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THE ECLAC ASSOCIATE MEMBER COUNTRIES: MEETING CHALLENGES AND NEW OPPORTUNITIES OF GLOBALISATION

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I. INTRODUCTION

Since the 1990s, the world economy has witnessed an intensified process of globalization. The process is driven by continuing innovation and technological change and is associated with the dismantling of national barriers to the global movement of goods, services, capital and technology. Small developing economies such the Associate Member Countries (AMCs) of the Economic Commission for Latin America and the Caribbean (ECLAC)[1] are particularly exposed to these developments in the world economy. For the most part, their exposure takes the form of vulnerability which derives from their small size, limited resources and inability to benefit from economies of scale that constrain their economies and accentuate their vulnerability to natural disasters and economic change.

Globalization poses challenges and opportunities for the AMCs. In order to position themselves to meet these challenges and to seize economic opportunities, they need to successfully carry out four major tasks. Firstly, the process of constitutional modernization must be accelerated to promote the economic freedom of the territories and their adaptation and insertion into the new global economy.

The second task, which is urgent, is to begin the process of adjustment and transformation of their economies as early as practicable. This process must involve enhancing their competitiveness in export manufacturing (e.g. Aruba, Curaçao and the United States Virgin Islands), tourism and international financial services, and creating the conditions to attract private foreign savings.

Thirdly, their integration into multilateral processes must be facilitated by regional, hemispheric, international economic organizations and the administering Powers concerned in order to support their development goals.

Fourthly, they must do so in the context of an ever-increasing globalized and competitive world economy, major transformations in North-South and regional trading relationships and the gradual erosion of trade preferences in their principal North American and European export markets. Within this context, it is incumbent upon the AMCs to begin the design of the process of adjustment. This starts with a careful examination of their constitutional status and current national development policies and strategies. It is, therefore, imperative that this discussion be strengthened by producing an issues paper that sets out a contextual framework in which to consider development challenges and new opportunities peculiar to the AMCs.[2] The methodology is based on surveys of pre-existing research and other material, as well as consultations with officials and social partners from Anguilla, British Virgin Islands, Montserrat and the United States Virgin Islands.

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[1] They are comprised of Anguilla, Aruba, British Virgin Islands, Montserrat, Netherlands Antilles, Puerto Rico and the United States Virgin Islands. Both the Cayman Islands and the Turks and Caicos Islands are expected to be admitted as associate member countries at the next ministerial session of the Caribbean Development and Cooperation Committee in January 2008.

[2] Puerto Rico is not included in the Issues Paper.

The remainder of this paper is structured as follows: Section 2 provides an overview of the AMCs highlighting their common features and notable differences. The major issues of transition to the changing global trade regime, including the erosion of preferences is presented in Section 3. An analysis of the new opportunities and challenges facing the tourism and offshore financial services sectors in the territories is given in Sections 4 and 5. The conclusion and recommendations are presented in Sections 6 and 7.

II. THE AMCs IN PERSPECTIVE

A. Common features

In terms of their development potential and capacity to respond to the challenges and new opportunities arising from globalization, the ECLAC AMCs share a number of common features, all of which are inter-related: small size, openness, narrow export base, environmental challenges and declining flows of official development aid.

1. Small size

The AMCs are all micro economies in terms of territory, population and limited domestic market size. For example, the British Virgin Islands is constrained by a limited stock of office and hotel space (including convention facilities), as well as a relatively small airport that precludes it from accommodating wide-body planes. These limitations are due in part to the physical nature of the islands, which are small, mostly volcanic and extremely steep, thereby limiting the amount of land suitable for construction of new or improved facilities. This lack of suitable office and hotel space has constrained the development of both the tourism and financial services sector in the British Virgin Islands.[3]

In addition, the relatively small population (i.e. less than 100,000) in each of the AMCs, coupled with the lack of superior onshore secondary education facilities, and labour and immigration laws have contributed to a relative dearth of available human capital. Currently, in the case of the British Virgin Islands and the Cayman Islands, respectively, more than 40 per cent of the workforce is comprised of expatriates with work permits, the majority of whom are from the Caribbean, Central America, the United States, Canada, the United Kingdom and Ireland.

However, unlike many Small Island Developing States (SIDS) in the Pacific, the AMCs share geographic advantages such as proximity to the United States market and strategic location on the main trading routes between the Americas and Europe. Moreover, their mild weather conditions and extended beaches provide a near-perfect scenario for the development of tourism services – despite the obvious limitations imposed by the hurricane season. Geographic location nevertheless also brings disadvantages in terms of high infrastructure and transportation costs arising from the territories' island status and territorial discontinuities. Consequently, the AMCs are generally unable to produce or grow industries that can compete in international trade

[3] IMF Country Report (April 2004), p. 14.

because their costs tend to be structurally much higher. This fact substantially handicaps their attempts to better integrate into the international economy. This phenomenon has been recognized in a World Trade Organization (WTO) paper published in 2002,[4] which concludes that small size when combined with remoteness limits competitiveness in a very large range of products (notably because of diseconomies of scale). Limited competitiveness, in turn, limits diversification, especially of exports. Hence it could be very much harder for such economies to adapt to global changes and reposition their economies.[5]

In addition to these constraints, their potential to benefit from globalization is hampered by their limited domestic market size. As a result, the economies of the AMCs do not benefit from the effects of competition on improving efficiency, lowering costs and spurring innovation. This is partly due to the fact that most of their enterprises are likely to develop into monopolies (e.g. the telecommunications, water and power utilities). Moreover, private sector firms in each of the territories tend to be small both by global standards and by comparison with MDC firms in the Caribbean region. Small company size will therefore continue to be a significant constraint in their ability to survive and compete in the global marketplace.

2. Openness

The AMCs are also open economies: their external transactions are large relative to their total economic output (table 1). The high degree of openness brings real benefits that accrue from trade – consumers in these territories are able to obtain a greater variety of goods at lower costs than if their choices were confined to domestically produced goods while their producers and service providers can sell on the world market, thus earning more than if they were confined to meeting domestic demand.

Table 1. The AMCs are highly open to trade, 2005

	Average share of GDP (percent): 2005		
Territory	**Exports**	**Imports**	**Exports + Imports**
Anguilla	57.65	98.88	156.53
Aruba	64.26	73.01	137.26
British Virgin Islands	104.54	80.18	184.72
Cayman Islands	…	…	…
Montserrat	37.59	104.43	142.02
Netherlands Antilles	82.99	83.83	166.82
Turks & Caicos	64.84	59.16	…
United States Virgin Islands	…	…	…

Source: ECLAC database. Based on data for exports of goods and services for latest available year.
---- Data not available.

[4] "Influence de la taille d'un pays sur son économie et son commerce extérieur"; WT/COMTD/SE/5, 23 October 2002. Quoted in An Overview of the Bi-Annual Small Island Micro-Economies Conference: Challenges Faced by Micro-Economies Like Those of the OCTA Members (2004), p. 4 at http://www.octassociation.org/reports_and_publications/overview_of_the_bi-annual_smallisland_micro-economies_conference_(sime).doc
[5] Ibid.

Openness to trade also renders these economies extremely vulnerable to external shocks such as fluctuations in international commodity prices or policy changes abroad. In presenting the 2007 budget address, the Minister of Finance of the BVI advised that global energy markets have been impacted by three main forces:

a) War and conflicts in the Middle East and parts of Africa have created uncertainty about the continued supply of oil from these regions;

b) The continued rapid rate of growth in India, China and the rest of Southeast Asia has created an even greater demand for this scarce resource and building material; and

c) The threat of sanctions against Iran for its continued pursuit of nuclear weapons has created further concern about the flow of oil from that country.6

Taken together, these forces have led to significant increases in the cost of oil and building material which directly impact Virgin Islanders as they find themselves having to pay more for gas at the pump, more for electricity, more for airfare when they travel, and more for building material. This has been compounded by the slow-down in the growth of the United States economy, with further slowing predicted for 2007. This, in turn, would impact negatively on the territory's tourism sector.[7]

Moreover, because of their high openness to trade, the AMCs are far more dependent than the CARICOM member countries on import duties for their fiscal revenue. The high volume of external trade provides a convenient, broad base from which taxes can be collected at a relatively low administrative cost. Reduction of average import duties as part of an overall import liberalization programme would therefore lead to a fall in tax revenues that would not be easy to offset in the short term by raising other taxes; thus creating potential problems of rising debt.

3. Narrow export base

The AMCs provide a stark example of commodity export concentration. Overall, there appears to have been little significant diversification away from tourism in the majority of the territories, except for the emergence of international financial services (Anguilla, Cayman Islands and the British Virgin Islands), petroleum refining (Aruba, Curaçao and the United States Virgin Islands) and production of premium rums (the United States Virgin Islands). Tourism expansion has particular consequences for the AMCs, however. It is generally associated with rapid import growth involving non-indigenous food imports or inputs to construction of tourism-related facilities – especially for territories, such as the Cayman Islands, the British Virgin Islands and Turks and Caicos. Linkages to the rest of the domestic economy are also weak as many types of tourist facilities are in effect enclave developments. In addition, the territories that have shifted the structure of their economies toward tourism are finding it to be increasingly insufficient to sustain continued per capita growth in the future owing to the following: (a) their declining market share in the North American market and the switch to Asia/Pacific and Middle

[6] Government of the Virgin Islands, The Virgin Islands Budget 2007, 29 December 2006, p. 3.
[7] Ibid.

East destinations; (b) the need for investments in infrastructure: and (c) vulnerability to natural disasters, such as hurricanes and external shocks.[8]

4. Environmental challenges

The European Commission's 2007 Environmental Profile of Caribbean Overseas Countries and Territories identified seven environmental challenges facing the territories. These are summarized in this sub-section.[9]

(a) Climate change: The AMCs are particularly vulnerable to the threat of global warming given their dependence on the tourism industry and their low altitude (except for the volcanic islands of the British Virgin Islands and Montserrat). The British Virgin Islands, Cayman Islands, Netherlands Antilles and Turks and Caicos Islands, in particular, extensively fringed by coral reefs which are a crucial component in the delicate ecosystem found in all of the territories, are very important as a tourist attraction and therefore to livelihoods on the islands, as a spawning ground for fish and as a natural buffer area protecting the islands from sea damage during storms. Climate change also poses a threat to their beaches – a major concern given their reliance on tourism.

(b) General environmental degradation due to development and tourism: The high rate of growth of the tourist industry in the AMCs (except Montserrat), coupled with the lack of strong physical planning legislation, means that the characteristic habitats of the territories are coming under increased threat. Examples of this are:

- Construction of buildings and infrastructure often involves clearance of mangroves, reclamation of wetlands, removal of beach sand (resulting in possible erosion), increased run-off of silt and soil into the near-shore sea-water (damaging both coral and sea-grass);

- An increased sewage load, much of which is pumped either untreated or partially treated into the sea, leading to algae formation, de-oxygenation of the sea-water and distress and destruction of coral reefs; and

- Increased solid waste loads, requiring new waste treatment facilities and probably, increased discharge of contaminated leachates into the sea.

These developments will have adverse effects on the quality of the islands' natural resources and wildlife and, therefore, their attractiveness as tourist destinations and, ultimately, livelihoods.

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[8] Not only is the Caribbean (including the AMCs) now trailing as a dynamic tourist destination but the benefits accruing from tourism are increasingly negated by "leakage"; that is, low retention of the revenue generated by total sales to foreign tourists within the region. See, for example, Caribbean Regional Negotiating Machinery, Improving Competitiveness for Caribbean Development, Ian Randall Publishers, 2003, pp. 13-14.

[9] European Commission, OCT Environmental Profiles, January 2007 at http://www.octassociation.org/partnership_working_parties/Caribbean_final.pdf.

(c) Waste management: All the AMCs face special problems, of one kind or another, in relation to waste management; viz:

- Lack of critical size and, therefore, ability to benefit from the economies-of-scale needed to make modern waste management techniques (i.e. sanitary landfills and safe incinerators) economic;

- Lack of facilities, critical size, markets to make recycling and composition feasible;

- Lack of public awareness about waste, need for prevention and reduction;

- Lack of facilities for dealing with hazardous waste including infectious clinical waste;

- Lack of suitable space for and resistance by local residents to new landfills; and

- Hurricanes can generate large volumes of waste and debris, which may be toxic (e.g. timber treated with preservatives).

(d) Water pollution: In Anguilla, for example, there is evidence of degradation of the coastal and marine environment due to pollution caused by the discharge of sewerage from hotels and restaurants and the discharge of sewerage and oil from visiting yachts and ships. Moreover, the groundwater is at risk of contamination from direct discharges of effluents, chemicals and pesticides in areas near the aquifer; intrusion of salt water; and uncontrolled disposal of solid waste.

(e) Air pollution: Air pollution is not a priority issue in most of the AMCs, with the exception of Aruba and Curaçao. Both of these territories have oil refineries which emit significant pollution (i.e. sulphur dioxide, nitrogen oxides, dust and carbon dioxide).

(f) Natural hazards: The AMCs are subject to hurricanes, volcanic activity, earthquakes and, to a lesser extent, tsunamis. These hazards are particularly severe in their effects because of the small size of the territories and their respective economies. ECLAC has estimated that the impact of Hurricane Ivan on the Cayman Islands in 2004, for example, amounted to 183.0 per cent of its GDP.[10] Hurricanes are expected to become more intense in the future as a result of climate change. Moreover, the Caribbean Sea region is active tectonically and seismically, and nearly all areas in the region have experienced a tsunami at some time in history (table 2). The last devastating tsunami in the Caribbean occurred in 1946 when an earthquake and tsunami caused 75 fatalities and left 20,000 families homeless. Since the last major event, however, the coastal regions have greatly increased in populations, and the importance of tourism means that many non-residents are also at risk. These factors make the AMCs much more vulnerable now than they were when the last tsunami occurred.

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[10] ECLAC, Comparison of the Socio-Economic Impacts of Natural Disasters on Caribbean Societies in 2004, LC/CAR/L.39, August 2005, p. 10.

Table 2: Caribbean Tsunami Fatalities in the last 165 years

Date	Place	Fatalities
1842	Haiti	300+
1853	Venezuela	600+
1867	Virgin Islands	23
1882	Panama	75+
1906	Jamaica	500
1918	Puerto Rico	140
1946	Dominican Republic (1)	1790
1946	Dominican Republic (2)	75

Source: Statistics from *Caribbean Tsunamis, A 500-Year History from 1498-1998* by Karen F. O'Loughlin and James F. Lander at http://www.srh.noaa.gov.

(g) Environmental governance: The governments of the AMCs recognize that their economic and physical development needs to be sustainable in environmental and social terms. However, none of them has yet succeeded in establishing the administrative structures, policy and legislative instruments needed to really ensure that their development is sustainable.

5. Declining flows of official development aid

The AMCs benefit mainly from four forms of financial assistance under the European Union-Overseas Countries and Territories (EU-OCTs) Decision of 2001:[11]

a) Grants from the European Development Fund (EDF)[12];
b) Refundable aid from the Investment Facility;
c) Loans from the European Investment Bank's own resources;
d) Aid under horizontal budget lines; and aid under community programmes.

A total of €286 million has been dedicated to the OCTs, including the AMCs, under the 10th EDF. The foreseen date of entry into force of the Agreement is 1 January 2008. In the interim, funds are being reallocated to create a bridge between the 9th EDF and the 10th EDF. The OCTs have nonetheless experienced significant bureaucratic delays in drawing down resources under the 9th EDF; thus prompting them to call on the EU to provide fixed, transparent and simplified procedures for the draw-down of future funds from the 10th EDF.[13]

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[11] Europa, Association of the OCT with the EC. Web page link: http://europa.eu/scadplus/leg/en/lvb/r12301.htm.
[12] However, Aruba, BVI and the Cayman Islands currently exceed the per capita GDP threshold for EDF funding, and therefore do not qualify for aid under the EDF territorial envelope. They are eligible, however, for regional EDF funding.
[13] European Commission, Final Declaration of the OCT – 2006 Ministerial Conference Containing the Political Resolutions of the Representatives of the Overseas Countries and Territories on their Discussions with Respect to the Implementation of the OCT-Decision (2001/822/EC, Nuuk, Greenland, 6 September 2006.

In spite of the generous flow of official development assistance under the EU-OCT Decision of 2001, the AMCs have been particularly hard-hit by declining trends in aid. Bilateral aid from Department for International Development (DFID), for example, has ceased for all of the British overseas territories except Montserrat, given the improvement in their respective per capita GDP ratios. The Turks and Caicos has been particularly hard-hit by virtue of the fact that they are required to pay the salary of the United Kingdom-appointed Governor in spite of the cessation of bilateral aid from the Administering Power.[14]

However, the flow of official development assistance from the Kingdom of the Netherlands to the Netherlands Antilles is still ongoing in the form of grants and soft loans.

Turning to private financial flows, some of the AMCs are limited in their access to external commercial borrowing. Montserrat, United States Virgin Islands and the Netherlands Antilles, respectively, are burdened by high levels of indebtedness that practically preclude them from commercial borrowing.

B. Notable differences

Despite a number of common features, the AMCs display noteworthy differences in terms of economic output and relative wealth. With the exception of Montserrat and the Netherlands Antilles, they are quietly some of the wealthiest small islands in the world with GDP figures that are on par with many developed countries. Moreover, while the problems associated with small size, limited resources and consequent high trade openness are magnified in the AMCs, these territories nonetheless record substantially higher per capita incomes than their larger neighbours in Caricom. For example, the estimated GDP per capita of the British Virgin Islands in 2005 was US$40,529[15] compared with US$10,700[16] for Trinidad and Tobago in the same year.

It is also true, however, that national income in several AMC economies continues to depend heavily on earnings from tourism and offshore financial services, which are now in danger of being eroded because of the growth of United States domestic tourism and the switch to Asia/Pacific and Middle East destinations, as well as the unrelenting attack on the offshore financial centres in the Caribbean. In this sense, GDP per capita may not be a very useful indicator of real economic strength, since it does not reveal much about the sustainability of income levels over the medium to long term.

The work carried out by ECLAC[17] and other organizations in analyzing the vulnerability of Caribbean SIDS demonstrates that most of them are considerably more vulnerable than their larger CARICOM neighbours. This vulnerability should continue to be taken into account in

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[14] Statement by the Representative of the Turks and Caicos at the Caribbean Regional Seminar on the Implementation of the Second International Decade for the Eradication of Colonialism: Next steps in decolonization, St. George's, Grenada, 22-24 May 2007.

[15] Briefing Guide on the British Virgin Islands for Delegates of The Outlook for International Financial Services Regulation Conference, Tortola, British Virgin Islands, 21-22 May 2007, BVI International Affairs Secretariat, p. 13.

[16] ECLAC calculations based on total GDP of US$77,634,000 in 2005 and a population of 1.3 million.

[17] ECLAC, Caribbean Small States, Vulnerability and Development, No. LC/CAR/L.60, November 2005.

programmes of assistance provided by the European Commission and other donors, particularly in the field of disaster preparedness, prevention and recovery.

III. POTENTIAL IMPACTS OF TRADE LIBERALISATION AND REGIONAL INTEGRATION

As they seek to position themselves to meet the challenges and maximize the benefits from globalization, the AMCs face four major challenges:

(a) They must attain greater autonomy and self-determination, either through full independence, free association or full integration, in order to promote the economic freedom of the territories and their adaptation to the new global economy.

(b) They must begin the process of adjustment and transformation of their economies as early as practicable. This process must involve enhancing their competitiveness in export manufacturing (Curaçao and the United States Virgin Islands), tourism and international financial services, and creating the conditions to attract private foreign savings.

(c) They must do so in the context of an ever-more globalized and competitive world economy, major transformations in north-south and regional trading relationships and the possible erosion of trade preferences in their principal EU export markets following the expiration of the EU-OCT Association Agreement in 2011. Appropriate policy responses and the implementation of effective economic diversification strategies will be crucial in determining their future economic potential.

(d) The AMCs must, at the same time, confront a number of social problems that directly impinge on their future development potential. Prominent among them is the growing problem of crime that impacts negatively on their tourism sector.

A. The CARIFORUM-EU Economic Partnership Agreement (EPA)

Anguilla, the British Virgin Islands, Cayman Islands, Montserrat, Turks and Caicos, and the United States Virgin Islands are all involved in a process of constitutional modernization that does not necessarily imply a desire for independence.[18] The Turks and Caicos Islands and the British Virgin Islands have already secured approval from the Privy Council in London for the promulgation of a new constitution.[19] Similar developments are expected by the end of the decade in Anguilla and possibly the United States Virgin Islands and the Cayman Islands.

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[18] United Nations, Statement by H.E. Margaret Hughes Ferrari, Permanent Representative of Saint Vincent and the Grenadines to the United Nations, Caribbean Regional Seminar on the Implementation of the Second International Decade for the Eradication of Colonialism: next steps in decolonization, St. George's, Grenada, 22-24 May 2007, Doc. No. CRS/2007/CRP.6, p.3.

[19] The Privy Council approved the Virgin Islands Constitution Order 2007 on 13 June 2007. The new constitution includes a human rights chapter. Other new provisions include a new cabinet form of government instead of the Executive Council, a Premier instead of the Chief Minister, a House of Assembly instead of the Legislative Council

The Dutch overseas territories are also in a state of constitutional flux. Under a new political structure, agreed with the Dutch Government in late 2005, the Federation of the Netherlands Antilles will be dissolved by July 2007. Curaçao and St. Maarten will each become autonomous territories of the Netherlands. Bonaire, St. Eustatius and Saba will become 'kingdom islands', a novel form of direct relations with the Netherlands. Aruba was already a State apart from the Federation with its own status.

Irrespective of the unusual range of constitutional ties that the AMCs have to Europe, they are all faced with a challenge for which there is no precedent. The creation of a CARIFORUM-EU EPA will potentially have the economic effect of isolating the AMCs from the independent Caribbean. In the trade sphere, products from Europe would be able to enter the CARIFORUM economies duty free under an EPA and trade in services would be further liberalized, but products and services from the AMCs would not benefit from this. The Caribbean market is critical for these territories, especially the Curaçao distribution hub.[20] Paradoxically after 2008 in the case of the French Overseas Departments (DOMs), an EPA will have the reverse effect. As a part of Europe, albeit remote, the DOMs will then be subject to the phasing in of the same trade reciprocities as are agreed for Continental Europe. This might also possibly be the case with Bonaire, St. Eustatius and Saba following the dissolution of the Federation of the Netherlands Antilles by July 2007.

Montserrat, of course, is a special case among the AMCs given its dual status as a British overseas territory and a long-standing member of CARICOM. Antoine (2006) has argued that the non-participation of Montserrat as a member of the CARIFORUM grouping could lead to an undermining of the regional integration process. It is suggested that a possible approach could be to have Montserrat choose which specific parts of the EPA Agreement it would wish to adopt while leaving aside any elements which would accentuate its economic vulnerability. Through a three-step process it would allow Montserrat to: (a) choose the specific areas to deepen regional cooperation with CARICOM (CSME); (b) select the areas to commence integration with the broader CARIFORUM grouping; and (c) adopt the specific areas to integrate with the EU (since at present the OCT Decision does not require reciprocity). Such an approach would also allow Montserrat to decide on the areas where it would prefer to maintain its existing policy space.[21]

Like Montserrat, there may also be some scope for accommodating some aspects of the trading relations critical to the other British and Dutch overseas territories, CARIFORUM and the EU. Antoine (2006) has once again suggested that this could be accomplished through an undertaking by the parties on joint action as an "add on" to the EPA process. The aim would be to commit both CARIFORUM and the EU - beyond best-endeavour type language - to find an appropriate vehicle for such an engagement that would involve the OCTs/AMCs, in three-sided

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and the separation of duties of the Attorney General and the Director of Public Prosecutions. Source: BVI News Online, 15/06/2007, at http://www.bvinews.com.

[20] ECLAC, *The Cotonou Agreement: Selected Issues, Effects and Implications for Caribbean Economies*, UN ECLAC/CDCC, Doc. No. LC/CAR/L.66, 14 December 2005, p. 32.

[21] Patrick A. Antoine, Montserrat: Prospects for Integration with Special Reference to the CSME and EU, Econo Tech, November 2006, p. 15.

exchanges. By this model, CARIFORUM and the EU would need to commit to engaging the OCTs/AMCs on trade matters outside the EPA.[22]

Paragraph 25 of the Plan and Schedule for CARIFORUM-EU negotiation of an EPA provides that during the third phase of negotiations: *"A CARIFORUM-EC EPA should also include measures designed to enhance the trading relations as well as overall co-operation between CARIFORUM Member States and DOMs/OCTs located in the Caribbean".*[23] The AMCs therefore need to seriously engage their CARIFORUM partners in advocating their inclusion in the EPA negotiations.

B. Erosion of trade preferences

The AMCs benefit from an advantageous trade system. Products originating in the AMCs and imported into the European Union are not subject to import duties or quantitative restrictions, according to the EU-OCT Association Agreement of 2001.[24] These arrangements are non-reciprocal, so that products originating in the European Community are subject to the import duties established by the AMCs on a most favoured nation (MFN) basis.

A few examples of product opportunities that can be exported free of duties and/or levies into the European Common Market, if produced or sufficiently processed in Curaçao, are:

- Instant coffee (this process has to start at green beans).
- Leather coats (this process has to start at fashioned leather).
- Agricultural products produced in Curaçao (i.e. locally cultivated).
- Sea products if caught in the Netherlands Antilles, or caught by ships with Netherlands Antilles flags outside of Netherlands Antilles territorial waters.
- Petroleum products with a maximum of 2 million tons and refined petroleum products.
- Recycled copper waste.
- Assembling silk flowers so as to create a shift in the tariff category.
- Fruit juices which are encased in such a manner that indicates that they are not for immediate sale.[25]

Products from third countries, which have been imported into the AMCs and subsequently re-exported to the European Common Market, are also not subject to customs duties/levies, provided that at least an equal customs duty/levy valid in the EU is paid in the territory.[26] The "Originating Products" and "Cumulation" arrangements become even more attractive as processing activities in the AMCs give products from an African, Caribbean, Pacific (ACP) country, another OCT or the European Community OCT originating status. In all cases in

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[22] Ibid.
[23] Ibid.
[24] European Commission, European Constitution, Article III-288, paragraphs 1-5. Web page link: http://gandalf.aksis.uib.no~brit/EU-CONST-EN-cc/ARTICLESIII-286to-291.html, p. 2..
[25] Curacao Chamber of Industry and Commerce, Preferential Trade Programs: EU Market. Web page link: http://www.curacao-chamber.an/c-info-htm/content/EUTrade Program.htm, p. 1.
[26] Ibid.

which the rules of origin are not fully met, derogation from the European Community can be requested by the AMC to obtain duty free access to the large European Common Market. The derogation can entail a reduced percentage requirement of value to be added in the territory, while its calculation of value added may include all costs incurred from the moment the raw materials or semi-manufactured articles are imported from the third country.

The new EU-OCT Association Agreement makes substantial changes from the predecessor arrangement of 1991 in relation to the import of certain sensitive foodstuffs, especially those imported from the AMCs and other overseas countries and territories under the principle of the cumulation of origin. The Community market has been seriously disrupted by the widespread arrival of certain sensitive foodstuffs (particularly sugar and rice) grown mainly by third countries but processed and exported as originating products by the AMCs and other OCTs which do not grow them.[27] Article III-289 of the European Constitution states as follows:

> *"If the level of duties applicable to goods from a third country on entry into a country or territory is liable, when Article III-288(1) has been applied, to cause deflections of trade to the detriment of any Member State, the latter may request the Commission to propose to the other Member States that they take the necessary measures to remedy the situation".* [28]

As a result, the possibility of the cumulation of origin for sugar will gradually be removed and will no longer be possible after the expiration of the Association Agreement in 2011. As far as rice is concerned, the use of the cumulation of origin for this product is limited through the imposition of quotas. This eventually contributed to the demise of rice processing operations in the Turks and Caicos Islands in recent years. Moreover, the safeguard clause contained in Article III-289 of the European Constitution may be used if the markets for rice of the Community or the Member States are disrupted excessively.[29]

There is also a procedure for the transshipment of goods which enables products not originating in the AMCs and other OCTs (but imported there from third countries) to be imported into the EC free of customs duties and taxes, providing that at least equal customs duties and taxes that are valid in the EC are paid in the territory.[30] The transshipment procedure does not apply, however, to agricultural products or goods resulting from processing of agricultural products.[31] The additional financial resources provided by transshipment operations have proven in the past to be able to contribute to the implementation of a policy of sustainable development in the AMCs. The AMCs, like the other OCTs, have therefore reiterated that the transshipment facility must continue to be implemented.[32]

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[27] Europa, *Association of the OCTs with the EC*, op. cit., p.2.
[28] Ibid.
[29] Ibid.
[30] Curacao Chamber of Industry and Commerce, *Preferential Trade Programs: EU Market*, op. cit., p. 3.
[31] Ibid.
[32] European Commission, *Final Declaration of the OCT – 2006 Ministerial Conference Containing the Political Resolutions of the Representatives of the Overseas Countries and Territories on their Discussions with Respect to the Implementation of the OCT-Decision (2001/822/EC*, op. cit., p. 5.

In the context of the EPA negotiations, the European Commission's willingness to adapt OCT-EU trade regime and rules of origin will impact on the legislative framework and business opportunities of the AMCs. The AMCs and other OCTs have therefore consistently called for a systematic extension of the duration of derogations in the context of the Partnership Working Party on trade of the Overseas Countries and Territories Association (OCTA).[33] However, the EC Director General (Development) has advised that "the duration of a derogation cannot be guaranteed beyond the duration of the Overseas Association Decision".[34] In response to OCTA, he also clarified that "a substantial revision of the trade regime laid down in the Overseas Association Decision is possible before the end of 2011, in accordance with article 62 of the Overseas Association Decision".[35] It therefore stands to reason that further clarification on the twin issues of an OCT-EU trade regime and rules of origin may be contingent on the successful conclusion of the proposed CARIFORUM-EU EPA in December 2007.

C. Potential impact of the CSME

The issue of the future relationship between the AMCs and the CARICOM member States within the context of the Caribbean Single Market and Economy (CSME) has so far not occupied the regional trade and development agenda. The salient question is whether the AMCs can remain outside the CSME without serious prejudice to their development prospects and, if they so choose, around which orbit should they converge.

In general, Antoine (2006) has observed that the results of studies using modified gravity models confirm the relevance of deepening the regional integration process through the CSME, which aims to create a single economic space among the countries of the region for goods, services, capital and labour.[36] While these studies provide good economic insights on the likely effects of regional integration efforts on the CARICOM countries, including the Organisation of Eastern Caribbean States (OECS), none of them actually address the situation of the AMCs. This suggests that there is a need to carefully examine the benefits and costs of the AMCs deepening their integration with the rest of the region through the CSME.

The Revised Treaty of Chaguaramas, in Chapter 7, includes a series of special provisions for Disadvantaged Countries, Regions and Sectors, specifically aimed at the Lesser Developed Countries (LDCs).[37] This includes the establishment of a development fund "for the purpose of providing financial or technical assistance to disadvantaged countries, regions and sectors.[38] These provisions are meant to assist the disadvantaged segments within the CSME as they move "towards becoming economically viable and competitive by appropriate interventions of a transitional or temporary nature" and to "redress to the extent possible any negative impact of the establishment of the CSME."[39]

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[33] European Commission, *Report on the Fifth OCT-EU Forum*, op. cit., p. 6.
[34] Ibid.
[35] Ibid.
[36] Patrick A. Antoine, op. cit, pp. 12-13.
[37] CARICOM. *The Revised Treaty of Chaguaramas (Articles 142 to 165), 1991.*
[38] Ibid. (Article 158)
[39] Ibid. (Articles 142 and 143)

The original Treaty of Chaguaramas also gave legal recognition to the Treaty of Basseterre, which provided OECS members recognition as a sub-grouping with the broader CARICOM arrangement. The Revised Treaty of Chaguaramas provides similar special status to the OECS and Belize, as LDCs through a revised Chapter VII. This is an important precedent for the AMCs to consider if and when they choose to join the CSME.

The AMCs (i.e. Anguilla, British Virgin Islands, Cayman Islands, Montserrat and Turks and Caicos) are also in a position to benefit greatly from functional cooperation arrangements with their CARICOM neighbours in such areas as health, human resources development, security, communication (e.g. air and sea transportation), foreign trade policies, research and development. This would be a means towards the sharing of services and undertaking of joint activities in order to reduce their costs and achieve synergies.

D. Impact of OECS Economic Union

The economies of the OECS have recently taken the decision to establish an Economic Union, in which several areas of exclusive competence will reside with the OECS Authority, which will itself vest the authority for decision-making in a commission structure. These areas of exclusive competence include a common market (customs union), monetary policy, trade policy, maritime jurisdiction and maritime boundaries, and civil aviation. The OECS has also developed a deep framework for functional cooperation in the areas of civil aviation, trade policy, management of marine and other resources and procurement of critical pharmaceuticals, among others.[40] The AMCs could benefit greatly from cooperation with the OECS member States in these areas and through the use of EU resources to support various regional partnerships in such areas as inter-island transport, disaster preparedness, sustainable tourism, maritime and air transport.

IV. MEETING CHALLENGES IN THE TOURISM SECTOR

The AMCs are highly dependent on tourism, with this sector contributing a third to a half of GDP for most of the territories. Tables 3 and 4 reveal the trends in tourist (stop-over) and cruise ship arrivals for 2003-2006. The forecast is that travel and tourism will continue to enjoy robust growth globally for years to come. However, in order for the AMCs to realize the promise of growth and sustainability in the sector there must be a strategic and proactive approach towards the development of the industry in preparation for the accompanying challenges.

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[40] OECS Economic Union Series at http://www.oecs.org/lib_econunion_series.html.

Table 3: Tourist (Stop-over) Arrivals: 2003-2006

Destination (Stay-Over)	2003	2004	2005	2006
Anguilla	46,915	53,987	62,084	72,962
Aruba	641,906	728,157	732,514	694,372
Bermuda	256,563	271,607	269,576	298,973
Bonaire	62,179	62,507	62,550	63,552
BVI	278,114	304,518	337,135	356,271
Cayman Islands	293,515	259,929	167,801	267,257
Curaçao	221,390	223,439	222,070	234,383
Montserrat	8,375	10,110	9,690	7,963
Saba	10,260	11,012	11,462	11,012
St. Eustatius	10,788	11,056	10,355	5,236
St. Maarten	427,587	475,031	467,861	467,804
USVI	618,703	658,638	697,033	671,362

Source: Caribbean Tourism Organization Latest Statistics

Table 4: Cruise Passenger Arrivals: 2003-2006

Destination (Cruise)	2003	2004	2005	2006
Anguilla	-	-	-	-
Aruba	542,327	576,320	552,819	591,474
Bermuda	226,097	206,133	247,259	335,874
Bonaire	44,601	53,343	40,077	61,844
BVI	304,338	466,601	449,152	443,987
Cayman Islands	1,818,979	1,693,293	1,798,999	1,930,136
Curaçao	279,378	219,385	276,217	321,551
Montserrat	-	-	285	-
Saba	-	-	-	-
St. Eustatius	-	-	-	-
St. Maarten	1,171,734	1,348,450	1,488,461	1,438,211
USVI	1,773,958	1,964,689	1,912,539	1,901,275

Source: Caribbean Tourism Organization Latest Statistics

A. Policy issues

A recent ECLAC report[41] outlined a number of policy issues facing the tourism sector in the Caribbean region (including the AMCs) which require strategic responses, viz:

a) Problems facing related sectors, such as the financial sector, could have a residual negative impact on tourism.

[41] UN ECLAC/CDCC, A Review of Caribbean Tourism in the 1990s and at the Beginning of the New Century, Doc No. LC/CAR/G.734, 26 February 2003, pp. 42-45.

b) Issues around globalization and international agreements relating to the liberalization of services will increase competition for the region (including the AMCs) and reduce its ability to reserve certain jobs and services in tourism for nationals. Proposals which are interpreted internationally, as subsidizing national or regional entities, will run counter to the WTO MFN stipulations.

c) The region's competitiveness is threatened by the continuous expansion of tourism as a global industry. There is major investment in new and refurbished accommodation products and man-made attractions in old competing countries such as the United States and in the Indian Ocean and Asia, and in new areas such as the Middle East. In addition, these destinations have the added advantage of large resources to invest in tourism, especially 'high end' quality products, and considerably easier means of access by air, road and sea.

d) The region is falling behind in its investments in research, scientific analysis and information management for the tourism sector which has implications for human resource development policies in tourism.

e) The region is also lagging behind its competition in the application of information technology in tourism development, management and marketing.

f) Consolidation and vertical integration within and across national boundaries within the tourism distribution system (i.e. tour operators, airlines, cruise lines and electronic travel agencies) that control international tourism is intensifying to the disadvantage of the Caribbean and other developing regions.

g) The fragile resources of Caribbean airlines, the difficulty they have in cooperating with each other, and the absence of regional aviation policies covering critical areas, makes it difficult for them to fill the gaps created by the departure of foreign operators.

Moreover, the ECLAC report reveals that the region also faces a number of challenges with respect to its product. These include:

- Unacceptably low levels of service quality across a broad spectrum of activities;
- Facilitation difficulties and inadequate amenities at many air and sea ports;
- Poor access to investment in some countries due to perceived low profitability;
- Red tape and a lack of transparency in how incentives are administered;
- High standards being set internationally in the areas of the environment, health and safety with punitive sanctions for countries and properties which are felt to be in breach thereof; and
- Concerns in the marketplace about crime, drugs, violence, health and Acts of God in the region.[42]

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[42] Ibid., pp. 42-43.

B. Investment flow

One of the major factors impeding the benefits to be derived from tourism by the AMCs relates to the flow of investments. Fortunately, the territories are starting from a strong base with natural advantages which augur well for the creation of a good investment climate. These advantages include an abundance of natural environmental beauty, political stability and close proximity to major markets. However, in order to hold their position, the AMCs must be prepared to compete aggressively for the investment capital needed to provide a competitive product. Capital investment is needed for new accommodations; improvements to essential infrastructure; and upgrading, expanding and refurbishing of existing hotel plant, amenities and attractions.

The prospects for attracting much needed foreign direct investment in the industry are becoming increasingly difficult for the AMCs in the emerging new economic order where the world appetite for investment is great and resources are dwindling. Capital is swiftly becoming globally mobile in a highly competitive environment, on the one hand, with profits being the sole motivation for involvement. On the other hand, the AMCs are being viewed as a conglomeration of territories with high cost operations (i.e. a clear disincentive for attracting investment).

The Caribbean Regional Negotiating Machinery (CRNM) has advised that new strategies must be employed to attract foreign capital, including more hotel chains that bring with them the added benefit of powerful marketing reach.[43] It is suggested that governments can assist this effort by making it possible to access capital at interest rates that are affordable for tourism ventures, through the use of fiscal incentives, by encouraging the banking sector to offer longer-term loans, and by suitable taxation policies.[44]

C. Upgrading of cruise-ship facilities

In addition to the above-mentioned factors, the AMCs are also hard-pressed to compete for investments to upgrade their port facilities in response to growing demand for mega cruise ships. St. Maarten's tourism commissioner summed up the problem in a few words at a March 2007 Seatrade Cruise Shipping conference in Miami Beach, Florida: "mega-ships for mega-ports for mega-bucks. That's what it costs".[45] He pointed out that authorities in St. Maarten had barely completed a new cruise terminal in 2000, when they went back to the drawing board to design another port to accommodate the larger ships.[46] With demand for larger ships showing no sign of flagging, industry officials advise that such investments are crucial if cruise ship destinations (e.g. Aruba, British Virgin Islands, United States Virgin Islands, St. Maarten and the Cayman Islands) want to remain competitive and "keep cashing in on the lucrative business".[47]

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[43] Caribbean Regional Negotiating Machinery, op. cit., p.16.
[44] Ibid.
[45] "*Supersize me: Caribbean ports struggle to cope with mega-cruiseships"* in Caribbean Net News, 07/05/2007, p.1. Web page link: http://www.caribbeannetnews.com/features/features.php?
[46] Ibid.
[47] "*Supersize me: Caribbean ports struggle to cope with mega-cruiseships"*, op. cit.

However, bigger ports alone are not enough to ease the headache as a growing number of disembarking passengers strain the infrastructure of ports-of-call. In the British Virgin Islands, for example, the Traffic Department was forced to issue an appeal to the motoring public "to be vigilant and cooperative" with particular attention to the movement of thousands of tourists visiting the capital from three large cruise ships (the Queen Mary II, Westerdam and Costa Magica).[48]

The super-sizing fever has also impacted on the luxury yacht industry, which is experiencing rising demand for super-yachts that are priced in the region of US$20 million each.[49] It was reported at the March 2007 Seatrade Cruise Shipping conference that the United States subsidiary of the Dutch luxury yacht builder Federship, for example, had received 435 orders for ships of over 30 meters (100 feet) in length in 2006, up from 87 in 1998.[50]

D. Connectivity – airlift into and within the territories

Schedule carriers operating from hubs of Antigua, Saint Lucia, Puerto Rico and Barbados are expected to play a greater role in ensuring that transatlantic, up-market leisure vacationers visit the AMCs. For example, American Eagle recently introduced a new service between the British Virgin Islands and Antigua and Barbuda.[51] This new service is a boost to the British Virgin Island's tourism industry and the economy, as it now provides additional seats into the territory for passengers arriving from London to Antigua and Barbuda.[52] Tourism authorities in the AMCs will therefore need to be more proactive in establishing inter-line agreements that will allow for ease of access to reliable connecting flights into their respective territories.

Destinations in the AMCs having in excess of 1200 middle to lower middle quality rooms would also have to embrace charter service as a critical strategic element in their overall marketing strategy for their destinations. Moreover, the tourism public and private sectors would have to assume all the financial risk for charter services from the United Kingdom and Europe and, in the near future, at least part of the risk of United States and Canadian charter operators in terms of marketing costs and a portion of the seat costs.[53]

E. Impending competition from Cuba

Cuba's geographical position relative to cruise ships in the western Caribbean could seriously threaten the tourism health of nearby territories such as the Cayman Islands. Cruise ships needing stops along the western Caribbean route currently circumvent Cuba (because of the United States-imposed embargo) and stop in the Cayman Islands, thus providing a natural

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[48] "Cruise ship congestion: is it wise?" in The Island Sun Newspaper, 08/05/2007, p.1. Web page link: http://www.islandsun.com.
[49] "*Supersize me: Caribbean ports struggle to cope with mega-cruiseships*", op. cit.
[50] Ibid.
[51] "*American Eagle announces new service between BVI and Antigua*", Caribbean Net News, http://www.caribbeannetnews.com/bvi/bvi.php?news, May 7, 2007, p.1.
[52] The BVI's European visitors arrive on international flights that terminate in either Antigua or St. Maarten.
[53] UN ECLAC/CDCC, "*A Review of Caribbean Tourism in the 1990s and at the Beginning of the New Century*", op. cit., p. 52.

stop at the half-way point for a seven-day cruise. However, if the United States commits a *volte face* by lifting the embargo against Cuba, then cruise ships will no longer be required to snub the island in favour of the Caymans. Cuba is handily positioned to pose such a threat. It possesses numerous ports to dock cruise ships. Furthermore, it already has significant hotel infrastructure to accommodate an unexpected surge in stay-over guests.[54] According to a recent report by the Los Angeles Times, 40 per cent of Americans would like to visit Cuba for a vacation and many would visit there as a cruise ship tourist.[55] It is therefore critical for the Cayman Islands to become more proactive in devising a strategy to hold its position in the face of the impending competition from Cuba, its closest neighbour.

F. Safety and security

The issue of safety and security has become very critical for the AMCs. The major challenges will be the protection of destination frontier areas such as airports and seaports, accommodation facilities and attractions to international standards, which have become much more exacting after 11 September 2001.

Safety and security in the accommodation sector is also playing an increasingly vital role in the tourism industry in many of the AMCs. Nearly 94 per cent of travelers surveyed say that they consider hotel safety to be an important factor when making their lodging selections during trip planning, according to the result of a study conducted by Harris Interactive for Safe Place Corporation, an independent provider of safety accreditation of lodging, commercial, healthcare and educational facilities.[56] The study also revealed that 93 per cent of the respondents preferred to stay in a hotel that was certified as safe versus a non-certified hotel, and more than 78 per cent would be willing to pay more for a hotel that offered this extra measure.[57] Indeed, from a destination marketing standpoint, safety and security is a 'double-edge sword' wielded with dire consequences when an incident occurs such as the disappearance in 2005 of Natalee Holloway, a student from Mountain Brook, Alabama, United States, during a graduation trip in Aruba.

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[54] "Embracing the impending US tourists rush to Cuba", Cayman Net News, http://www.caymannetnews.com, 10/05/2007, pp. 1-3.
[55] Ibid.
[56] UN ECLAC/CDCC, "*A Review of Caribbean Tourism in the 1990s and at the Beginning of the New Century",* op. cit., p. 53.
[57] Ibid.

G. Green-house gas taxes

The Secretary General of the Caribbean Tourism Organization recently alerted Caribbean governments to the fact that the United Kingdom Government has been attaching taxes of up to 80 pounds sterling per person on long-haul flights, ostensibly as a part of addressing the problems associated with global warming.[58] It has been argued that the imposition of these burdensome taxes should be challenged on four grounds:

a) Firstly, the airline industry contributes less than one per cent of the global stocks of green house gases.

b) Secondly, by placing a tax on long-haul travel to the Caribbean, the United Kingdom Government (e.g. one of several industrialized countries most responsible for the current stock of green house gases in the atmosphere) is, in fact, punishing the Caribbean which has been one of those regions that has contributed the least to the stock of green house gases.

c) Thirdly, the imposition of these taxes is clearly intended to increase the funds of the United Kingdom Treasury and, therefore, has nothing to do with reducing the stocks of green house taxes.

d) Fourthly, the Caribbean was ahead of the curve in its concerns about green house gases and was doing something about it in the public and private sectors long before others became aware of the problem.[59]

V. OFFSHORE FINANCIAL CENTRES

As discussed in Section 2, the AMCs that have shifted the structure of their economy towards tourism are finding that there are significant limits to growth in this sector owing to increased competition from new countries entering the market, the need for investments in infrastructure and vulnerability to natural disasters, such as hurricanes and other external shocks. As a result, some of these territories (notably Anguilla, British Virgin Islands and Cayman Islands) have looked to establishing activities in other services or in niche industries, such as offshore financial centres (OFCs). According to the latest available data, there are 7,222 international business companies registered in Anguilla,[60] 774,573 in the British Virgin Islands,[61] and 74,905 in the Cayman Islands.[62]

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[58] Speech by V. Vanderpool-Wallace, Secretary General & CEO of the Caribbean Tourism Organization, at the 9th Annual Caribbean Tourism Conference, Grand Cayman, Cayman Islands, 21 May 2007. Web page link: http://www.onecaribbean.org/information/documentview.php?rowid=4586.

[59] Ibid.

[60] Anguilla Financial Services – Statistical Bulletin 2006 at www.anguillafsc.com.

[61] BVI Financial Services Commission – Statistical Bulletin 2006 at www.bvifsc.vg.

[62] Cayman Islands Monetary Authority – Statistical Bulletin 2005 at www.cimoney.com/ky.

A. Why OFCs exist

The OFCs in Anguilla, British Virgin Islands, Cayman Islands (and elsewhere in the Caribbean)[63] provide a number of legitimate and important services that can be broadly grouped into three categories:[64]

a) **Private investments**, in which investments are managed in order to minimize potential tax liabilities and maximize protection granted under statutory confidentiality provisions;

b) **Asset protection**, in which the use of an international jurisdiction separate from the client's residence allows for the protection of income and assets from political, fiscal and legal risks; and

c) **Estate planning**, in which the administration of assets is done in the most favourable legal and fiscal jurisdictions.

The Organization for Economic Cooperation and Development (OECD) identifies three key factors in considering whether a jurisdiction is a tax haven: [65]

a) No or only nominal taxes. Tax havens impose no or nominal taxes (generally or in special circumstances) and offer themselves, or are perceived to offer themselves, as a place to be used by non-residents to escape tax in their country of residence.

b) Lack of effective exchange of information. Tax havens typically have laws or administrative practices under which businesses and individuals can benefit from strict secrecy rules and other protections against scrutiny by tax authorities. This prevents the effective exchange of information about taxpayers who are benefiting from the low tax jurisdiction.

c) Lack of transparency. A lack of transparency in the operation of the legislative, legal or administrative provisions is another factor used to identify tax havens. The OECD is concerned that laws should be applied openly and consistently, and that information needed by tax authorities to determine a taxpayer's situation is available. Lack of transparency in one country can make it difficult, if not impossible, for other tax authorities to apply their laws effectively and fairly. 'Secret rulings', negotiated tax rates, or other practices that fail to apply the law openly and consistently are examples of a lack of transparency. Inadequate regulatory supervision or a government's lack of legal access to financial records is a contributing factor.

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[63] For example, Antigua and Barbuda, The Bahamas, Barbados, Dominica, Grenada, St. Kitts and Nevis, and St. Vincent and the Grenadines.

[64] Oral H. Williams, Esther C. Suss and Chandima Mendis, "*Offshore Financial Centres in the Caribbean: Prospects in a New Environment"* in World Economy, Blackwell Publishing Ltd. 2005, p. 1174.

[65] Tax Haven , Wikipedia, the free encyclopaedia at http://en.wikipedia.org/wiki/Tax_haven.

B. Impact of stricter regulation on the OFCs

The OFCs are under the spotlight today as much as they have ever been. As early as 1999, the G7 launched several related regulatory initiatives designed to tame tax competition, counter money laundering and shore up international financial stability.[66] One expert has argued that these initiatives were premised on a 'top-down' or exclusionary approach, whereby standards were set in closed forums and diffused to small tax haven States by blacklisting and sanctions.[67] This approach was intended to yield quick results and avoid 'lowest common denominator' standards. The Cayman Islands were one of nine English-speaking Caribbean countries that were subsequently declared to be non-cooperative following the release of the OECD's Financial Action Task Force (FATF) report in 2000.

In the light of the heightened scrutiny following the issuance of the FATF report, Anguilla, British Virgin Islands and the Cayman Islands have been coerced into strengthening their legal and regulatory framework at the expense of their competitiveness in international financial services vis-à-vis other jurisdictions that are far less stringent. A just-released study by the Centre for Freedom and Prosperity Foundation suggests that many nations belonging to the OECD are, in fact, tax havens according to the definition devised by the Paris-based bureaucracy.[68] Among the observations made in the study are:

a) The United Kingdom, Austria, Belgium and the Netherlands[69] are tax havens since they all have bank secrecy and/or other provisions that make them a magnet for financial capital. Interestingly, the OECD does not blacklist these member nations.

b) Whether it is because foreigners do not pay tax on United States-source interest and capital gains, or whether it is because Delaware, Nevada and Florida companies are among the world's best offshore vehicles, favourable rules for non-resident aliens have attracted trillions of dollars of foreign capital to the United States economy. In other words, the United States is a tax haven according to the OECD definition.

c) Major players in international finance, like Hong Kong and Singapore, restrict exchanging tax information to domestic interests; and Switzerland restricts it to cases of tax fraud and the like.

d) The OECD tax agenda is inconsistent with tax reform. It seeks to help governments double-tax income that is saved and invested, and to help them enforce this bad tax

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[66] For example, the Financial Stability Forum which operates under the auspices of the Bank of International Settlements, and the Financial Action Task Force with the responsibility of examining money laundering techniques and trends and setting out measures to counter money laundering.

[67] J. Sharman, *"International Organisations, Blacklisting and Tax Haven Regulatory Reform"* at http://www.allacademic.com/meta/p73446_index.html.

[68] Daniel J. Mitchell, "Tax Havens: Myth Versus Reality", Prosperitas, Vol. VII, Issue IV, May 2007 at http://www.freedomandprosperity.org/Papers/th-myths/th-myths.pdf.

[69] Michiel van Dijk, Francis Weyzig and Richard Murphy have also argued that the Netherlands deliberately offers companies which would not otherwise seek to be resident within its territory the means to reduce their tax charges on interest, royalties, dividends and capital gains income from subsidiary companies. See, "The Netherlands: A Tax Haven?" at http://www.somo.nl/html/paginas/pdf/netherlands_tax_haven_2006_NL.pdf.

law on an extra-territorial basis. This means that the OECD, for all intents and purposes, feels compelled to target and penalize jurisdictions that have tax systems (such as the flat tax or the sales tax) that tax income only one time and only tax income inside national borders. This is both because pro-growth tax systems attract jobs and capital from nations with bad tax law and because nations with good law have no reason to collect the information that high-tax nations need to tract (and tax) flight capital.

What the latest report shows is that for the OECD, business has remained as usual. While the OECD has insisted that small jurisdictions like Anguilla, the British Virgin Islands and Cayman Islands remove banking secrecy laws, strengthen regulation, end bearer shares for companies and adopt tax information exchange agreements, many of their own member States have not done so. Nonetheless, the attacks on the OFCs have continued unabated even though many OECD countries continue to break or ignore their own rules. For example, Caribbean governments are being advised to keep a close watch on the progress of three bills proposed by two United States senators to put low/no-tax jurisdictions such as Anguilla, British Virgin Islands and the Cayman Islands on a blacklist.[70] The bills would force American firms and expatriates based in OFCs to pay more United States tax. Behind the latest move are estimates that more than $100 billion in tax revenue is lost each year due to investments in offshore funds.[71]

Concern in the United States about offshore companies purportedly stems from at least two significant incidents involving Cayman-registered subsidiaries. In December 2003, Parmalat Finanziaria SpA, a large Italian food company, collapsed after telling investors it had lied about its finances. Italian prosecutors claimed the company and its top executives had used three Cayman subsidiaries and a mutual fund registered on the island to misrepresent assets.[72] Prior to this incident, the Houston-based energy company, Enron, was found to be bankrupt. Senate investigators charged that the company had used 441 Cayman affiliates to help hide $2.9 billion in losses.[73]

The United States Congress is also looking into offshore hedge-fund investments by tax-exempt entities to establish new sources of tax revenue. Universities, pension funds and foundations, for example, do not have to pay tax on their investment proceeds, although they are required to pay "unrelated business income tax" when they receive profits from debt-financed investing. Hedge funds set up what are called "blocker" companies in tax havens such as the Cayman Islands that convert such profit into dividends, which are not taxed.[74]

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[70] This warning has come from a top conservative American economist, Dr. Dan Mitchell, as a United States senate panel takes up the bills designed to limit the presence of U.S. firms in Barbados, The Bahamas, Cayman Islands and a host of other Caribbean states with offshore financial services sectors. See, Tony Best, *"Warning of a racist attack"* at http://www.nationnews.com/story/288829746916293.php.

[71] Ibid., p. 2.

[72] Cayman Net News, *"US Senators Probe Ugland House"*, at http://www.caymannetnews.com/cgi-script/csArticles/articles/000154/015427.htm.

[73] Ibid.

[74] Cayman Net News, *"US Congress Joins Offshore Witchhunt"*, at http://www.caymannetnews.com/cgi-script/csArticles/articles/000156/0156737.htm.

Similar measures are being mounted by the United States Internal Revenue Service. Since 2004, the agency has begun audits of hundreds of United States Virgin Islanders as part of a crackdown on an economic development programme that allows qualified hedge-fund managers and investors to pay an effective 3.5 per cent tax on income earned in the territory (i.e. a 90 per cent cut on their United States tax bill). Half of the hedge funds have since divested their operations and left the islands. Each of these firms supported the local economy by way of a minimum investment of at least $100,000 in the territory, the purchase of products such as office supplies and computers in the United States Virgin Islands, charitable contributions and the hiring of at least 10 persons per firm, 80 per cent of whom were natives of the islands.[75]

The threat of stricter regulation of the OFCs has spurred investors - especially Chinese companies - to look to other jurisdictions, such as Mauritius, where the OECD rules and proposed tax compliance measures by the United States Congress will not apply. Recent promotions by Mauritius are believed to have encouraged interest that has pushed the island into the top ten Chinese offshore investment locations.[76]

VI. CONCLUSION

The AMCs are at a crossroads. The colonial model based on trade preferences under the Association Agreement of 2001, as well as current constitutional relationships with the Administering Powers is fading and a new model is being born. Bilateral aid from DFID has already ceased for all of the British-dependent territories except Montserrat. Moreover, the terms of trade of some of the territories, such as Curaçao and the United States Virgin Islands, may suffer as export prices for refined petroleum products decline when preferred access is eroded while aid flows may continue to decline.

These challenges have been exacerbated by the vulnerability of these mainly small islands to natural disasters such as hurricanes, floods, landslides, beach erosion, earthquakes and volcanic activity. To adjust to these changes, public policy will have to be devoted toward accelerating the pace of economic diversification as early as practicable. This process must involve enhancing their competitiveness in export manufacturing (Curaçao and the United States Virgin Islands), tourism and international financial services, and creating the conditions to attract private foreign savings. Beyond that, the AMCs must position themselves to progress up the knowledge continuum. Their long-term competitiveness and robustness will, in fact, hinge on their ability to plan their effective transformation into world-class, knowledge-based economies.

Globalization has reinvigorated capitalism and created increased demand for tourism and offshore financial services in the AMCs. In the new economy, market development and promotion, exceptional service, safety and security, and solid financial performance will

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[75] Ibid.

[76] Cayman Net News, "*Chinese Rethink Cayman Link*", at http://www.caymannetnews.com/cgi-script/csArticles/articles/000157/015777.htm, p. 1.

characterize the 'winners' in the travel and tourism industry in these territories. At the same time, the leading offshore financial centres in Anguilla, the British Virgin Islands and Cayman Islands will be tested in the days ahead. They will therefore need to be strategic and demonstrate a willingness to cooperate with, and contribute to, international standards for the delivery of financial services. They will also need to be proactive in countering negative perceptions and disinformation in the mainstream media, as well as position themselves in relation to current international initiatives that affect cross-border trade in services, and thus their respective economies and financial services sector.

VII. RECOMMENDATIONS

On the basis of the aforementioned, the AMCs should consider the feasibility of implementing the following measures:

1. Because of the importance of the service sector in terms of its contribution to GDP and employment, the AMCs are likely to benefit more from trade in services than from free trade in goods. They should therefore seek to develop or enhance capability in the following services:

    - Tourism-related services, including airline reservations, entertainment, culture, health and sports;
    - Telecommunications-based services, including informatics and geographic information;
    - Systems and drafting;
    - Financial services;
    - Environmental services; and
    - Business services, including accounting, legal and marketing.

    A possible strategy is to develop services on two basic pillars. The first pillar is tourism upon which a number of related services would develop. The second pillar is telecommunications services upon which a set of related services like informatics, Geographic Information Systems (GIS), drafting and business services could develop. Cheaper telecommunications would open avenues for people to vacation and work in the territories if greater connectivity were provided.

2. In order to develop capability in the service sector, the following issues need to be addressed:

    - The AMCs should pay more attention to human resource development. The emphasis must be on training a skilled and flexible labour force.
    - The cost of telecommunications services as a result of the monopoly status held by the main carrier. Ongoing initiatives to generate competition and lower telecommunications and internet fees are critical (e.g. liberalization of telecommunication services in the British Virgin Islands).

- Incentives should be given to foreign service-providers of tourism-related and offshore financial services to establish commercial presence in the AMCs.

3. The ECLAC Subregional Headquarters for the Caribbean and the OCTA Secretariat in Brussels should seek to establish a collaborative research programme for the benefit of the territories.

4. The European Union, the Caribbean regional organizations and the AMCs need to work together to come up with simplified methods of regional cooperation tailored to the circumstances of the territories. For example, participation in regional projects could be de-linked from membership in the various regional organizations (e.g. the Association of Caribbean States (ACS), ECLAC, CARIFORUM, and OECS Secretariat). Perhaps a simple framework cooperation agreement between the AMC and the regional body might suffice; thus opening cooperation projects to AMC participation on mutually agreed terms. Also, relatively quick-disbursing financing facilities with simplified approval procedures might be considered, giving more authority to the local territorial authorizing officers in charge of managing EDF funds.

5. The OFCs in Anguilla, the British Virgin Islands and Cayman Islands must demonstrate a will to cooperate with, and contribute to, international standards for the delivery of financial services. It is logical to assume that their contribution to the integrity of the international financial services sector will convert into a fuller recognition by international standard-setting organizations. At the same time, they must insist on a level playing field in the application of these standards, and take a strong stance in countering negative perceptions and misinformation about their jurisdictions in the mainstream media.

6. The AMCs should commission a study on the benefits and costs of deepening their integration with the rest of the region through the CSME. A key element of the proposed study will be to understand the possible trade, fiscal and adjustment impacts for them, as a result of participation in the CSME. At its core, this remains an empirical question, the answer to which can only be approached from insightful analysis of their structure of trade and border taxes.

7. The AMCs should commission a study to assess the options for regional technical cooperation in health, human resources development, security, communication (e.g. air and sea transportation), foreign trade policies, research and development.

8. The AMCs should develop a coalition with the CRNM and also meet regularly with the DOMs to lobby for recognition of their particular status, both in the EU and at the WTO.

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