

CHAPTER 7 : OPPORTUNITIES FOR EXPANDING EXPORTS OF SERVICES

7.1 **Services have become the most important source of growth in the OECS countries, with a growth rate of 4.3 percent per year during 1980-2003.** As a result, the share of services in GDP (excluding the government sector) increased from 53 percent in the 1980s to 64 percent during 2000-2003 (see Chapter 1). As the OECS countries continue their transition to service economies, developing innovative and competitive clusters around areas of identified comparative advantage will be critical for future growth. Given relatively high wages, it is unlikely that the OECS can be competitive in labor-intensive manufacturing or in traditional agricultural production in a more open market trading regime. However, there are several sectors, especially in services, where small economies can be competitive. While some diversification has already taken place, including in niche manufacturing and various service sectors, this process needs to be accelerated to reverse the growth decline of the 1990s in a sustainable way. In creating successful service and niche manufacturing exports, the OECS can leverage its geographical location, its English speaking population, its alluring natural beauty, and rich culture. There are numerous examples of service exporters that have successfully exploited these advantages and there are already emerging examples of dynamic service exporters that point to potential for further growth.

7.2 This chapter explores illustrative case studies for further growth and diversification of tourism activities, offshore education, ICT-enabled products and services, health and wellness activities, and offshore financial services. While these sectors present opportunities for the OECS, they are meant to be illustrative of the issues and constraints facing all service sector firms in the sub-region. As the case studies demonstrate, success in moving to higher-end services will require raising skill levels and expanding numbers of skilled workers, reducing costs of interconnectivity and increasing collaboration among industry actors. There is a critical role for governments in coordinating private and public sector efforts and establishing the standards and certifications that raise the quality of service. It should be noted that this is different from “picking winners”, since it only creates an enabling environment that allows market forces to channel investment into competitive sectors, such as services.

A. Tourism

7.3 **Given the numerous competitive advantages of the sub-region in tourism, this sector is likely to remain a major contributor to growth, employment and export earnings in the OECS for some time.** Despite a strong start during the 1970s and 1980s, recent performance both in terms of market share within the Caribbean and worldwide has been lagging. The major reasons are declining cost competitiveness in key market segments against new destinations in the Caribbean and beyond, and slow response to the changing nature of the tourism business worldwide. However, the strong growth projected in global tourism and the emergence of new market segments in which the OECS has potential to compete have created the possibility for the sub-region to reinvigorate tourism and, further, to make it the centerpiece of a cluster of new service exports. In order to realize this potential, the sub-region will need to update its strategy for managing and marketing the sector, focus public interventions and expenditures more closely on critical constraints such as the skills shortage and coordination with the private sector, and cooperate more effectively at a sub-regional and regional level.

7.4 **Tourism currently accounts for 28.8 percent of GDP, 38.7¹ percent of employment and 54.2 percent of export earnings in the OECS.** Although these shares vary across countries, with Dominica having the smallest sector, all of the OECS countries hope to expand and deepen the sector over the near future. The industry is mainly divided into stay over and cruise business, with cruise accounting for 64 percent of arrivals but only 6 percent of receipts (see Table 7.1).

TABLE 7.1: TOURISM SEGMENTS, 2000

	Arrivals		Receipts		Spending per arrival
	('000s)	share	(US\$ millions)	share	(US\$)
Stay over	852	36%	861	94%	1,011
Cruise	1,544	64%	52	6%	34

Source: CTO (2003).

7.5 **Comparatively, the OECS has under-performed in tourism both within the Caribbean and worldwide over the period 1990-2002.** Tourist arrivals have grown at 2.8 percent, slightly slower than the Caribbean as a whole (including the Dominican Republic and Cuba) but much slower than the world tourist arrivals which grew at 3.7 percent over the same period. Similarly, OECS tourism earnings have grown at only at 1.9 percent compared with 4.7 percent for the Caribbean (including the Dominican Republic and Cuba) and 4.9 percent for the world. As a result, the OECS market share of Caribbean tourism receipts fell from 14.6 percent to 10.5 percent, and from 0.24 percent of world tourism to 0.17 percent between 1990 and 2002. Spending per arrival, although higher in level than the Caribbean, grew by only 3 percent per year during 1990-2002, compared with 17 percent for the Anglophone Caribbean and 21 percent for the Dominican Republic and Cuba over the same period.

TABLE 7.2: INTERNATIONAL TOURIST ARRIVALS BY REGION OF DESTINATION

Share of world market (%)	1990	1995	2000	2001	2002
Africa	3.3	3.6	4.0	4.1	4.2
Americas (excl Carib)	17.9	17.2	16.1	15.1	14.1
Caribbean	2.5	2.6	2.5	2.5	2.3
CARICOM	0.9	0.8	0.7	0.7	0.7
OECS	0.13	0.14	0.12	0.11	0.12
Dominican Republic and Cuba	0.4	0.5	0.7	0.7	0.6
Asia (excl NE Asia)	6.5	7.5	7.7	8.1	8.2
North East Asia	6.1	8.0	9.1	9.6	10.5
Europe	61.5	58.6	57.1	57.1	56.9
Middle East	2.1	2.5	3.5	3.5	3.9

Source: World Tourism Organization (2004).

7.6 **The slowdown in growth in tourism is accounted almost entirely by lagging performance in stay over arrivals.** Growth in stay over arrivals fell from an average 8 percent per year during 1985-94, to 0.1 percent in 1995-2003. Meanwhile the cruise sector has seen stronger, but also declining growth in arrivals, from 15 percent in 1985-94 to 4.4 percent in 1995-2003. The yachting segment appears² to be growing fast in the Eastern Caribbean, and the market currently remains dominated by the French Antilles and St. Maarten. St. Vincent and the Grenadines, for which this segment accounts for about 40 percent of tourist expenditures, and

¹ WTTC (2004) data on employment measure both the direct and indirect impacts of tourism on the economy.

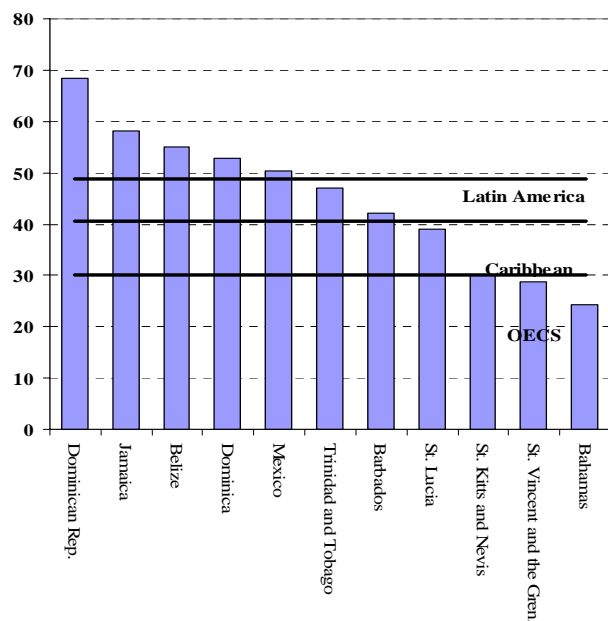
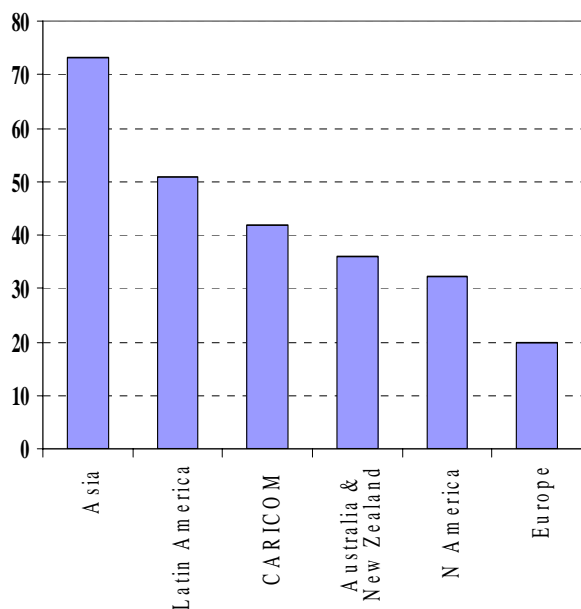
² The yachting sub-sector is not yet being systematically measured.

Antigua and Barbuda are the major players in the OECS group. While the cruise segment remains a minor player in terms of receipts accounting for only a 6 percent share of tourism earnings, the yachting sector is strengthening as a key segment because of the higher per capita spending of these visitors. Like yachting, other new and emerging segments are not yet being measured systematically.

7.7 More recently, tourism in the sub-region has rebounded from the effects of the terrorist attacks in the US in 2001. Arrivals grew by 7.6 percent between 2002 and 2003, compared with an average decline of 2.3 percent per year in 2001 and 2002. This performance surpassed that of world tourism which continued to contract in 2003 on account of SARS and the war in Iraq, and of the Caribbean which grew by 6.5 percent in 2003.

7.8 The loss of market share in both the Caribbean and world markets during 1990-2002 can be attributed to a loss of tourism-related price competitiveness in the principal sun, sea and sand product offering. Until recently, the OECS tourism product comprised a dominant beach resort tourism segment which offered the traditional *sun, sea and sand* tourism complemented by a host of very small properties which attempted to specialize in more *experiential* tourism, but represent a relatively very small share of stay over guests. However, the demand for *sun, sea and sand* product has become very price elastic (Maloney and Rojas, forthcoming). The experience in the 2001/2002 winter season, following the terrorist attacks in the US in 2001 revealed that resorts were able to substantially dampen the contraction in demand through price discounting. Unfortunately, the OECS countries are among the least price competitive within the Caribbean, which itself is much less competitive in terms of prices than other regions of the world (see Figure 7.1). As a result, during the 1990s, the expansion of lower cost *sun, sea and sand* offerings combined with mass marketing techniques by the emerging destinations in the Caribbean – mainly the Dominican Republic, the Cancun/Cozumel region in Mexico and more recently Cuba – were able to capture market share from both the OECS and broader CARICOM destinations. In addition, with the decline in transportation costs worldwide, long haul destinations have become increasingly attractive, as evidenced by the rising share of tourists worldwide traveling to Africa, Asia, and the Middle East (see Table 7.2). To exacerbate the problem, the WTO now describes the *sun, sea, and sand* product as “approaching the mature/saturation stage for the product life cycle” (WTO 2004).

FIGURE 7.1: INDICES OF PRICE COMPETITIVENESS IN TOURISM



Note: These indices are based on hotel price comparisons, purchasing power parity and consumer price indices adjusted for taxes on goods and service.

Source: WTTC (2004).

7.9 **Nevertheless, the OECS has the potential to strengthen its market position in some of the fastest growing segments of tourism.** Globally, tourism is expected to grow by 4.1 percent per year through 2020. High growth segments include adventure and nature-based tourism, expected to grow annually by 20 percent per annum, cultural, meetings and conference tourism by 10 percent, and health and wellness tourism by 6 percent. Given its physical and cultural assets, the OECS is in a position to capture a growing market share of these segments. Indeed, the sub-region has already demonstrated its ability to expand product offerings into these segments, for example, with St. Lucia’s Jazz Festival and world class spa hotel, Dominica’s

Creole Musical Festival and world-renowned diving market, Antigua's nascent health tourism operations, plantation tourism in St. Kitts and Nevis, and yachting in St. Vincent and the Grenadines and Antigua and Barbuda. In a recent market test with specialty tour operators in Dominica, 34 out of the 40 operators expressed interest in exploring further business opportunities in adventure, nature, culture and heritage packages.

7.10 The small hotel sub-sector which has been languishing for some time can be a key participant in these emerging segments. The OECS tourism sector has a larger share of small properties (75 rooms or less) than much of the Caribbean. Notably, guest houses account now for 11 percent of available accommodation in the OECS, compared with 2.1 percent for other Caribbean destinations. In Dominica, St. Kitts and Nevis and St. Vincent and the Grenadines,³ less than 40 percent of properties have 100 or more rooms. However, the small hotel sector has generally under-performed in comparison to larger properties. Occupancy rates for these hotels have been persistently below sustainable levels averaging 40-55 percent compared with island-wide occupancy rates of 60-75 percent. The problem has been exacerbated in recent years by the introduction of electronic booking agents, such as Orbitz and Expedia, which charge a significant share (20-30 percent) of room revenues for their services rendering them prohibitively expensive for smaller properties. That said, the growing specialty market niches identified above are particularly well matched to the products and services of small tourism enterprises which tend to offer more by way of local culture and adventure.

7.11 These emerging market niches have the potential to deepen the impact of tourism on the local economy but require a more complex role for the public sector - **old management techniques and investment regimes are not adequate for these emerging activities.** In the past, the tourism sector in the OECS was viewed as comprising mainly airlines, cruise lines and hotels which combined to produce the traditional, but now maturing, *sun, sea and sand* product which failed to create significant linkages with the domestic economy. However, tourists worldwide, and particularly in the growing market segments identified above, are now demanding much more from their vacation 'packages'. The new business model for competitive tourism involves managing the customer experience from the planning and booking stage through post-trip activities, and spanning the entire destination including hotels, restaurants, taxis and tour operators, activities, cultural and heritage sites, and scenic locations. While this model has the potential to create more linkages with the economy as a whole, it also means that management of the tourism sector, and by extension the role of the public sector, is much more complex if it is to ensure competitiveness.

7.12 This interest of visitors in experiencing more of the destination as a whole has deepened the public good factor in the tourism production function, and presents challenges to the public sector. The role of the state sector in tourism can no longer be limited to general destination marketing, administering investment incentives for large enclave-type resort hotels, directing credit to locally-owned properties, and maintaining adequate air services and transportation infrastructure. The entire destination has become the tourism plant. As such, the management of tourism must now embrace a host of new areas including but not limited to environmental protection and solid waste management, land use planning to ensure the maintenance of scenic views, policies to protect and showcase culture and heritage sites, establishment of quality standards in broad ranges of services, and ensuring a legal framework for consumer protection. Moreover, the role of the public sector in developing overarching

³ Based on CTO, 2002-2003 data. This may have changed for St. Vincent and the Grenadines recently with the opening of the Raffles Resort on Canouan Island in the Grenadines.

destination development and management strategies and coordinating the various actors in the sector, is even more fundamental.

7.13 In order for the OECS to take advantage of the emerging market segments and to transform its tourism from the *sun, sea and sand* model to the destination model, the sub-region will have to:

- strengthen management and marketing of the destination, including environmental management;
- raise the capacity of the industry to deliver quality services;
- reform investment promotion strategies;
- promote backward linkages in tourism;
- improve allocation of public expenditures on tourism; and
- address trade-related constraints to tourism.

7.14 ***Destination management and marketing.*** **The destination model requires a moderate and consistent level of infrastructure and security throughout the country, and maintaining the model requires a robust tourism cluster that coordinates various sectors' efforts for mutual benefits.** Around the sub-region, many destinations have not paid sufficient attention to the impact on tourist spending of general island-wide infrastructure that could encourage visitor exploration and increased visitor spending. Roads often lack adequate signage and tourism facilities such as pull-offs at scenic viewing points. Taxis, local tours and activities are expensively priced. Public information for tourists is fragmented and not delivered in a user-friendly way. Land use and environmental policies may not recognize and protect important scenic, natural, and heritage resources of interest to visitors. Antigua and Barbuda's experience with the location of open-faced quarries that mar the landscape is one example. In addition, tackling the issue of rising crime takes on added urgency, for both tourists and investors alike, as destinations move from "safe" enclave tourism to more complete "island experiences".

7.15 **As such, improved coordination among public sector actors is key for successful destination management.** In order to address the above concerns, the government will need to integrate tourism issues into other parts of public sector management – such as public works, land use planning, transportation policy and cultural preservation. This will involve expanding the ambit of the tourism ministry or board, and/or placing a priority on mainstreaming tourism into public sector management. Given the more intrusive nature of the tourism destination model, such a strategy may generate a perception that the government is concentrating on visitor needs at the expense of the general public or the poor, and so a public education campaign may be required to explain the destination model and its beneficial spillovers to the society as a whole.

7.16 **The destination model also puts a premium on coordination between the public and private sectors and within the private sector** because so many more actors are part of the supply chain – for example, restaurant owners, cultural site operators, community guides – and because the strategic positioning of a tourism sector or cluster will generally require some common approaches or/even cooperative activities among private enterprises. Efforts to date in the OECS to strengthen collaboration between the public and private sector in tourism have not been fully effective in part because of weak private sector organizations, but also because the government's strategy may have been to focus its attention on the needs of key investors, rather than the sector as a whole. This type of coordination is never straightforward, and particularly so

if private sector organizations are not considered representative by the industry participants.⁴ For example, a survey for the Small Tourism Enterprises Program (STEP) (Box 7.1) revealed that 71 percent of small hotels were not members of national hotel associations. Over time, ongoing efforts by CPEC and donors to strengthen the capacity of private sector organizations in tourism, combined with the governments' ongoing efforts to engage with industry representatives rather than individual operators should close the gap over time.

7.17 Collaborative strategic planning and improved monitoring of implementation and outcomes can serve to strengthen coordination. In a number of cases in the sub-region, the national tourism strategy has been prepared by an external consultant for the government. Other than the early fact-finding interview, discussions with the private sector are limited to a few industry representatives, and take place after the fact. Although complicated to organize, joint strategic planning exercises with the private sector as much at the helm as the public sector, will help to improve coordination. In addition, there is a need to strengthen monitoring of tourism sector performance, as well as implementation of any agreed action plans. The data currently collected by the government statistics departments for the national accounts or balance of payments are not sufficient to fully understand the performance of the sector from a business point of view. There is a need to strengthen the collection of data by both the tourism authorities and private associations to effectively monitor developments. Regional coordination on the development of appropriate monitoring indicators, and perhaps introduction of periodic regional surveys may help to overcome the capacity constraints of local authorities and associations.

7.18 The OECS countries need to strengthen their commitment and update their approaches to tourism marketing. The traditional marketing model in the Eastern Caribbean relies heavily on the large resort and hotel properties driving business through their tour operator's relationships and reservations systems. Small tourism enterprises are not well integrated into national marketing strategies. Weaknesses in the marketing system, however, compromise results. Many countries have neither a strategic marketing plan nor the marketing infrastructure necessary to compete in today's marketplace. Effective use of the internet to support marketing strategies is rare. The strong growth of new niches has spawned a growing number of travel intermediaries who are constantly looking for new products to deliver to their customers. Destination marketing success requires building relationships with these specialty tour operators and travel agents, providing destination information tailored to their interests, and ensuring that destination suppliers have the skills, capabilities and systems to engage with the international travel trade.

7.19 Given the relatively weak private sector organizations, the public sector may have to assume/continue leadership of the marketing program in the short term. However, some element of cost recovery should be instituted at an early stage to both reduce the incentives for free-riding, as well as to strengthen accountability. Coordination with the marketing programs of the large properties, tour operators and airlines as well as attention to the needs of the smaller hotel sector will be crucial.

7.20 As a matter of priority, improved destination management will also require improved environmental management. Regardless of the direction of diversification of tourism in the OECS, the industry will continue to depend heavily on the natural resources of the sub-region. Hence the need to strengthen management of the environment as a strategic

⁴ The main challenge for the public sector is often in choosing between when and how to motivate and when to stipulate actions on the part of the individual private enterprises, while maintaining an enabling investment climate.

development priority. In order to achieve sustainable tourism development, the OECS needs to urgently address key environmental problems such as degradation of coral reefs, coastal and marine habitats, forests and woodlands, and preservation of the overall landscape, urban and rural. In addition, the sub-region needs to extend advances made in solid and shipwaste management to wastewater, and address issues such as agro-industrial pollution, agricultural run-off and soil erosion stemming from increased residential construction.

7.21 The sub-region will need to: (i) strengthen enforcement of environmental policies for land use planning, urban-rural zoning regulations and landscaping; (ii) expand protected areas; (iii) improve monitoring of the quality of coastal waters and beaches; and (iv) make additional efforts in solid waste and wastewater management, air and water pollution control, and natural disaster mitigation. Necessary policy reforms include enabling legislation for national environmental units, and enactment of regulations to strengthen existing Environmental Impact Assessment laws. Finally, the OECS needs to embark on a sub-regional effort to monitor critical eco-systems in collaboration with ongoing initiatives in the wider Caribbean.

7.22 ***Improving product quality through training, standard setting and certification.*** Targeting the new high growth segments of the tourism market is essentially a strategy to concentrate on less price elastic and higher price portions of the demand curve, as a way to offset high costs. However, without real improvements in quality of service to justify the higher spending by visitors, this strategy will fail. Improvements in quality require an increase in the numbers of trained staff. For example, one of the differences between a three-star and four-star hotel as rated by the Automobile Association is that the ratio of staff to guest rises substantially, “Reception is staffed 24 hours a day, with porters available on request [and] services such as portering, 24-hour room service, laundry and dry-cleaning will be available.”⁵ Moving to the destination model will require an increase in the range of skills required by the sector. Given the shortage of skilled labor in the OECS (see Chapter 5) this is an important constraint that has to be addressed.

7.23 **Tourism sector’s human resource development is a real challenge for small countries, given their small market size.** In order to address this, the OECS has established Hubs of Excellence for training such as in the British Virgin Islands for culinary arts, St. Lucia for front office operations, and Antigua and Barbuda for general customer service, but it is not clear whether the nomenclature has been accompanied by increased investments in training in those fields. Some training is provided by community colleges, tourist boards and associations in a limited number of areas, including general degree/diploma programs in hospitality. However, there does not appear to be any standardization of these programs across the sub-region. The delivery of much of the applied skills training remains particularly dependent on donor projects or on internal training by the larger hotels. One hotel in St. Lucia suggested that it has probably trained all of the massage therapists in the island through its in-house training program, because there are no other facilities locally that offer this expertise. Notwithstanding the above, the shortages of skilled labor in the tourism sector are likely to be a major constraint to improving destination and product quality.

7.24 **The international trend is for tourism training to be left to the private sector and for technical education systems specializing in skills training, and toward accreditations that are internationally recognized and portable.** The OECS should build on regional programs such as the OAS Small Tourism Enterprise Program (see Box 7.1), to help standardize training

⁵ Hotels in London (2005).

across the sub-region, whether financed by donors or the public purse. Efforts should be taken to encourage private provision of training by larger operators.

7.25 The establishment of standards and certifications can be an important incentive for the private sector to improve quality. In a recent inspection of 211 small hotel properties in the Caribbean conducted for the STEP program (see Box 7.1), the majority of which were in the OECS, the inspection team found that product quality did not meet commonly accepted basic marketplace standards in more than 70 percent of the cases. An estimated 15-20 percent of the cases could easily have been rectified without major expenditures or incurring capital costs (e.g. clean-up of the property, fresh coat of paint, new drapes, front desk hospitality, etc.), but most of the hoteliers were not aware of the shortfalls in their property because of a lack of awareness of these standards.

7.26 Worldwide, there has been an explosion of both public and private programs to establish quality standards and use brands or ratings to signal product quality to consumers. Most of the OECS countries are undertaking the establishment of national standards and certifications for a variety of tourism related services. However, it is not clear how harmonized these efforts are across countries or whether already-developed international standards that are easily recognizable by visitors are being used. At least in the area of environmental conservation – one of the early areas of this type of branding and certification – a growing number of hotels are using international standards. In a survey of 180 hotel operators undertaken in 2004 for a recent World Bank report on the environmental sustainability in OECS tourism sector,⁶ just under 20 percent of the respondents reported participating in voluntary environmental certification schemes. However, another 43 percent saw no benefits for their operation. Notably, Dominica is currently undertaking the process of becoming the first entire destination, rather than property, to be certified by Green Globe 21.⁷

7.27 One form of certification which should be destination-specific is that of “market” or “export readiness” increasingly used by tourist boards and associations to certify enterprises for participation in publicly- or cooperatively-financed marketing and investment promotion programs. This concept combines market ready standard requirements with international business procedures. For example, the British Columbia Export Ready Criteria include being in business at least one year, having an adequate budget and marketing plan including tour operators, being willing to contract and honor wholesale net rates, being able to communicate and accept reservations by phone, fax or email and providing same day confirmations, and being willing to consider the development of a website with possible digital video footage (for a full description, see Annex 4). Since these criteria are used to coordinate enterprises, they will need to be country specific and agreed through consultation with the private sector. The STEP program (see Box 7.1) created such a standard for assessing the capacity needs of the small hotel sector, and during its baseline survey found that two-thirds of all small hotels in the Caribbean were not “market ready”.

BOX 7.1: THE SMALL TOURISM ENTERPRISES PROGRAM (STEP)

The Small Tourism Enterprises Program (STEP) was developed by Organization of American States to assist small hotels in the CARIFORUM to enhance their competitiveness and performance. The majority of the hotels taking advantage of this program are in the OECS. More recently, the program has expanded its services to non-hotel small tourism enterprises. The range of interventions and assistance include:

⁶ World Bank (2005a).

⁷ Green Globe 21 is a worldwide benchmarking and certification program for sustainable tourism. It is based on Agenda 21 and principles for Sustainable Development endorsed by 182 governments at the United Nations Rio de Janeiro Earth Summit in 1992.

- the development of a **branded marketing cooperative**, *caribbeanexperiencesTM* modeled after the Best Western cooperative, along with an **investment facility** for member financing;
- a **small property rating system** designed specifically for the Caribbean that covers different types of small operations from guest houses to inns and holiday villas;
- **training and certification programs**, developed with partners such as the American Hotel and Lodging Association (AHLA), Netcorps Canada, and the Culinary Institute of America;
- **technical assistance for developing computer skills and applications** to improve marketing and management capabilities;
- **operational management toolkits** aimed to introduce hotels to industry best practices; and
- a **program of environmental walk-throughs** aimed to help properties identify their footprint on the environment, and to formulate and implement environmental management actions.

7.28 **Reform investment promotion strategies. The OECS countries also need to reform their investment promotion strategy in tourism.** OECS governments have long relied almost exclusively on the use of fiscal incentives (and directed credit) to promote both foreign and domestic investment in the tourism industry. As noted above in Chapter 4 on the investment incentives, there is no real economic rationale – based on a market failure or public good situation – for most of these particular incentives in the tourism sector, other than cross-country competition for investors. The Statutory Hotels (Aid) Acts in the OECS provides corporate tax holidays ranging from 5 years in Antigua and Barbuda to 20 years in Dominica, and duty free importation of materials and equipment for new construction during the tax holiday period only. In St. Kitts and Nevis the duration of the tax holiday depends on the size of the property, and in St. Lucia it is lower for extensions versus original construction. These incentives violate the 1973 CARICOM agreement because they are awarded on the basis of sector and project characteristic rather than domestic value added. In general, tax holidays should be avoided because they are not targeted to investments *per se*, but rather general operations which could be expanding or shrinking over time. If the incentives are really deemed necessary, they should be replaced with alternatives such as investment tax credits, accelerated depreciation, and loss carry forward provisions as has been done in Barbados. The provisions are more closely targeted to actual investments and help to mitigate investment risk. In addition, incentives should not discriminate between new construction, maintenance, rehabilitation or extensions. Import duty concessions should apply to particular products, such as construction materials, rather than prescribed by use.

7.29 **The incentives-based competition among countries is facilitated by their often discretionary, rather than rules-based, application.** In addition, the discretionary application also creates an environment of policy uncertainty for industry participants, including foreign investors, about the treatment of competitors in the same market. In one fairly egregious case, two new foreign entrants were granted certain concessions that had not been granted to the incumbent local operator who had in fact paved the way for this line of business in that country. In the end, the incumbent was unable to compete due to higher costs, and went out of business.

7.30 It should be noted that even though there is intense incentives-based competition for investors across the sub-region, a recent **World Bank report on sustainable development in tourism⁸** found that there is no evidence of a race-to-the-bottom on environmental standards, although there is some anecdotal evidence of “fast-tracking” environmental impact assessments in order to attract investment. The absence of sound technical baseline information on the state of the environment, however, may provide an excuse for decision makers to avoid the

⁸ World Bank (2005a).

issue, particularly if the prevalent belief is that rigorous environmental mitigation requirements may scare off potential investors. The risk remains that the costs of inducements outweigh the long-term benefits of safeguarding the sub-region's main natural resource.

7.31 The singular focus on fiscal incentives had the inadvertent result of attracting only investments that had limited impact on the local economy. By concentrating their limited capacity on administering fiscal incentives, tourism authorities have not paid sufficient attention to strengthening the broader environment in which investors operate. In response, the investors that were most attracted to the Caribbean were the ones who found ways of mitigating the risks of operating in a less than adequate environment (other than the spectacular beaches) where something in the local environment might prevent repeat visits of their clientele. Hence, the development and popularization of the all-inclusive concept in the Caribbean in which hotels organize their own transportation from the airport, eliminate the need for their guest to frequent outside restaurants and bars, provide competing recreational activity on site, and arrange their own tours to a hand selected group of sites.

7.32 Given the increasing importance of destination quality to the competitiveness of individual properties, investors are now more dependent on public policy and thus paying closer attention to other issues like the government's commitment to destination marketing which mitigates their investment risk. Investor risk encompasses marketing, management, costs associated with creating the investment, operating costs, and the degree to which the product might be placed at risk by external forces that are not controlled by the investor. In general, investors are looking for a commitment to the tourism sector as reflected in infrastructure programs, economic policy and planning related to critical infrastructure and a (financial) commitment to destination marketing that is consistent with the destination's positioning, and directed at markets in which the investor also hopes to source clients.

7.33 Not only do tourism authorities have to manage the broader environment better, they have to devise effective ways of communicating the government's strategies and actions to potential investors. For example, a recent group of investors on tour in Dominica needed precise and regular information from the Government about the implementation of the airport upgrading project and rehabilitation of the road between the airport and the capital city, Roseau. Yet communications between the tourism authorities and the Ministry of Construction, Works and Housing is not systematic.

7.34 Finally, despite the underlying competition for investors, there is scope in the OECS for sub-regional collaboration on investment promotion and destination marketing in tourism. The recent activities by the Heads of Government to establish a Ministerial Committee on Tourism, and by the OECS Secretariat to coordinate efforts to promote the yachting sector mark important developments in this regard, and should be enhanced.

7.35 Promote backward linkages. The destination model also offers a new way to promote backward linkages from the tourism sector to the local economy. Visitors and governments alike have lamented the limited backward linkages from the tourism sector to the domestic economy all across the OECS. In part, this has stemmed from the predominance of enclave type resort hotels attracted by the earlier investment promotion strategies (see para. 7.31). In an attempt to encourage some linkages, most OECS countries imposed high duties on beverage imports, in particular beer, in order to boost sales from local breweries and rum distilleries to the tourism sector. However, while these policies have provided rents to the local breweries, they have also raised costs for hotels of maintaining a wide range of popular beverages for their guests, reducing their international competitiveness.

7.36 The new destination model of tourism deepens the linkages between the visitor and the domestic economy, because the tourists are seeking to have a broader experience of the destination. **To ensure these linkages are effective in transferring resources from the visitors to a much wider range of local enterprises, it is necessary to ensure that local firms have the capacity and knowledge about how to provide these services.** The public sector can support training and certification for a wide range of service providers including restaurateurs, tour operators, beauty salons, and community guides. It can facilitate coordination between hoteliers and other service providers, and encourage competition between service providers. The growth of the specialty manufactured goods, such as handmade soaps and pepper sauces, provides other linkages with the tourism sector. Marketing these goods to visitors is another channel for increasing market penetration and awareness overseas. Conversely, the sale of these goods in overseas markets can raise awareness about the destination.

7.37 **Improve allocation of public expenditures on tourism.** In line with the reforms proposed above on the investment promotion strategy, governments in the sub-region will need to rethink the allocation of their public expenditure on tourism. Public resources allocated to tax incentives, guarantees and investor-specific infrastructure raise the return to a single private operator, as opposed to spending on destination marketing, training, and development of standards which raise the return to the entire sector.

7.38 Given the size of the industry which varies from around US\$45 million in Dominica to under US\$300 million in Antigua, **the budgets for management of the tourism sector in the OECS, and in the Caribbean, are quite small**, at 1.7 percent and 2.1 percent of visitor spending respectively (see Table 7.3). In terms of public spending per visitor, the OECS averages about US\$7 per arrival, compared with US\$10 per visitor for the Caribbean, US\$17 per visitor for Barbados and a whopping US\$64 per visitor by Bermuda. **Savings from any reduction of fiscal incentives should be targeted to strengthening the capacity of tourism authorities,⁹ maintaining and improving destination marketing programs, maintaining and improving general public infrastructure, environmental conservation and providing incentives for the private sector to undertake training.**

TABLE 7.3: PUBLIC EXPENDITURE ON TOURISM

	Tourism authority budget as a percentage of visitor expenditures (2001)	Public investment classified under Tourism ^a as share of total capital expenditure (Avg 1995-2001)
Antigua and Barbuda	0.92	..
Dominica	1.67	2.6
Grenada	2.21	3.5
St. Kitts and Nevis ^b	4.92	3.1
St. Lucia	1.94	11.4
St. Vincent and the Grenadines	1.07	1.6
OECS	1.74	5.2
Other Caribbean^c	2.05	

a. Does not include public investment classified under Transport and Communication or Infrastructure that would include re/construction of cruise ship ports, access roads to attractions, etc, and in some cases includes non-capital spending on donor-financed tourism projects.

b. Includes capital spending on culture and environment.

⁹ Many of the tourism authorities in the sub-region are understaffed, and in some cases with non-established or contract positions that provide little performance incentives to the staff.

c. Does not include Jamaica.

Sources: Caribbean Tourism Organization (2003).

7.39 ***Address trade-related constraints to tourism.*** Finally, although tourism is a relatively competitive industry worldwide with few barriers to trade, as is the case for many services, **there are some constraints that should be addressed through ongoing bilateral, regional and multilateral trade negotiations.** The Caribbean Regional Negotiating Machinery (2003) has identified some important constraints to the development of a competitive tourism sector that need to be addressed through trade negotiation fora. These include:

- restrictions to intra-regional travel which represent a growing share of OECS arrivals, in the form of taxes and visas, which could be facilitated by the introduction of a CARICOM passport;
- Mode 2 restrictions on “consumption abroad” in the form of various types of travel taxes imposed by source markets when their residents travel overseas including to tourist destinations;
- prohibitively low duty free exemptions for EU, US, and Canadian residents returning from CARICOM countries which encourage both cruise and stay over tourists to make purchases in the US Virgin Islands where exemptions are substantially higher. For example, taxes and other costs can amount to 30 percent of vacation costs for Europeans; and
- barriers to mode 4 movement of tourism professionals and students hamper the Caribbean’s marketing efforts and limit educational opportunities for its tourism students.

B. Offshore education

7.40 **There is an emerging cluster of education exports in the Caribbean, comprised mainly of twenty-four medical, and one veterinary, schools throughout the sub-region of which more than half are in the OECS** and a small, but growing, number of English language training providers in Dominica, Guyana and Barbados. The following analysis focuses on the offshore medical schools.¹⁰

7.41 There is currently a shortage of both North American medical school places and licensed physicians in the US. As such, the factors affecting the demand for offshore medical education are the US government’s decision to increase or decrease support to medical education within its borders and the current and future shortage of physicians in North America. However, the number and enrollment of medical schools in the US has remained flat over the past 20 years at around 126 schools accepting around 17,500 students per year from a cyclical but growing number of applicants. The current ratio of applicants to accepted applicants is around 2:1.

7.42 Recent reports in the US have pointed to imminent shortages of primary care physicians, certain specialties, and of physicians in rural areas and metropolitan centers.¹¹ These shortages have been attributed to faster-than-projected population growth, the growing share of older and female physicians who generally work less hours¹² (see Table 7.4), an aging population requiring more medical care, increasing indebtedness of medical graduates who in turn choose only high

¹⁰ This section is based entirely on a background paper by Swedish Development Advisors (2004).

¹¹ Swedish Development Advisors (2004).

¹² Ibid.

paying specialties, rising malpractice insurance costs forcing practitioners out of service and increasing difficulties for foreign physicians to obtain visas to work in the US.¹³

TABLE 7.4: STATISTICS ON THE US MEDICAL PROFESSION

	1970	1980	1990	2000
Active physicians to total physicians	83%	80%	66%	77%
Women physicians as % of total physicians	8%	12%	17%	24%
Physicians over 65 as % of total physicians	12%	14%	15%	18%
International medical graduates as % of total physicians	17	21	21	24

Source: Swedish Development Advisers (2004).

7.43 In response to the growing demand for physicians, the number of residency positions at US hospitals has grown to around 20,000 positions per year, but in 2003 only 65 percent of these positions were filled by US medical school graduates.¹⁴

7.44 **This has paved the way for offshore schools to play a “gap-filling” role between the 17,000 rejected applications each year and the 35 percent of residency positions that are not filled by US medical graduates.** In order to fill the gap, US medical schools would need to increase annual enrollment by around 7,500 students or 43 percent of current enrollment. Given current levels of support from Federal, state and local governments (around US\$17.1 billion per year,¹⁵ or on average US\$254,000 per student) this would imply an increase in government support by US\$1.9 billion per year. Moreover since 1990, only one new medical school has been opened in the US and first year enrollment has increased by only 300 students. Even if one new US medical school opened every three years starting in 2005 with an average intake of 500 students, it would take 15 years to close the gap. Therefore, assuming the stream of applicants continues to grow, there would still be demand for offshore medical education in the medium-term.

7.45 On the other side, based on current trends in retirement and changing demographics of the physician stock, the US will need to replace 18 percent of physicians due to retire in the next few years, as well as increase the number of physicians to offset the increasing share of female physicians. Although only 24 percent of active physicians are female, 48 percent of medical school enrollees are currently female. As such, there is likely to be continued high demand for international medical graduates as physicians in the US over the medium term. Of course, in the longer term, prospects for the sector will depend on how the US market responds to the shortages in medical education.

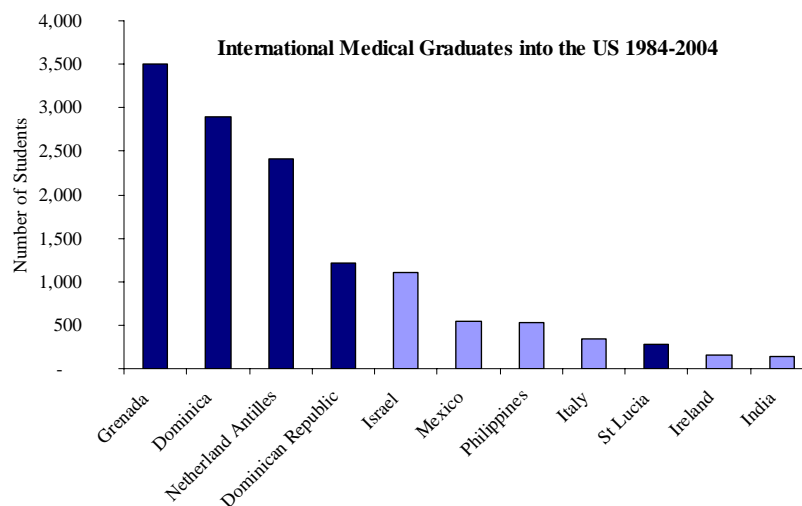
7.46 **The OECS has already demonstrated a comparative advantage in the area of off-shore education.** Seventy percent of the international medical graduates entering the US between 1984-2004 have been from the Caribbean offshore medical schools. Currently, there are an estimated 11,000 offshore students enrolled in these schools, half of which attend schools in the OECS. Indeed, the two largest medical schools serving the US market are in Dominica and Grenada.

¹³ More than one third of all international medical graduates are on exchange visitor visas, requiring them to return home for at least two years before applying to reenter the US.

¹⁴ Swedish Development Advisers (2004).

¹⁵ Ibid.

FIGURE 7.2: INTERNATIONAL MEDICAL GRADUATES IN THE US, 1984-2004

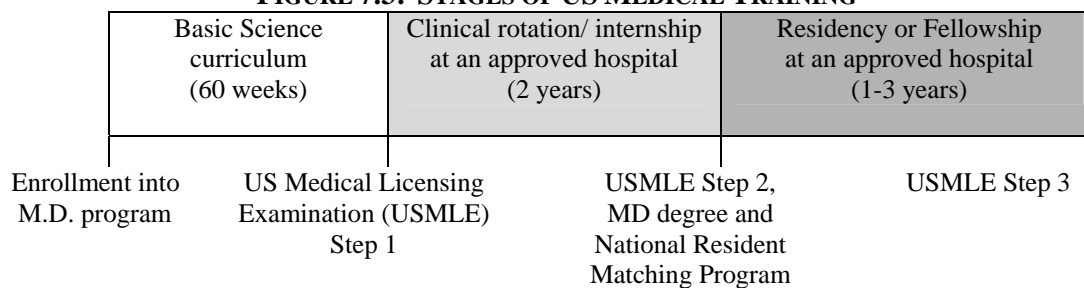


Source: Swedish Development Advisors (2004).

7.47 Moreover, there has been an increase in investment in this area in recent years. Of the 23 primarily¹⁶ offshore medical and veterinary schools in the Caribbean, four were established before 1990, seven between 1990 and 2000, and twelve in the last four years. The sub-region is attractive to investors because of location, language, and security, meanwhile the programs are attractive to students because of the lower cost and shorter time to completion compared to US medical schools.

7.48 **The business model.** The offshore medical schools in the Caribbean are all geared to the US market. The main difference between the US medical schools and offshore medical schools are the latter only offer the first two stages in the training of physicians for the US market (see Figure 7.3) – with the first stage provided in the Caribbean, and the second stage completed at a US hospital – and they are established as commercial, not not-for-profit, ventures.

FIGURE 7.3: STAGES OF US MEDICAL TRAINING



7.49 Accreditation requirements (a state-level function) for US medical schools include notably that they be not-for-profit institutions, associated with a full service university, and have established research programs for both faculty and student participation, and maintain a full service hospital. This latter requirement substantially raises the costs of establishing such schools. Funding comes mainly from medical service revenues (50 percent), government support

¹⁶ The Caribbean has 37 medical schools registered with the WHO, but those in Trinidad and Tobago (1), Jamaica (1) and the Dominica Republic (9), and one of the schools in Guyana, cater primarily to domestic or regional students.

and research grants (21 percent), endowments and charities (16 percent), with very little from tuition and fees (3 percent).

7.50 It is significantly less expensive and easier to establish an offshore medical school in the Caribbean where accreditation requirements do not include research programs, full service universities or hospitals. The schools are accredited by local institutions, which in turn may be reviewed by the US National Committee of Foreign Medical Education and Accreditation (NCFMEA) but only for eligibility in federal student loan programs.¹⁷

7.51 Because the schools concentrate on basic sciences instruction and contract out clinical rotations to US hospitals, they forego the investment costs of research, hospital and clinical facilities. Faculty salaries are lower because they are not required to engage in research, and many are on short-term contracts. The teaching staff is a mix of older experienced MDs or PhDs who have practiced or taught medicine in the US, or younger physicians who want to live in the Caribbean for a short period. None of the schools interviewed indicated any difficulties in recruiting teaching staff. Operating costs are also lower, because of lower costs of living in the Caribbean, and of non-medical staffing. Finally, the schools are able to boost revenue by taking in a new batch of students each trimester, rather than each year as is common in US medical schools. Rough estimates based on survey information of the profit margin for a small school of 100 students in the Caribbean are on the order of 28 percent before taxes and financial charges.

7.52 As such, the offshore schools can compete with US schools by significantly reducing the cost and duration of medical training to the students. Tuition runs between US\$10-40,000 per year compared with private and non-state resident tuition of US\$34,000 per year. Most have shortened the instruction period for the basic science curriculum by running trimester, instead of semester, systems with no summer break.

7.53 In order to attract students, the schools prepare students specifically for the US Medical Licensing Examinations (USMLE) and arrange clinical rotations at US hospitals, regardless of the local accreditation requirements. Indeed, many of the local accreditation bodies were developed specifically to facilitate these investments. The USMLE pass rates for a subset of the schools surveyed, including the two largest, are as follows:

TABLE 7.5: OFFSHORE MEDICAL SCHOOL USMLE PASS RATES

	Number of schools
Pass rate 90% or above	3
Pass rate above 80%	2
Pass rate below 80%	1
Information not provided	3
Total	9

7.54 In addition, the New York and California state medical boards, which oversee a large number of residency positions, do accredit foreign institutions – the two largest schools in the Caribbean have been accredited by the NY board which allows their students to compete in residency programs in other states as well.

TABLE 7.6: COMPARISON OF US AND OFFSHORE MEDICAL SCHOOLS

US Medical Schools	Offshore Medical Schools
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¹⁷ In the Caribbean, the Cayman Islands, Dominica, the Dominican Republic, Grenada, Monserrat, Saba, St. Lucia and St. Maarten have been accepted by the NCFMEA as having appropriate accreditation standards for this purpose.

	US Medical Schools	Offshore Medical Schools
Programs	Offer several degrees and subjects	Offer only MD degrees.
Academic calendar	<i>School year:</i> 2 semesters per year <i>MD program:</i> 6-7 yrs	<i>School year:</i> 3 semesters per year. <i>MD program:</i> 4-5 yrs
Accreditation agencies	LCME in the US CACMS in Canada.	National accreditation agencies, in turn reviewed by NCFMEA
Accreditation requirements	<ul style="list-style-type: none"> • Not-for-profit organizations only • Affiliation with full service university • Research program • Financially independent board • 130 weeks of instruction • Evaluation system in place • Placement services for residency programs • Financial aid programs and debt counselling • Provision of health services & insurance to students 	<ul style="list-style-type: none"> • For-profit organization allowed • Affiliation to university not required • Research program not required • Private company boards • Generally, 60 weeks of Basic Science instruction <i>in situ</i> plus 80-100 weeks of clinical rotations in the US/Canada • Many rely only on USMLE results for evaluation • Few have placement systems but most help to organize clinical rotations in US/Canada • Some schools are eligible for US Federal loan programs • Some have health clinics, most do not provide health insurance
Student pop	Avg age: 24 years GPA: minimum 3.6	Avg age: 27-30 years GPA: average 3.0 40 percent from other medical professions. 20 percent apply directly
Student teacher ratios	3.4 : 1 reflecting LSME requirement that teachers also do research	9-13 : 1 more on par with US liberal arts programs
Tuition costs	<i>Private/non-state residents</i> US\$34K/year <i>Overall cost:</i> US\$180-250K for 6-7 yr prog	<i>Tuition:</i> US\$10-40K per year. <i>Overall cost:</i> US\$50-200K for 5 yr prog
Finance	<i>Avg teaching salary:</i> US\$110-160K <i>Financing:</i> Tuition and fees 3% Medical services 50% Govt (federal, state and local) 10% Federal research grants 21% Other (endowments, charities) 16%	<i>Faculty salary:</i> US\$36-90K <i>Financing:</i> Tuition and fees, only Estimated profit margins: 28%

Source: Swedish Development Advisors (2004).

7.55 These lower thresholds and high profit margins have allowed for more entry and competition. Following the model of the earlier schools, there has been a steady increase in entrants to this market over time. Investments have generally been undertaken by groups of physicians and entrepreneurs intending to reap a profit. More recently, however, institutional investors have gotten involved, with the purchase of Ross University, first by venture capitalists and then by DeVry Inc., one of the largest publicly-held higher education companies in North America.

7.56 **In relatively small economies, a number of smaller offshore medical schools or a large one could have a potentially large impact on the local economy.** All the surveyed offshore medical schools are registered as for-profit educational institutions in each of the countries where they are located, however FDI incentive regimes allow for tax holidays and duty concessions, and repatriation of profits, dividends and imported capital. The regimes vary not only across countries, but also between schools in the same country. In all but two of the countries surveyed, the schools were exempt from corporate tax, whereas in others, schools enjoyed concessional income tax rates. Foreign instructors are also generally exempt from local income taxes and all the schools received either reduced duty, or duty exemptions on imports of intermediate goods. Instead, most countries levy an annual per student tax or fixed annual fees on schools, but these also vary by country and institution. The annual fiscal yield ranged from US\$50,000 to US\$300,000 per year. Recognizing the non-transparent and discriminatory treatment of different schools, one country reported plans to harmonize the tax treatment across institutions.

7.57 Estimates of annual spending by students range from US\$6,500 to US\$21,000 for the countries surveyed. The surveyed schools employed some 710 local staff, paying higher than average wages in the domestic market. The ratio of local non-medical staff to students ranges from 1-30, decreasing for the larger schools. The smallest schools typically have more persons employed in the US tasked with recruitment, enrollment, marketing and finance. As they grow, these tasks are often transferred to the islands, but the employment benefit is offset by the reduced ratio of local support staff to students.

7.58 **Overall, the estimated direct impact on the economy ranges from 0.2 percent of GDP in St. Lucia to 8.3 percent in Dominica. The indirect impact however is substantially large.** First, the schools have an impact on local health care institutions to which they provide a range of support in terms of financial and equipment donations in exchange for clinical exposure for their students, and incidental training for local medical professionals. Most of the schools offer a few scholarships to local students. One school has diversified into other areas of post-secondary training and is targeting the local and regional tertiary education market which is notably under-served.

7.59 **The growing number of schools being established in the Caribbean (including by DeVry) is evidence of the market's outlook for further potential for growth in this area.** Lobbying and accrediting agencies in the US and Canada have begun to take notice. New entrants are beginning to differentiate their instructional approaches – one school has started a distance learning program, while another is focusing on a holistic approach to training a “good” doctor with links to similar-minded clinical and residency programs in the US. Older entrants have achieved direct accreditation by state medical boards and established reputations that allow their graduates to enter competitive residency programs in the US. However, the growth encouraged by strong demand and the low entry requirements (both in terms of finance and accreditation) has been accompanied by increased churning as some new entrants succeed and others fail. This can risk damaging the reputation of a country if one operator misleads students and provides sub-standard services.

7.60 **Countries can encourage the appropriate types of investments by raising accreditation standards to allow for NCFMEA, federal loan program, and key state board accreditations.** This may also help to diffuse negative attention from US associations that may lobby for expansion of domestic education in response to challenges on quality. Costs of an accreditation body could be minimized by supporting a regional, rather than national, accreditation agency.

7.61 Second, given the demonstrated supply of investors, it would be unfortunate for the OECS, as well as the other Caribbean countries, to engage in tax competition to attract entrants. **A harmonized, transparent and non-discriminatory investment regime would be more appropriate to position the sub-region for continued flows of investment.**

7.62 **Finally, the sub-region needs to strategize on how to build on its success in this area to maximize the impact on the domestic economy and the local provision of training, but also expand offshore education exports into other related areas.** US imports of education services have been growing on average at 11 percent per year since 1984. The emergence of an English training cluster is a notable development in this regard.

C. ICT clusters

7.63 **An important distinction to be made is between ICT as an *output sector* and ICT as a *technology* that enables the production of other goods and services in the economy.** The former focuses on production of direct ICT goods and services, such as Business Processes Outsourcing services, call centers, software development and production, communication services and telecom/computer equipment production. The latter emphasizes the adoption of ICT technologies throughout the economy and calls for attention to the development of appropriate infrastructure, expansion of ICT skills and services, the introduction of e-government, and a broadly enabling environment including such elements as a legislative framework for e-commerce.

7.64 **Throughout the Caribbean and in the OECS, ICT as an output sector has been, and is being, over-relied upon to be a major source of growth in the coming future.** Most of the efforts to trigger the development of ICT sectors have failed to live up to expectations. There are some good reasons for this, particularly the choice of low wage-centric clusters such as call centers, and the failure to link foreign investment to local skills and generate spillovers. This section focuses on the experiences to date with trying to develop ICT and ICT-related services as an output sector in the OECS and the broader Caribbean and extracts some of the lessons for the way forward. In Chapter 6, ICT as a factor of production is covered in Section A and telecom infrastructure is covered in Section C.

(i) Call centers and offshore business processes¹⁸

7.65 **The outsourcing of business processes to the Caribbean began as early as the 1980s** when US companies started looking for low cost markets nearby. The Caribbean did manage to become a hub for a near shore data processing industry coming out of the US. Notably American Airlines established its data processing services in Barbados (see Box 7.2). However, when the US companies began to face lower cost pressures, business fled to low wage countries like India and the Philippines. At the same time, the market began to open up for higher valued-added services that were more complex and required staying at the cusp of technological innovations. In general, the Caribbean was unable to keep up with skills and infrastructure requirements and was unable to compete for these new lines of business.

¹⁸ This section is based on a report prepared by the consulting firm, OTF Group, Inc., for the Information Development Program (*infoDev*, www.infodev.org), a consortium of public, bilateral and multilateral development agencies including the World Bank, and assisted by an expert secretariat housed at the World Bank.

BOX 7.2: AMERICAN AIRLINES' DATA PROCESSING OPERATION IN BARBADOS

In 1981, American Airlines assessed different locations to place a wholly owned subsidiary devoted to data processing services (payroll reports and checks, frequent flier database management, customer queries and upgrades). It decided to invest in Barbados for the readiness of the workforce for training, the work ethic, the stable environment and of the proximity to headquarters. At the peak of the business in 1998, the company, known as Caribbean Data Services, employed 1,500 Barbadians. The operation became so successful that it started servicing other big US companies like AT&T and Blue Cross/Blue Shield and opening subsidiaries in the Dominican Republic and Jamaica. By end of the 1990s, the company employed more than 3,500 people in the Caribbean.

However, Caribbean Data Services was not able to survive the technological transformation of the industry or to take its services to the next level of complexity. As data processing began to rely more on the use of the internet and online transactions, telecommunications costs in Barbados became prohibitive for this type of business. At the same time, the client companies were also facing increased pressure to reduce costs. Once countries such as India, China and the Philippines with an abundance of cheaper labor made a full-fledged entrance into the business, the Caribbean could no longer compete and eventually the operation closed. Notwithstanding the low wage competition, the company and the country did miss an opportunity to make a strategic shift to more value added services in some core competencies, such as airlines, healthcare, tourism customer service, in part because of the poor technology platform and high costs of connectivity.

7.66 Almost every Caribbean country has experimented with call centers. The OECS embraced them as potential unemployment buffers, and some governments offered to fund training, engage in joint ventures, provide fiscal incentives or straight subsidies to both local and foreign operators. Despite the use of basic technologies (telephony), many foreign companies demanded generous concessions promising spillover effects. Whereas the governments supported call centers in Jamaica, Antigua and Barbuda and the Dominican Republic, these activities did not receive preferential government support in Barbados and St. Lucia.

7.67 Wide-scale unemployment absorption was either not achieved or was not sustained, in general because countries had positioned themselves at the wrong end of the market. There are basically two types of call centers operations: telemarketing and customer care. Telemarketing involves outbound calling to sell products and services and receive commissions on sales closed. Typically, a call center will purchase call lists is paid by a credit card company based on how many credit cards are sold. Customer service centers mostly do inbound calls answering concerns and solving customer problems. In the OECS, the early emphasis was on telemarketing and low-end customer service as a means to reduce widespread unemployment among the less skilled workers. This business generally competes on low labor and low connectivity costs. Because of the relatively lower wages and the commission-based system, workers in the OECS attracted to the call center business saw it mainly as temporary employment where they could gain “hands-on” IT experience. Employee turnover was high resulting in transient customer relationships and higher training costs and thus high costs to close sales. Add on the high telephone rates for outbound calls (see para. 6.59), and the call centers were unable to produce the margins required by US firms. The case of Call Centers Antigua Limited (see Box 7.3) is illustrative on a number of these points.

BOX 7.3: CALL CENTERS ANTIGUA, LIMITED

Call Centers Antigua Limited (CCAL) was a joint venture between the Government of Antigua and Barbuda and Caribbean Information Technologies established to provide employment and exposure to IT skills. The government invested EC\$ 3 million for a 40 percent stake to pay for the initial investment in computers and training. The center, which started operations in February 2002, held approximately 400 stations equipped with networked computers. At full capacity, it was projected to hold 850 agents.

The hope was that skilled labor could be sourced from the large pool of Antiguan unemployed workers. However, compared to wages in the rest of the economy, the call center at US\$110-150 per week was not such an attractive employment option (manufacturing jobs paid close to US\$200, and high tech jobs in gaming industry were US\$750/ week). Furthermore, these wages were based on sales closed as is the case with most telemarketing centers. The closing rates were much lower than those in other regions of the world, such as India and the Philippines.

At these wage levels, employees regarded this work as transient employment and the call center became the temporary holding place for those in-between jobs, looking for better opportunities. There was low employee morale and high turnover, and a strong inclination, particularly among young people, to pursue a higher level of computer literacy. Hence, as employees became more computer literate, they sought employment in other fields of work since within call centers there was not much opportunity for upward mobility. Within that environment, the most ambitious and entrepreneurial young people had the incentive to move on to more satisfying jobs and positions. The CCAL call center reached close to 200 job at its peak, but has since closed operations.

7.68 Despite recent examples, there are viable opportunities in the call center business, if the OECS can re-enter at the high end of customer service for larger US companies, instead of continuing with the low-cost telemarketing model. Whereas the earlier pressure on US firms was to lower costs, quality of customer service is fast becoming a key source of differentiation in the market place. For instance, in 2001 the worldwide customer care industry was estimated to represent a US\$34.9 billion market; experts project the market will exceed US\$90 billion by 2006.¹⁹

7.69 The advantage of higher-end customer service accounts is three fold. First, the business is usually based on longer-term contracts (2 years plus) because the call center has to make greater commitment in training which focuses not only on customer service skills, but also on the company products, policies and procedures, and generally involves more sophisticated software applications. This supply of training in technology and customer service could have spillovers both in the hospitality industry and the broader economy. Second, the call center employees generally become part of the outsourcing company, improving motivation and reducing turn over rates. Finally, because large companies and their clients tend to have more direct contact with their customer service operations offshore and thus visit more often; the proximity of the Caribbean and the cultural affinity to the US is a comparative advantage.

7.70 Establishing cyber parks is another option that has been considered as a means to attract ICT clusters to the OECS. Unfortunately, many governments have seen cyber parks as simply the development of an industrial park with high tech connectivity, with the mentality of “if we build it, they will come”. However, successful parks, such as the ones in Taiwan, Indonesia, Malaysia and the Philippines, are established to spur the development of high-tech industries by integrating technologically modern facilities with technical training, education and research centers, business incubators and other support services. Their development requires a long-term commitment to provide the expensive infrastructure, establish the learning institutions, and attract the skilled management to integrate the many components. The experience of prospering cyber parks throughout Asia shows that it can take up to 15 years for the model to fully develop to a stage where all of its components are pushing towards a common objective - to enable innovation and increase competitiveness through cooperation. In the earlier stages, complementary institutions may not be an immediate necessity to attract initial investment, but as these supportive components develop, so do the types of businesses within the park and the human capital it employs. In the Caribbean, Barbados has pursued a private-sector led approach where

¹⁹ InfoDev (2005).

private entrepreneurs have invested in high-tech conference centers and industrial parks at the request of international interests, whereas Trinidad and Tobago is currently constructing a cyber park. The most notable experience in the region is in the Dominican Republic, where the government's experiment cost US\$ 30 million, but failed to live up to expectations due to wavering political commitment and inconsistent management. **As such, the decision to establish a cyber park needs to be a *strategic one* that is integrated into a clear vision of where the economy is headed, and a detailed understanding of competencies and infrastructure needed to get there.**

(ii) Internet gaming in Antigua and Barbuda

7.71 **Antigua and Barbuda's development of the internet gaming industry shows the potential for the OECS to make strategic inroads into ICT-enabled clusters.** Antigua and Barbuda's government approached this sector as an opportunity to compete in a growing business worldwide. The internet gaming sector has around US\$6 billion in sales worldwide and continues to grow – especially in Asia, where Australia is a big player. Antigua and Barbuda positioned itself carefully to enter the industry early on, based on the comparative advantages of having a population with solid communications skills and in the same time zone as its main US market, which up until then was under-served. The development of the industry was undertaken in a very proactive manner. Even more importantly than the fiscal incentives provided to attract firms, the government took the necessary steps to establish the right enabling environment. In internet gaming this meant putting in place a strong regulatory environment that would allow firms with the cover of being in a reputable environment. The country invited experts from around the world and studied legislation in major gaming markets like the UK and Australia. The result was a well-regulated environment whose seal of approval has become a stamp of credibility in the industry and attracted companies to Antigua and Barbuda despite higher licensing fees and in many cases higher wages. Licensing fees range from US\$50-80,000 and involve an in depth due-diligence process, compared with Costa Rica that offers fees as low as US\$800.

7.72 The industry grew quickly and successfully. During 1996-2000, it provided US\$25 million in revenue for the government. In 2000, there were close to 100 firms operating in Antigua and Barbuda. Firms were moving to Antigua and Barbuda from other locations where the environment was less favorable, for example Austria which had changed its rules to allow only state-owned players in the sector. In line with international regulations, companies are required to keep their servers on the island and so they employ highly skilled engineers, web-designers, customer service representatives, etc. Salaries are relatively attractive, paying US\$15-18 per hour. Further, companies generally invest in training. The demand has spurred the development of a local training institute, with spillovers to the local economy. Despite the negative societal connotations, young IT professionals are eager to take jobs in the gaming industry and there is low turnover, because aside from the pay, "it's much more fun to be in a laid back atmosphere, watching the NFL games, dealing with customers, than working in a bank", according to one manager.

7.73 **The industry continues to face some challenges – one being high telecom rates.** This has prompted Antigua and Barbuda to move quickly on joining the Eastern Caribbean Telecom Authority (ECTEL). Notwithstanding the high charges, the private telephone company has been cooperative in upgrading their equipment to manage the increased traffic brought by gaming companies. **A second issue is the operations of customs,** which can delay the delivery of servers and IT equipment for weeks.

7.74 **The development of the industry has not been without setbacks.** The government made some mistakes in the past, but demonstrated quick resolve to correct them. The first was the introduction of a 3 percent tax on gross earnings which caused massive exit and was later rescinded. This experience is similar to that of the UK which imposed a similar tax only to rescind it when many operators moved to Gibraltar. The second mistake was the decision to introduce a black box into every operator's servers so that all betting transactions would be monitored by the regulating agency. This interfered with transactions speed and reduced enterprise productivity significantly, but was eventually reversed. More recently, the US imposed a restriction prohibiting credit card transactions for online betting which severely reduced revenues. Antigua and Barbuda challenged this restriction in the WTO and in August 2004 won an important victory. Negotiations with the US are underway to reach a solution. The collaboration between the Gaming Commission and the industry on the WTO case is a good example of how the government can work with the private sector to solve the problems of the sector, enabling continued growth and competitiveness. It is also a good example of how the rules-based trading system of the WTO can work to the benefit of small states.

(iii) Software development

7.75 **The computer software industry is a fairly new and fragmented sector in the Caribbean.** Some of the first firms sprang up during the mid-1990s as a natural extension of back office business data processing. The majority were foreign owned companies, outsourcing part of their software engineering process to the Caribbean mainly because of the incentives provided by national governments. Most operated under the offshore jurisdiction, receiving favorable tax treatments and other enticements for setting up shop. The two major players were Barbados (in areas such as coding and abstraction) and Jamaica.²⁰ However, this was not supported by a comprehensive strategy for the development of the industry. The experience of one firm in Barbados (see Box 7.4) illustrates that fiscal incentives are rarely sufficient if there are other underlying constraints related to the business environment facing the sector.

BOX 7.4: HIGH TELECOM COSTS HINDER THE SOFTWARE DEVELOPMENT INDUSTRY

PRT Ltd was one of the first software development companies in the Caribbean. This US company set up operations in Barbados in 1996 and employed close to 300 Indian programmers to develop software for companies such as JP Morgan and Prudential Insurance. PRT was classified as an offshore company enjoying tax benefits and rent-free facilities. In turn, the company employed and trained locals and convinced the government to procure high performance communications equipment. One problem, although seemingly trivial, was a shortage of quality housing for such a large overseas workforce migrating to Barbados. The second was that telecommunications costs remained high. When the Internet bubble burst in the US, the company was forced to lower costs. Even though the Barbados Investment and Development Corporation managed to negotiate a 50 percent reduction in broad band charges by the private telephone company, the cost remained prohibitively high and the firm eventually closed its operations in Barbados.

7.76 **Recently, there has been a new wave of interest in the software industry in the Caribbean following the advent of Open Source Software (OSS).**²¹ OSS is advocated as an attractive option for developing countries because the programming code used to create software

²⁰ Cleland and Gomez (2003).

²¹ Open Source Software is software for which the underlying programming code is available to the users so that they can read it, make changes to it, and build new versions of the software incorporating their changes. Types of Open Source Software differ in the licensing terms under which altered copies of the source code may be redistributed.

is available for inspection, modification, re-use, and distribution by others;²² hence software applications can readily be adapted to address local needs and are often cheaper than established off-the-shelf software. For example, a start-up gourmet delivery company in the Dominican Republic had a local programmer create CRM and logistics back end system customized to its customer base for less than one tenth of the price of established off the shelf software. In turn, the software developing process and upgrading can also help cultivate domestic talent that flows into a local computer software industry serving both the private and public.

7.77 The OSS industry in the Caribbean is still quite fragmented. Most of these companies are sole proprietorships.²³ Currently, there are a lot of individual efforts and small scale businesses, but no one really knows what the other players are doing in the region. However, a few of these players are trying to foster collaboration throughout the industry to create a forum to share innovative ways in which OSS has been used, and to reduce the amount of duplication and replication across the region. Digisolv, Inc in St. Lucia is one such firm (see Box 7.5).

BOX 7.5: PROMOTING OPEN SOURCE SOFTWARE DEVELOPMENT IN ST. LUCIA

Digisolv, Inc is a software company in St. Lucia that provides networking and network-oriented solutions to private companies, governments and NGOs. The company started out in hardware sales but quickly moved to offering sophisticated ICT solutions using OSS. The company sees potential for growth in areas such as networking, business communication applications, email group work, scheduling, and document, content and project management. The main challenges include lack of awareness of the potential, a shortage of trained personnel in OSS-Linux operating systems, and financing. The company is currently organizing seminars with the trade associations in St. Lucia to raise awareness and throughout the region to bring together businesses and individuals working on OSS.

7.78 These types of initiatives taken by the private sector are generally a much stronger signal of the potential of an industry than “feasibility studies” prepared by donors and government officials. **As such, mechanisms for identifying and supporting similarly innovative and proactive entrepreneurs should be an important part of the government’s private sector development strategy.**

D. Health and wellness services

7.79 Some emerging trends in the OECS point to potential for joining the growing cross-border delivery of health and wellness services worldwide. These trends include: (i) an increasing number of hotels offering spa and wellness services including the world class facilities, Le Sport spa in St. Lucia and the Crossroads Center in Antigua and Barbuda providing spa, wellness and rehabilitation services (see Box 7.6); (ii) a steady stream of medical professional recruits to North America; (iii) the offshore medical education sector; and (iv) the proposed private development of a regional nursing training school in St. Kitts and Nevis.

BOX 7.6: WORLD CLASS WELLNESS FACILITIES IN THE OECS

Le Sport Spa Resort in St. Lucia is one of the world’s most acclaimed health spas. European readers of Condé Nast Traveller recently named Le Sport the number one destination spa in the world and one of the 100 Best of The Best in Travel. The resort’s main offering, the Body Holiday, combines a beach vacation with the personalized aesthetic and spa services ranging from yoga, Tai Chi, meditation, aerobics, stress

²² InfoDev (2005).

²³ Data on the number of firms operating in this sector does not exist, and information pertaining to the ICT sector overestimates the number of companies since it includes a wide range of operations from telemarketing to IT training to more sophisticated business segments.

management, fitness with personal trainers, stress and tone classes, aromatherapy, hydrotherapy, thalassotherapy, Swedish and Shiatsu massage, ayurvedic treatments, acupuncture and acupressure, reflexology, and skin clinics. Le Sport caters primarily to couples, but has facilities for families and those traveling alone. Le Sport targets the European market, primarily UK and Germany. It is owned and operated by a St. Lucian family under the Sun Swept Resorts which also has facilities in the US, Canada, UK and Europe. Staff is primarily from St. Lucia and the Caribbean and has received training in treatments and therapies. The facility has 154 rooms and relatively high occupancy rates.

***The Crossroads Center** for drug and alcohol rehabilitation in Antigua and Barbuda was established by Eric Clapton in 1998. It has since developed into an internationally recognized Treatment Centre of Excellence, providing services to individuals and their families suffering from addiction. The Center utilizes a combination of effective therapies to address addiction and recovery. Individuals participate in a structured 29-day residential 12-step based program, developed by Alcoholics Anonymous, which allows clients to experience a whole person wellness approach to recovery. Roughly 70 percent of its clientele is from the US, Canada and Western Europe. The Clinical staff is trained and licensed to practice overseas (either the US or UK). In terms of treatment and lodging, the facility is on par with some of the best centers in the US, such as the Betty Ford and Hazelden centers, but costs much less at about US\$14,500 for the month-long inpatient program inclusive of lodging. An equivalent program at a Betty Ford or Hazelden center is about US \$21,000. The center strives to maintain a high staff to patient ratio. The cost advantage of Crossroads is attributed to lower health-care worker costs in the Caribbean, and the fact that the organizational structure of Crossroads is a lot more simple and streamlined. For example, since admissions at Crossroads are pre-paid, there is no need for an accounts receivable department.*

7.80 It has been estimated that by 2005, the global health services sector will amount to US\$4 trillion, and that the value of health services exports will be approximately 5 percent of that market or US\$140 billion. Expected growth in exported health services (Mode 4) is estimated to be six percent annually, but given the growth in information and communications technology and greater openness of health systems, trade in health services including Modes 1 and 2 may in fact grow at much higher rates.

7.81 **The OECS has several characteristics which make it an appealing destination for visitors seeking offshore health and wellness services.** These include its proximity to North American and European markets; climate and natural environment; a steady supply of well-trained health practitioners; lower cost labor; reasonably reliable telecommunications and transport services; a well-developed hospitality sector; and an established health and medical service sector with both public and private operators.

7.82 The approaches that countries have taken with respect to fostering trade in health services can be grouped into three categories. The first, a *government-led* approach, is based on a national policy or strategy of export-promotion to pursue medical or health tourism as a means of generating needed revenues for the health sector. Countries such as Cuba, Jordan, and Singapore provide examples of such approaches. In the second, a *private-sector led* approach, countries have left development of medical tourism to private entrepreneurship, with governments developing the legal and regulatory enabling environment necessary for private investment and private sector expansion. India is an example of this approach. Finally, Latin American and East Asian countries have both adopted national policies or strategies and also have expanded private sector growth in this area (mixed).

7.83 Notwithstanding the above, the range of services that could be developed will depend upon where the private sector sees the most potential for profitable business, and how the public sector regulates these activities. There is good potential for expanded trade in rehabilitation and addiction services, as well as alternative and complementary medicine. The expansion of spa and wellness tourism services can be implemented without drawing too heavily on the pool of skilled

health professionals. Medical tourism, however, will be limited by the availability of adequate referral and skilled staff, and the quality of secondary care. Because the OECS countries do not have large private health sectors nor excess capacity in public health systems, it is likely that any growth in health and wellness service exports will evolve initially through the tourism sector and the wellness and spa business.

7.84 There are a number of constraints and issues that would still need to be addressed with public sector involvement:

7.85 **One overarching issue will be to avoid the development of a dual and inequitable health system with enclaves of high quality health facilities catering to foreign visitors, at the expense of the national health system.** Just as with the offshore medical schools, there may be a need for explicit linkages between the private and public health sectors, and between state-of-the-art health services and community health needs.

7.86 **The second issue would be to address any skills shortages.** Distribution of human resources between primary and secondary care is of concern, as is shortage of health professionals in general. Migration and retirement of staff have left a large void. Increased trade may induce repatriation and retention of health professionals to work in joint private sector ventures. There may be scope for offshore training facilities to provide staff for local markets. The experience of the offshore medical schools shows that the OECS does not face any particular difficulty in recruiting overseas physicians to work in the islands, provided remuneration is competitive. While the quality of nurse training in the OECS appears to be adequate as evidenced by the steady training-recruitment-migration path for nurses, the overseas opportunities could raise reservation wages for trained nurses in the OECS, eventually offsetting some of the cost competitiveness in this sector. Greater flexibility on intra and inter-regional mobility of health professionals would help to mitigate some of this effect.

7.87 **In the event medical tourism is pursued, licensing and accreditation for medical services will have to be strengthened in order to satisfy the demands of the discerning health tourist, to safeguard residents who may access new private services, and encourage coverage of overseas services by insurance companies and other third parties.** The OECS should support and fully participate in ongoing regional efforts in this area, with the support of the Caribbean Association of Medical Councils, nursing bodies and the Joint Commission International.

7.88 **Increasing the portability of health insurance both within the Caribbean and from beyond can provide impetus to the sector.** At the moment, few health insurance plans offer coverage for non-emergency medical treatments overseas. This would limit the market to those who can afford to pay out of pocket. Discussions with operators in the insurance and care management organizations suggest that innovations in case management across international borders may be lessening this problem. In addition, the OECS countries may want to ensure that this issue is adequately addressed in the FTAA negotiations.

7.89 An appropriate legal framework for medical liability and consumer protection would have to be established to safeguard both practitioners and patients. However, care should be taken not to replicate the shortcomings of the current US system, as this would further reduce cost competitiveness.

7.90 **Other recommended measures include:**

- Facilitate public-private sector partnerships. There is a need to provide support to local entrepreneurs in development of viable business plans for expansion of spa/wellness services, and in development of public-private partnerships, including careful market analysis.
- Generate linkages with care management companies, such as the Canadian Medical Network/Care Management Network National which will reduce search costs for potential consumers and provide a mechanism for reimbursement and financing.
- Strengthen marketing of health tourism in the UK, North America, and Asia. The Caribbean might be informed by the experiences of other countries with health tourism, particularly from the Apollo Health Services in India which caters to both national and international consumers.
- Develop indicators and a tracking system to monitor development of this sub-sector. Because of the dearth of information regarding the number, origin, expenditures, and characteristics of tourists who may be coming to the Caribbean for health and health-related services, it is highly recommended that a tracking system be developed and implemented, either by CARICOM, with the support of the Pan American Health Organization (PAHO) and the Caribbean Development Bank (CDB) or other appropriate regional agency such as the Caribbean Tourism Organization (CTO). As part of this effort, it may be useful to establish a health tourism desk at the national level to collect and evaluate data.

E. Offshore financial services

7.91 **While the offshore financial sector has yielded sizeable revenues for the OECS countries in the past, the sector has declined in most countries since the late 1990s.** This decline was initiated by the cyclical downturn in the financial markets in the late 1990s and then exacerbated by the increased international scrutiny on offshore financial flows from the OECD Financial Action Task Force and others, and then again following the terrorist attacks in the US in 2001. This decline combined with the increasing cost of regulation and supervision has motivated several OECS countries to actively re-think whether to maintain these sectors. However, little analysis has been done on the impact of the sectors beyond the contribution of registration fees to government revenues.²⁴ One additional consideration is that having an offshore financial service regime complicates the negotiation of bilateral tax treaties that may encourage onshore foreign investment.

²⁴ Fees paid to government are captured in the balance of payments accounts. In addition, there is an attempt to measure payments made to local service providers as well in the balance of payments. National accounts statistics only captures data on domestic investments of offshore entities.

TABLE 7.7: OFFSHORE FINANCIAL CENTERS

	Banks	IBCs*	Trusts	Mutual funds	Insurance companies	Max % of current revenues collected during 1995-2000
Antigua and Barbuda	15	6,000	--	--	--	6.6 (1999)
Dominica	1	8,000	--	--	--	5.2 (1998)
Grenada	44	3,400	11	--	--	4.6 (2000)
St. Kitts	1	13,800	--	--	--	3.3 (2002)
Nevis	1	17,000	--	--	--	
St. Lucia	1	61	--	2	--	...
St. Vincent and the Grenadines	9	6,000	350	15	9	1.5 (2000)
OECS	72	54,000	360	17	9	3.6 (2000)
The Bahamas	200	117,520	n.a.	700	230	1.3
Cayman Is.	450	30,000	n.a.	2300	500	14.6
Br. Virgin Is.	0	314,000	n.a.	2000	360	54.6

* International business companies.

Sources: Suss, Williams and Mendis (2002) and US Department of State (2004).

7.92 **With the exception of Nevis, none of the OECS countries have succeeded in establishing a significant market presence in any of the offshore financial services market segments.** Table 7.7 provides comparative data on offshore financial centers in the Caribbean. Among the other Caribbean jurisdictions, Bermuda dominates the global captive insurance and reinsurance markets; the Cayman Islands is a major player in offshore banking with over 450 banks, and has recently become the second largest captive insurance center; the British Virgin Islands is a significant player in the registration of international business companies (IBC) with over 300,000, followed by the Bahamas with around 120,000 IBCs registered.

7.93 **The general outlook for this segment is that, as OECD and other international efforts result in a tightening and harmonization of regulations regarding tax and other treatment, the demand will likely shift from tax minimization toward asset protection and regulatory arbitrage in the mutual fund and insurance business.** As such, any further growth in the market is likely to come from increasing complexity of the services provided to the holders of offshore assets, rather than simply in the volume of assets registered. In addition, some countries like the Bahamas are migrating from 'banner like' companies without a physical presence to "virtual headquarters" that requires trained staff using sophisticated interface to communicate with their client base. These types of services provide positive spillovers because of their demand of supporting staff, specialized software applications, and strategic and legal consulting services, among others. A number of OECS countries have also begun preparing for the introduction of offshore mutual fund administration and insurance services. However, these segments also demand a much higher level of skills in terms of services to be provided by local agents and ICT infrastructure, and require much more complex regulation and supervision infrastructure than the traditional offshore banking, IBC or trust business. Without the adequate regulatory capacity, jurisdictions run the risk of reputational events that could dampen future growth.

7.94 With the recent upward trend in international financial markets, there is some potential for a rebound in the offshore financial services sector on the volume side of the business. However, without strengthening the types of services offered in the OECS, offshore financial services are likely to remain at the current low end commodity-side of the market, which will continue to face pressure as international scrutiny and financial regulations tighten worldwide.

7.95 Given the increasing complexity of the business, any growth in the OECS offshore financial sectors will require a major expansion of accounting, financial and IT-related skills as well as improvements in the telecom infrastructure for data transmission. One strategy that has been proposed by several industry participants would be to concentrate on strengthening the current lines of business and to gradually climb the skills ladder as the required services become more complex. In this regard, attracting one of the larger branded multinational service providers, that has the capacity to offer the full range of quality services and could have spillovers in terms of capacity building, could be critical to support the expansion of the sector. Finally, industry participants have suggested that there is a need for more coordination between the governments' marketing strategies for the sector, and those of the service providers.