. Vincent & Grenadines in the 1980s.<sup>1</sup> In the 1990s, the Dominican government began taking more aggressive steps in building an offshore banking regime. The Offshore Banking Legislation that was adopted in 1996 formally established many provisions that would enhance the offshore banking industry in Dominica. An important feature of the Legislation is Part X of the Act which grants the licensee exemption from all taxes and duties in respect of its offshore banking business in Dominica. The fiscal framework is attractive not only because it provides for zero tax or duty liability but also because the offshore banking initiative provides various exemptions, for the licensee, as regards exchange controls in respect of income, profits and securities amassed. As of June 2000 there were a total of 7 offshore banks operating in Dominica's jurisdiction.<sup>2</sup> During the period 1996 to 2000 these banks have generated revenues for the government – through registration and renewal fees alone – that cumulatively only total EC\$589,279.

Dominica also has in place an IBC framework. Central to the offshore framework in the IBC regime is the guarantee that the owner, who would have total control over assets, is ensured the complete privacy and confidentiality of a *tax haven*.<sup>3</sup> The International Business Companies Act of 1996 represents an important initiative to consolidate and strengthen the internationalization of Dominica's trade and investment regimes. The Act's primary objective is to build a tax-free regime for IBCs in Dominica through a scheme whereby a twenty year tax and duty exemption is given to IBCs domiciled in Dominica (Dominica, 1996). The Act is attractive, not only because it promotes a tax-free regime for IBCs, but also because it ensures total anonymity and confidentiality through the availability of bearer shares and the non-requirement to file organizational or accounting information with the registrar of companies. The Act also enables the issue and re-issuance of shares without par value and waives statutory requirements to hold annual general meetings. The IBC registration process itself has also been simplified under the Act and typically the services provided by Private Trust Companies, where IBCs can be registered, also serve to complement an IBC friendly environment, as the Trusts generically offer complete privacy as regards access issues, asset protection services, custody of securities and corporate domicile services to name a few.

As is the case with Dominica's offshore banking sub-sector, revenue generation in respect of fees from registration, renewals, and agents for the IBC regime has consistently performed below expectations. In 1996 revenues generated were N/A, in 1997 revenues generated were EC\$750,437, in 1998 EC\$721,737, in 1999 EC\$331,223, in 2000 EC\$29,525 for a cumulative total during the period 1996 to 2000 of EC\$1,832,922 (IBU, 1999). Trends in IBC sub-sectoral performance are further highlighted in Table 2 below.

*Table 2 – Performance of Dominica's IBC Sub-Sector*

	<b>1999</b>	<b>2000</b>	<b>1997/98</b>	<b>1998/99</b>	<b>1999/00</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
	<b>Projected Rev</b>	<b>Projected Rev</b>	<b>Actual</b>	<b>Actual</b>	<b>Actual</b>				
<b>IBCs</b>	<b>2,692,764</b>	<b>475,475</b>	<b>1,058,210</b>	<b>409,010</b>	<b>191,255</b>	7.45	7.25	3.40	0.61
<i>Registration Fees</i>	991,764	291,600	989,496	308,124	134,136	7.39	6.19	2.34	0.32
<i>Renewal Fees</i>	1,701,000	172,125	56,700	93,960	53,460	0.00	0.96	0.98	0.28
<i>Sundry Fees</i>	-	5,000	539	2,876	1,634	0.01	0.01	0.04	0.00
<i>Agency Fees</i>	-	6,750	11,475	4,050	2,025	0.06	0.10	0.05	0.00

Source: Adapted from International Business Unit, *Annual Offshore Sector Report for the Period Ending December 31<sup>st</sup>, 1999* (1999).

Table 3 reinforces IBC sub-sectoral performance patterns evidenced in Table 2; in that it illustrates the acute and consistent decline in company registration/renewals and agent registration that would have a direct effect particularly on sub-sectoral revenue generation through fees.

*Table 3 – Company/Agent Registration and Renewals for Dominica's IBC Sub-Sector (1996-2000)*

	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>Cumulative Total (1996 – 2000)</b>
<b>IBCs</b>						
<i>Number of Companies</i>	-	3,061	2,534	937	64	<b>6,596</b>
<i>Number of Renewals</i>	-	-	235	235	34	<b>504</b>
<i>Number of Agents Registered</i>	-	7	16	7	0	<b>30</b>

Source: Adapted from International Business Unit, *Annual Offshore Sector Report for the Period Ending December 31<sup>st</sup>, 1999* (1999).

Further to the above account of performance dynamics within Dominica's offshore banking and IBC sub-sectors it would be inaccurate to surmise that the offshore sector, in general, is under-performing; quite the contrary, the offshore sector has benefited the Dominican economy immensely. In the International Business Unit's 1999 *Annual Offshore Sector Report* it is noted that total revenue generated from the offshore sector during the period 1996 to 1999 was EC\$34,395,196 (IBU, 1999). In 1999, alone - as highlighted in Table 4, total revenue generated from the offshore sector was EC\$9,748,169 (ECCB, 2000).

*Table 4 – Dis-Aggregated Offshore Revenue Data for Dominica (1999)*

<i>Type of Offshore Programme/Service</i>	<i>Revenues Generated</i>
Economic Citizenship Program	\$7,787,188
Offshore Banks	\$132,624
International Business Companies	\$331,223
Internet Gaming	\$1,430,001
International Exempt Trusts	\$21,058
Exempt Insurance & related Company Management Services	\$32,669
<b>Currency Trading</b>	<b>\$13,500</b>
TOTAL	\$9,748,169

*Source: Adapted from ECCB, Departmental data provided by Bank Supervision Department, Eastern Caribbean Central Bank (October 2000).*

What is apparent - upon closer inspection of Dominica's offshore framework – as is the case with many second tier offshore jurisdictions that emerged in the 1990s is certain sub-sectors of the industry are not performing dynamically. In the case of Dominica, offshore sectoral components like the Economic Citizenship Programme have historically been the principle revenue generators. However, with the suspension of the programme, in August 2000, and if it should come to pass the programme is permanently cancelled this raises the *sustainability* and *viability* question in respect of the extent to which Dominica's offshore sector can continue to be a major contributor to government revenue.

The pattern of sub-sectoral non-dynamic performance, highlighted above, is also apparent in offshore jurisdictions that have been in place since the 1980s. The average annual revenue from the sector for Montserrat, for example, in the last three years has only been approximately EC\$0.5 million; revenue from the sector in 1999 constituted just 0.84% of GDP. Grenada's offshore services sector, however, performed relatively better in the last three years and as of the end of 2000 is expected to contribute just over EC\$44 million to the economy - which represents about 5% of GDP, approximately 15% of private investment and 14% of government recurrent revenue (see Table 5).<sup>1</sup>

*Table 5 – Contribution of the International Financial Services Sector to the Grenadian Economy*

	<b>1998</b>	<b>1999</b>	<b>2000</b>
<b>Offshore Companies (EC\$M)</b>	3.05	15.12	32.78
<b>Economic Citizenship (EC\$M)</b>	4.91	8.53	12.00
<b>TOTAL (EC\$M)</b>	<b>7.96</b>	<b>23.65</b>	<b>44.78</b>
<b>Gross Domestic Product</b>	1.0%	2.8%	5.1%
<b>Private Investment</b>	3.1%	8.7%	14.9%
<b>Government Recurrent Revenue</b>	3.4%	8.6%	14.2%

Source: Adapted from Departmental data provided by Office of the Executive Director of the Grenada International Financial Services Authority (October 2000).

Similarly, Anguilla's annual Government revenues from financial services have progressively increased over the years. Revenues for 2000, for instance, are budgeted at EC\$2,850,000 and is currently projected to surpass this indicative target by years end.<sup>1</sup> Relatively speaking, in the last five years indicative revenues have progressively risen as have actual revenues generated. In fact, as is illustrated in Table 6, this upward trend is evident since the inception of the offshore jurisdiction in the mid-1990s (Anguilla, 2000).

*Table 6 - Revenues Generated from the Offshore Sector in Anguilla (EC\$)*

<b>Year</b>	<b>Estimate</b>	<b>Actual</b>
2000	2,850,000	2,400,000*
1999	2,424,000	2,359,722
1998	2,048,000	2,006,003
1997	2,051,000	1,998,308
1996	1,767,000	1,577,951
1995	1,728,500	1,112,676

\*As of the end of the third quarter of 2000.

Source: Adapted from Departmental data provided by Office of the Director of Financial Services (Anguilla, 2000).

As is conspicuously evident from the review of Grenadian, Anguillan and even Dominican offshore sectors, above, the industry is a valuable contributor to national revenue and economic growth. While there may be a temptation to seek a replacement for a collapsing banana industry, however – as is the case in the Windward Islands - the offshore sector does not, *as yet*, constitute such a replacement. This is because once offshore sector performance, especially in emerging OECS offshore jurisdictions, is dis-aggregated the analyst quickly finds skewed and un-balanced sub-sectoral performance. In the case of Dominica, a disproportionate amount of macro-level sectoral performance is attributable to the Economic Citizenship Programme whereas other sub-sectoral component parts have performed significantly less dynamically.

#### 4. Concluding Remarks

While the offshore sector must certainly be viewed as a means of *enabling* economic diversification and providing alternatives to national revenue generation, it is premature for OECS policy-makers to view the offshore sector as *replacing* the agricultural sector at least in the short- to medium-term. While economic diversification is a necessity amidst a haemorrhaging banana industry a distinction must be made between economic diversification imperatives on the one hand and structural economic change on the other, through the pursuit of offshore sector frameworks, as this will ultimately temper the thrust of national economic planning modalities in the near and distant future. It is conspicuously evident, though, that at the dawn of the 21<sup>st</sup> century the OECS Member States – especially those of the Windward Islands – are in a period of transition and the offshore sector does constitute an important tool for long-term development.

#### Notes

<sup>1</sup> First tier offshore jurisdictions – for the purposes of this article - comprise Bahamas, Bermuda, British Virgin Islands (BVI) and Cayman Islands. Second tier jurisdictions make reference to offshore centers in the OECS sub-region (BVI excluded).

<sup>2</sup> The rate of growth of the global offshore market is projected at an average of 15% for the next few years.

<sup>3</sup> There are various types of offshore services, for example, international banking, company registration, insurance, mutual funds, shipping registration, trusts and estates, and trademarks, patents and copyrights registration.

<sup>4</sup> Financial transactions, in this regard, comprise mutual and hedge funds, Eurobonds, insurance, and Eurocurrency deposits & transactions.

<sup>5</sup> Asset protection frameworks protect income and assets from political, fiscal and legal risks. In addition to sheltering income and assets from taxation or liability, banking institutions - within an offshore sector framework - will often also offer higher than average yields to foreign depositors.

<sup>6</sup> The years in which second tier offshore jurisdictions were established:

<i>Jurisdictions Established in the 1980s</i>	<i>Emerging Offshore Jurisdictions</i>
Antigua & Barbuda (1982)	Anguilla (1994)
Montserrat (1980)	Dominica (1996)
St. Vincent & Grenadines (1982)	Grenada (1997)
	St. Kitts and Nevis (1993)
	St. Lucia (2000)

<sup>7</sup> Antigua & Barbuda and St. Vincent & Grenadines both put in place Offshore Banking Acts in 1982.

<sup>8</sup> These banks are Banc Carib Ltd., British Trade & Commerce Bank Ltd., Euro Bank Inc., First International Bank Limited, Global Fidelity Bank & Trust Corp., Griffon Bank Ltd., Overseas Development Bank & Trust Co. Ltd..

<sup>9</sup> Privacy in this regard refers to keeping the names of shareholders, directors and officers completely private.

<sup>10</sup> In addition, government fees, licenses and associated charges over a three year period 1998 to 2000 have generated revenues of EC\$1.09 million, EC\$4.81 million and EC\$14.85 million respectively.

<sup>11</sup> As of the end of the third quarter of 2000 revenues generated amounted to around EC\$2,400,000, reflecting an aggressive growth trend that was especially highlighted in the second quarter when revenues generated had already exceeded half of the amount indicatively planned for this year.

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