



**DOES OFFSHORE BUSINESS MEAN
ONSHORE ECONOMIC GAINS**

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Abstract: In recent years the prominence of the offshore sector has grown considerably, yet, national GDP estimates fail to account for activity in this sector. This has been mainly due to the deficiency in data on the offshore sector. This study attempts to bridge part of this gap by providing estimates for offshore banking output. Interestingly, estimates of offshore banks' GDP does not rely strictly on the number of banks licensed and bankers closely monitor conditions in the local economy, in determining the size of their operations. Overcoming challenges to the viability of offshore sector depends heavily on the timeliness and resources committed to ensuring that the competitiveness of the jurisdiction is maintained.

* This paper would have been severely lacking if not for the patience and assistance of the Central Bank's Supervision Department, the helpful comments of Mr. Venner (Ministry of International Trade and Business) and the cooperation of some offshore banks.

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1.0 Introduction

A number of factors ranging from favourable tax regimes and convenient regulatory frameworks, to the possibility of engaging in illegal activities including money laundering - promote offshore business. Offshore jurisdictions aim to attract business to gain access to international capital, technical expertise and skills, generate income and create jobs. For Barbados in particular, developing the offshore sector is also linked to aiding the diversification of the local economy.

The original intent of this paper was to (1) define and quantify the economic contribution and linkages of the offshore sector to the local economy (2) contrast these with forgone tax revenue and the administrative and supervisory expenses of having an offshore sector (3) to explore threats to the future viability of the sector. These intents were significantly altered by the severe data constraints encountered, thus, only objective (3) is fully achieved. Pending the development of a useful database on the sector, our focus was directed to the offshore banking industry and we were nevertheless able to address other relevant issues.

This paper is organized as follows: The growth and economic relevance of the offshore sector are outlined in Section II and Barbados' market structure and products are reviewed. Section III examines the offshore banking industry and GDP estimates for this industry are derived and analysed. The challenges facing the offshore sector are discussed in Section IV. Section V concludes.

2.0 Overview of the Offshore Sector

Offshore business refers to companies incorporated or licensed in a particular country, whose customers are nonresident located around the world. Offshore business and international business are terms used synonymously by the professional community. However, there is a distinction between international financial service companies and offshore business companies. The latter refer to businesses involved in manufacturing, processing, shipping, licensing and many other operations, while international financial service companies specialize in banking and nonbank financial activities.

The offshore sector is recognized for its foreign exchange earning capacity, promotion of technical expertise, skills and job creation. The process to establish Barbados as a low-tax international business centre can be traced back to the 1960's when the first fiscal initiatives were taken. As an international domicile, Barbados has been demarcated by its network of double taxation treaties with North America, some European countries, Venezuela and most recently Cuba. The provisions of these treaties allow for the exchange of information to ensure that tax obligations are met and provide tax advantages to users.

2.1 Current Economic Status of the Offshore Sector

Over the last five years the offshore sector has matured considerably. The number of licensed offshore companies has risen on average by 652 companies per year and at the end of 1998 there were more than 5,600 companies licensed in Barbados (see App. 1).

The majority (approximately 90%) of these companies originate from North America, primarily Canada.

Prospects for the sector are set against fluctuations in the establishment of new companies, experienced in 1996 through 1998 (see charts below). These statistics have raised queries as to whether the sector has reached its peak and is stabilizing. However, not only is it too early to deduce such, but our analysis is further limited by the inadequacy of data on the sector. What this speculation emphasize is the uncertain nature of offshore business and how responsive it can be to factors outside the local economy.

Since the early 1990's there has been strong growth in the two largest business entities, international business companies (IBC's) and foreign sales companies (FSC), which both doubled in number over the last five years.

Chart 1.

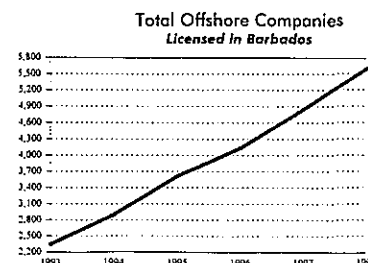
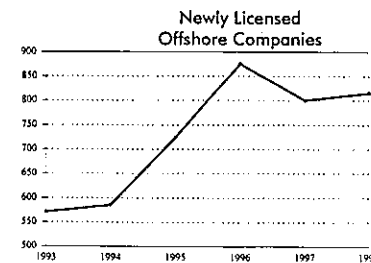


Chart 2.



These expansions gave rise to the formation of two associations of managers, the Barbados Association of IBC's and Offshore Banks and the Association of FSC Managers. The number of established exempt insurance companies has risen steadily over the years, but since companies have also been exiting the market, growth in this category has been sluggish. Growth in the establishment of exempt insurance management companies and offshore banks has also begun to slow. Nevertheless, licensed offshore banks are at an all time high and the societies with restricted liability continue to expand.

The prominence of the sector has been emphasized by steady growth in net foreign exchange earnings which averaged \$110 million between 1995 and 1997, second only to the tourism sector. Foreign exchange earnings for 1998 are projected to exceed \$120 million. Since offshore companies only hold foreign currency and are restricted from borrowing in the local financial market, funds spent on government taxes, labour and goods or services, are considered foreign exchange earnings for the economy (see Appendix 2).

Based on payments for corporate services and other administrative expenses, expenditure on goods and services accounted for almost half of the sector's foreign exchange earnings. Labour costs tend to represent 30-35% of an offshore company's budget, which includes payments to nationals and nonresident. Government taxes and fees account for 17-19% of expenditure.

This category rose significantly in 1996, as this was the highest year on record for newly licensed offshore companies. It is possible that Government's tax revenue is not commensurate with the administrative and supervisory costs of the offshore sector. Hammer and Brewer (1996) suggest that Government taxes and charges to the sector can be raised without any major risk to business. Table 3. presents a detailed list of the major expenses of offshore companies in Barbados.

Table 3.

Summary of Expenses of Offshore Companies

1. Salaries and Employee Benefits	
2. Staff Training	
3. Government Fees	Licences, Registration fees, Work permits, Stamp duties, Custom duties, Property tax
4. Public Utilities	Electricity, Water, Telephone, Fax, Courier and Mail services
5. Rent	Office and Residential properties
6. Administrative Expenses	Management fees, other Professional services (accountants, lawyers, bankers), Travel and entertainment expenses (on restaurants, taxis and hotels), Insurance payments, Repairs and maintenance, Data processing charges, Printing, Stationery and Advertising costs
7. Capital Expenditure	Purchase of Land, Buildings, Motor vehicles, Office furniture, Computers and Leasehold improvements
8. Miscellaneous Expenses	Other purchases from local companies and community donations

Actual data on job creation by the sector is not available. Using employment data in offshore banking and the information services industry, employment in the offshore sector is projected at over 3,000 persons. The offshore sector enables the transfer of skills, the development and expansion of information technology and provides a market for support businesses that service it. This paper concentrates on measuring gross output and ignores other economic linkages.

2.2 Entity Categories

International Business Companies: It is mandatory that IBC's incorporated in Barbados or be registered as an external company under the Company's Act. Any company engaging in local manufacturing and internationally trading its goods and services beyond the Caribbean, is eligible for the classification of an IBC¹. A 1998 amendment to the IBC Act made it possible for Barbadians to fully own an IBC. The diverse operations of IBC's range inter alia, from information services, electronic commerce and document archiving, to sophisticated software development. Since more than half of the offshore companies licensed are IBC's, the economic contribution of these entities is considered to be the largest.

Insurance Companies: Exempt insurance companies undertake to cover risks originating outside Barbados. These companies are exempted from taxes and must ensure that none of their shares are beneficially owned by Caricom residents. The solvency requirement for

offshore insurance companies is strictly governed by the Supervisor of Insurance. Captive insurance companies deal primarily with insuring their owners' risks. In Barbados, some of these companies have also concentrated on business in the international reinsurance market. It is mandatory that insurance entities be managed by an individual within the company or by a registered insurance management company. Exempt insurance management companies offer to maintain statutory and financial records, perform active insurance management and reinsurance contracts for their clients; in 1986 a Barbados Exempt Insurance Management Association was formed to liaise between Government and the industry.

Foreign Sales Corporations: Foreign sales corporations engage in the sale of export property with persons not resident in Barbados. The majority of these companies originate from the United States, because approximately 5% of the earnings from foreign subsidiaries are exempt from US federal tax.

Offshore Banks: Offshore banks may only engage in financial transactions and accept the deposits of nonresident. Licenses are vetted and approved by the Central Bank of Barbados. Oversight requirements attempt to promote the transparency of banks and adequate risk management, to ensure client protection. Shareholders' identities must be revealed under the Offshore Act of 1980 and changes in the bank's capital structure, approved. Audited annual statements must be submitted to the Central Bank, as well as

¹Source: International Interests, Ministry of International Business and Trade.

quarterly financial schedules. On-sight inspections are performed and efforts to improve the transparency of banks are ongoing.

2.3 Barbados' Market Structure

According to Hammer & Brewer (1996), the primary product groups in Barbados are:

- Canadian investors - who derive tax benefits from being listed in another territory
- US foreign sale corporations - who also derive a tax benefit from income earned abroad
- US Captives - the tax advantage for these companies was eliminated with the establishment of the Barbados/US tax treaty, nevertheless most of these companies have remained
- Information Services - which in the past relied heavily on the availability of low cost skilled labour

Barbados has created a niche of being a low tax jurisdiction with a highly trained English-speaking labour force. It is recognised as a pristine jurisdiction, which offers a level of confidentiality and flexibility but does not condone money laundering through extensive secrecy provisions. Its environment is touted for its availability of corporate services, political stability, modern infrastructure and telecommunication system. Efforts to safeguard the financial offshore industry are enforced by the Bank Supervision Department of the Central Bank of Barbados and service providers are expected to perform due diligence on clients to be aware of indications of illegal activities.

Tax savings remain one of the primary incentives for the establishment of offshore companies. Income tax credits of up to 35% of salaries are granted to persons working in the sector, as they contribute to the foreign exchange earning capacity of the economy. Imported plant, machinery, equipment and raw materials for the exclusive use of an IBC are not subject to any custom duties or other import charges. Taxes and duties for IBC's and offshore banks are chargeable on a sliding scale ranging from 2.5% on profits up to Bds\$10 million, to 1% on profits in excess of \$30 million. Exempt insurers, captives and insurance management companies are subject to zero tax for the first 15 years, thereafter taxation is charged at 2% per annum. Foreign sale corporations are exempt from taxation.

There are other legislative incentives for companies. Currently there is no restriction on foreign ownership of land or securities in Barbados, while some publications² refer to the relatively easy process of attaining work permits, especially for the information services industry. However, the high level of bureaucracy and the slow response time of some Government agencies has been criticized by industry officials as a hindrance to business operations. Even though Barbados has retained some restrictions on foreign exchange movements, these do not apply to offshore business.

²Schware and Hume (1996).

3.0 Offshore Banking

In the absence of data for the entire sector, this section concentrates on the economic contribution of the offshore banking industry. Offshore banking services are provided by 44 licensed³ institutions. Five of these account for approximately 85% of the industry. Many of these banks were licensed between 1995 and 1996, when IBC's operating as banks were required to license under the Offshore Banking Act. Appendix 3. depicts the billion-dollar magnitude of offshore banking and how it has changed over the last five years. Similar to the entire offshore sector, Canadian entities comprise the largest share of the offshore banking market. Retail banking which involves deposit taking, lending, electronic banking and credit/debit cards - is the main service of banks. Wealth management is also offered in the form of trusts, investment management, securities trading and to a lesser extent, propriety and private equity trading.

3.1 Local Expenditure in Offshore Banking

Annual local expenditure for banks was \$50 million in 1996 and expanded to \$61 million in 1998. Expenditure on professional fees and other administrative expenses related to management, travel and insurance ranged from \$13 - \$19 million. Banks employed approximately 169 individuals in 1998, 77% of whom were local personnel who received salaries totalling \$6.4 million. The ratio of local to foreign employees has remained

³Some of these banks are offshore units of local banks.

relatively constant over the last three years, but since most banks operate through offshore service companies or their local counterparts, employee numbers are somewhat low. Salaries in the offshore industry tend to be higher than that in the local market. In 1998 the average offshore banking employee earned \$56,600 per annum, 17% more than in 1996, while an employee in the local banking industry earned \$48,507, 27% greater than two years prior.

Capital expenditure on property purchases or leasehold improvement has risen in recent years, while expenditure on office rent remained in the region of \$1.5 million. Expenses on real estate and other fixed assets average approximately \$3.0 million and approximately \$2 million is spent on public utilities, inclusive of communication expenses. All banks are required to pay an annual licensing fee of Bds \$25,000 to the Central Bank of Barbados and this combined with work permit fees are the main Government fees incurred by banks. Remaining funds are spent on miscellaneous items.

3.2 Deriving Banking Sector Output

There are differing views on what output is actually produced by the banking industry and the methodologies which should be used to measure this output (Berger & Humphrey, 1992). Three of the most popular estimates are; the asset approach, the user-cost approach and the value-added approach. In order to avoid the measurement errors associated with the first two techniques, for the purposes of this paper the value-added approach is adopted as the most suitable methodology for estimating output.

The Asset Approach: Banks' liabilities can be characterised as inputs for lending activities and other investment activities. Under this intermediation service, loans and other bank assets can be considered as banks' output. In actuality, many banks raise funds through other financial services such as safety-deposit boxes, which are not accounted for under the asset approach, (Mamalakís, 1987). In circumstances where there is interbank lending, applying this approach can be problematic, since only commercial lending to clients is considered as banks' output. This can result in the output of some banks being underestimated.

The User Cost Approach: The user cost approach assesses whether a financial product is an input or output, based on its net contribution to bank revenue. When revenue generated on an asset exceeds the opportunity costs of funds, it is categorized as financial output, as is a liability if its financial costs are less than its opportunity costs. Otherwise, assets and liabilities are deemed financial inputs (Berger & Humphrey, 1992). Measurement errors in calculating revenue contributions and opportunity costs for deposits and loans, can easily arise which may skew their categorization as inputs or outputs.

The Value-Added Approach: According to Berger, Hanweck and Humphrey (1987), the value-added approach explicitly uses all operating cost data for labour (salaries and fringe benefits) and capital (occupancy, furniture and equipment expenses), as inputs. These inputs are used for activities related to generating deposits and loans, which are considered

significant bank outputs⁴. It is proposed that the volume of loans and deposits are proportionate to the financial services banks' produce.

3.3 GDP Estimation

Following the value-added approach, depreciation (D), wages (W), and operating surplus (OS), are used to estimate GDP for offshore banks⁵. The weights for these variables were derived using average ratio analysis and are reported in equation (1).

$$GDP_{OB} = 0.002D + 0.014W + 0.984OS \quad (1)$$

Nominal annual GDP output for offshore banks is presented in Table 5. The output of banks is not priced in the same manner as the services of other industries which poses difficulty in establishing the appropriate deflator for real GDP estimation. Furthermore, what is suggested in the current literature is not available for Barbados⁶.

Nominal GDP output fluctuated prior to the 1990's, subsequent to which a sizable downturn was experienced. Beyond 1993, a more stable period of growth was achieved (see following charts). In 1998 output growth was curtailed by portfolio investment losses, nevertheless, nominal GDP output for banks peaked at Bds\$1,701 million. Comparing

⁴Government paper and other non-loan investments are also considered as output but are not significant to the analysis.

⁵This methodology is similar to that used by the Barbados Statistical Service to calculate GDP for local commercial banks.

⁶See UN publication, 'National Accounts of Caribbean Countries', (1998).

these figures to total nominal GDP for the services sector, indicates that the exclusion of offshore banking results in the significant underestimation of GDP (Appendix 4). The inclusion of GDP offshore banking for 1998 would result in services accounting for 78% of total GDP, rather than the 68% currently recorded. As concluded by Craigwell and Clarkson (1997), if national GDP estimates are to be representative of the current economic situation, offshore activity must be included.

Granger causality⁷, which measures whether a particular variable can be used to explain and predict another variable, was employed to assess what Granger causes offshore bank GDP. The number of licensed banks was not found to Granger cause GDP. This is not surprising since five of the 44 banks licensed account for the majority of the industry's operating surplus. Secondly, for periods when the number of licensed banks grew significantly, banks' GDP did not rise in a tandem since these banks were small IBC's being converted to banks. Initiatives to raise the foreign exchange earning capacity of the industry or its GDP contribution need not concentrate heavily on increasing the number of banks licensed in Barbados. Instead, focus can be given to strategies which would encourage banks to expand their operations.

⁷See Johnston and Dinardo (1997) and Appendix 6.

Table 5.

Nominal GDP for Offshore Banks

<i>Year</i>	<i>Depreciation ('000)</i>	<i>Salaries & Employee Benefits ('000)</i>	<i>Operating Surplus ('000)</i>	<i>Nominal GDP SBds Millions</i>
1982	73	549	8,328	8.20
1983	63	542	7,148	7.00
1984	69	501	34,531	34.00
1985	94	388	40,187	39.60
1986	147	410	50,891	50.10
1987	117	554	3,391	3.30
1988	79	602	70,731	69.60
1989	13	607	81,817	80.50
1990	223	1,722	314,988	310.00
1991	279	2,485	353,165	347.60
1992	413	2,629	252,703	248.70
1993	235	2,973	151,094	148.70
1994	312	3,797	163,068	160.50
1995	580	5,878	234,028	230.40
1996	1,090	9,773	421,020	414.50
1997	4,170	17,223	1,135,606*	1,117.90
1998	4,322	19,466	1,799,690*	1,771.50

Source: Central Bank of Barbados

* This surge was caused by the establishment of some large offshore banks. Income earnings for banks were boosted by portfolio investment gains in 1997 and lending for exploration and drilling operations.

Chart 5.

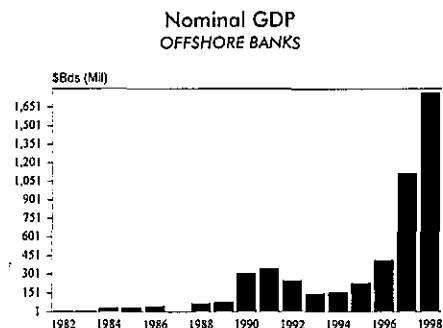


Chart 6.

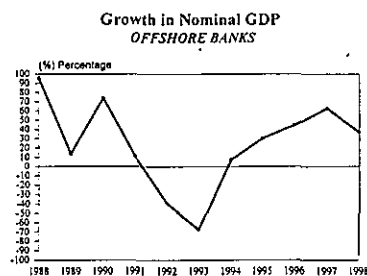
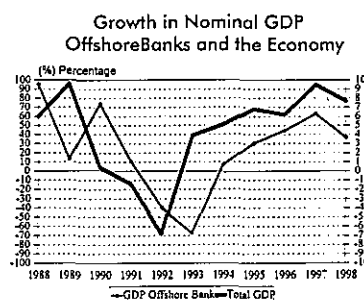


Chart 7.



Rising employment opportunities in the offshore banking industry should not be taken as an indication of rising bank GDP, since employment does not Granger cause offshore bank GDP. Chart 7. shows that the GDP of banks may be correlated with total nominal GDP, which implies that offshore banking activity responds to factors in the local economy.

This does not augur well for offshore banking being used to achieve greater economic diversification. Diversification is best achieved when industries are uncorrelated, so that a downturn in one part of the economy can be offset by growth in another industry. Otherwise, the entire economy will be prone to individual fluctuations or what is termed unsystematic risk.

3.4 Prospects for Offshore Banking

Material presented on offshore banking clearly shows that the industry is economically viable. Further growth in the number of banks licensed is not expected to be as strong as before, given that these increases were the result of some IBC's switching to being licensed as banks. Nevertheless, an ageing world population and the liberalisation of restrictions on capital flows, are driving forces to the future prosperity of offshore banking and its contribution to GDP. Individuals are constantly seeking new opportunities for their money and there are many products yet to be offered by offshore banks in Barbados. But these require legislative amendments which, inter alia, are discussed in the following section.

4.0 Challenges for the Offshore Sector

The future viability of the offshore sector is crucial to the foreign exchange earning capacity of the economy and lower unemployment. To promote the future success of the sector some private sector entities and the Ministry of International Trade and Business have initiated studies focussed at determining the current challenges facing the sector. One such effort was R. Hammer and C. Brewer (1996), who established a strategic framework for the

development of the sector. Ultimately, the success of the sector is underpinned by the timeliness and resources committed to ensuring that the competitiveness of the jurisdiction is maintained.

R. Schware and S. Hume (1996) outlined some of the main factors that are expected to impact on the sustainability of the information services industry, which are applicable to the entire offshore sector.

- human resource development
- an improved business environment by revising laws and policy
- making telecommunications competitive and less costly
- active marketing
- increasing domicile competitiveness

4.1 Human Resource Development

One essential success factor for any industry is the availability of a cost competitive, proficient labour force, which is what led to the development of a strong information services industry in Barbados. Globally, the information services industry has become more technological and is requiring less manual data entry. This will alter Barbados' position in the market, since there has not been enough human resource development to produce highly technical workers such as skilled software developers and engineers.

After steady employment growth over the last decade, employment in information services contracted by 53.4% in 1998 (see Appendix 6). Companies are reluctant to implement new technological developments that rely heavily on costly telecommunications in Barbados. Yet more companies are likely to opt to move their operations and it is expected that employment will continue to contract as a result.

To offset this human resource deficiency, the scale of computer literacy must be intensified beyond the basic level, towards more technical training. Some private firms have taken the initiative to enhance skills by encouraging students to pursue computer science majors and research. Consideration has also been given to the development of a Master's degree in International Business and specialised seminars, to promote the efficiency and competitiveness of the labour force.

The progress of other offshore companies has been sustained by the availability of highly accredited professionals, who are familiar with North American and British systems. Based on promotional efforts of local accounting and financial advisory firms to secure market recognition for themselves, this trend is likely to continue. However, it is mandatory that firms continue to train staff and upgrade their technology, if they are to retain their market advantage.

4.2 Enhancement to the Business Environment

There has been a concerted effort to improve Barbados' profile as a domicile by policy amendments and additional taxation treaties. Hammer and Brewer (1996) stress the importance of these incentives being consistent in their treatment and coherence with current Government policy, which appears to be the case. Concern about the timeliness of initiatives to upgrade legislation and policy operations has been expressed, as this could prevent market opportunities from being exploited and the competitiveness of the jurisdiction being maintained. One case in point is the slow enactment of mutual fund legislation.

Currently all offshore financial service entities must be licensed as banks. This requirement is somewhat onerous and may in part account for the nascent state of nonbank financial services. Because the risk profile for nonbank services differs from pure vanilla banking, a new type of licensing and regulation (for investment bankers, mutual fund trusts, etc.) is required, to ensure that these entities are not burdened with the capital reserve provisions of banks. Market assessments need to be conducted to determine what initiatives can further stimulate activity in nonbank financial services. For example, consolidating trust legislation could be structured to allow offshore banks to act as trustees for domestic trusts with nonresident beneficiaries. Securitisation of financial assets could also be encouraged, while changes to insolvency laws would serve to extend the market for derivatives and debt related products.

4.3 Telecommunications

For some time, the high costs of telecommunications in Barbados has been heavily criticized as a major constraint to more efficient production. This is a major disincentive for firms wishing to engage in high level data transmission, which is becoming the standard operating environment of most industries. As R. Schwarc and S. Hume (1996) state, "*....international competitiveness can only come about by altering the monopolistic ownership structure of the telecommunications industry, as well as lobbying for lower rates on a regional basis*".

4.4 Marketing Approach

The nature of competitive business dictates that new products and market opportunities are created and exploited. Product innovation in Barbados has not been as intense as in some other jurisdictions. In the past, marketing initiatives for Barbados focussed on North America but the inherent vulnerability of a narrow market base is now a grave concern. Efforts at market diversification have sought to create business in the UK, the rest of Europe and Latin America. Unfortunately, the success of these initiatives has not been systematically monitored; data on the home countries of new offshore companies has not yet been compiled.

Strategic market planning will continue to be limited by the lack of data on the sector. Currently, limited data is available from the Central Bank, the Barbados Investment and Development Corporation, the Supervisor of Insurance and the Ministry of International Trade and Business. Some of this data is basic in nature, sufficient for supervision purposes

but not for detailed market intelligence. More detailed data on tax revenue, countries of origin, employment and foreign exchange earnings, must be compiled by the Ministry. Instruments for collecting this data must be standardised, consistently collected and properly coordinated and compiled, to avoid duplication of effort. These amenities would promote easier sectoral marketing and measures that have been implemented or that are being considered, can be better evaluated.

4.5 Domicile Competitiveness

Taxation savings remains the principal token of domicile competitiveness, while secrecy provisions are favoured by some investors, especially those interested in engaging in money laundering. According to some specialists in the industry, offshore business in Barbados is more business-driven than tax-driven. Companies did not exit the market to take advantage of the tax benefits offered under the North American Free Trade Agreement, as was the case in Jamaica, the Dominican Republic and Haiti. Firms are more anxious to position themselves globally and greater credence is being placed on factors such as infrastructure, stability and integrity. Even though in essence the offshore market was born out of individuals searching for ways to protect the value of their assets from taxation, political seizure, exchange controls and even terrorism; this picture has changed to some degree.

Tax havens have been criticised in an OECD report for what has been described as 'harmful tax competition' by tax havens. That is, the potential for these tax regimes to cause economic distortions⁸, tax evasion and money laundering. Technically, Barbados is not a tax haven, so it should not face any backlash from efforts to curtail business activities in tax havens. Nevertheless, industry officials are monitoring this situation and it is hoped that adequate dialogue between parties will ensure a positive outcome. In the worse case scenario, some offshore businesses may opt to move their operations to jurisdictions in developed countries, to avoid being in the midst of any controversy.

Another threat beyond the direct control of the Barbados Government is the possible reform of Canadian legislation to redress the tax treatment of domestic Canadian companies' income from foreign subsidiaries or banks. If this occurs, there will be less of an incentive or it may even become burdensome for Canadian companies to operate out of Barbados. This could have a profound impact on the sector because of the reliance on the Canadian market.

It is pertinent to enquire as to the status of our principal competitors in the Caribbean, namely Bahamas, Bermuda, BVI and Cayman Islands. Offshore financial services continue

⁸These distortions are to real investment flows, the desired level of taxes and public spending, while causing undesired shifts of the tax burden to less mobile tax bases such as property or consumption, (Zagaris, 1999). Some of these contra-welfare effects are implicit of any unrestricted global market setting, where companies concentrate on seeking the best locations for their operations to maximize business goals and enhance their market position in the world market.

to grown in the Bahamas. In April 1998, the Government established a joint private and public sector Bahamas Financial Services Board to promote the development of the sector.

In this context, 15,775 IBC's were incorporated during the next 11 months, bringing the number of IBC's to 84,540. Growth in the mutual funds market also points to heightened investor confidence in the Bahamas.

Bermuda has been described as the Belgravia of tax havens, a reputation gained as much by professional integrity as by government regulation and supervision. The facilities offered do not differ essentially from those of other zero-tax jurisdictions. Exempted companies are not in general permitted to have any interest in local land or local companies which are not exempted companies. Neither can they conduct offshore banking business, although they can act as group finance subsidiaries. Offshore insurance, by contrast, is encouraged. The concept of 'captive' insurers was first put into practice on a significant scale in Bermuda and it is estimated that a third of the captives in the word are in Bermuda.

The principal source of competition from the BVI, is their specialized product of International Business Company (IBC). Over 250,000 have been registered but new registrations of IBCs are estimated to have declined from 50,067 in 1997, partly as a result of the crisis in South East Asia and to inertia in the global economy. In contrast, a Mutual Funds Act initiated at the beginning of 1997, resulted in more than 1,000 registrations being recorded during 1998, with there being almost as many outstanding applications.

Among offshore financial centers, Cayman is regarded as second in the world, just behind Hong Kong. It is the fifth largest banking centre and has developed its shipping registry.

Cayman attracts considerable insurance and re-insurance business rivalling Bahamas for captive and other offshore insurance companies. The number of regulated mutual funds and captive insurance companies recorded increases of 14.4% and 5.1% to reach 1,928 and 473, respectively in 1998.

Section 5. Conclusion

The offshore sector has played a significant role in the Barbadian economy and is poised to continue on this path. The steady expansion in foreign exchange earnings and the rising GDP contribution of offshore banking, are evidence of this rising prominence. The future prosperity of the sector is juxtaposed with the timeliness and amount of resources committed to initiatives to address the current challenges facing the sector. One such initiative which should be urgently undertaken is the development of a database on the sector, to afford greater market intelligence.

Occurrences in the local economy impact on offshore banking, which does not augur well for this industry being used as a means to achieving greater economic diversification. It would be worthwhile to investigate if this also holds for the entire offshore sector. This attribute of offshore banking does not alter the fact that the inclusion of banks' GDP significantly enhances services GDP and allows a more representative estimate of total nominal GDP. It is important to recognise that increasing banks' GDP output is not strictly dependent on the number of offshore banks licensed, but rather the operating base and profitability of banks.

APPENDIX 1.

Table 1.

Total Active Offshore Companies						
	1993	1994	1995	1996	1997 ^P	1998 ^P
IBCs	1171	1474	1822	2126	2453	2872
FSCs	923	1172	1514	1726	2076	2393
Exempt Insurance Companies	190	194	205	193	200	200
Exempt Insurance Management Companies	48	38	38	38	36	32
Society with Restricted Liability	-	-	-	14	32	65
Offshore Banks	14	18	32	38	44	44
Total	2,346	2,896	3,611	4,135	4,841	5,606

Source: Ministry of International Trade & Business and the Central Bank of Barbados

P: Provisional

Table 2.

Newly Licensed Offshore Companies						
	1993	1994	1995	1996	1997	1998
IBCs	372	302	348	437	372	441
FSCs	168	249	342	393	384	317
Exempt Insurance Companies	23	24	23	23	17	23
Exempt Insurance Management Companies	3	3	2	1	3	-
Society with Restricted Liability	-	-	-	14	18	33
Offshore Banks	5	7	9	7	6	1
Total	571	585	724	875	800	815

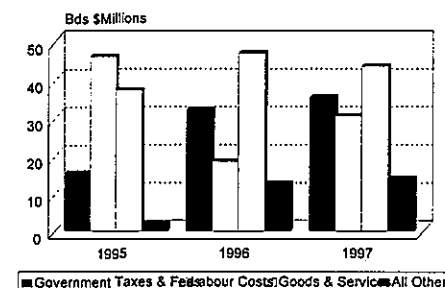
Source: Ministry of International Trade & Business

APPENDIX 2.

Chart 3.

Foreign Exchange Earnings

OFFSHORE COMPANIES

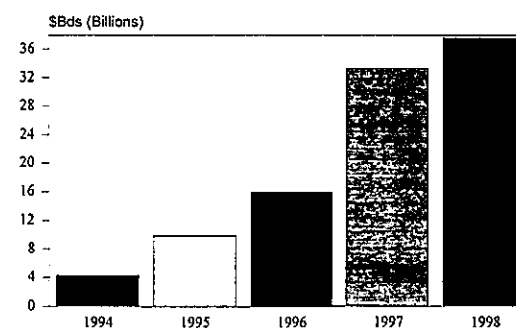


Source: Central Bank of Barbados.

This information is compiled based on an annual survey of accounting and financial advisory firms which service approximately 75% of the offshore companies in Barbados. Based on the response rate of the survey, it is probable that the stated foreign exchange earnings are underestimated.

APPENDIX 3. Chart 4.

Offshore Banks' Assets



Source: Central Bank of Barbados

APPENDIX 4.

**The Contribution of the Service Sector to GDP
Nominal Estimates (BD\$ MILLIONS)**

Sector	1982	1986	1990	1994	1998
Wholesale & Retail Trade	398	486	589	515	702
Government Services	233	379	549	523	675
Finance, Insurance, Real Estate, & Business Services	250	311	433	472	716
General Services	77	94	109	122	180
Electricity & Water	45	72	92	102	126
Tourism	181	234	339	409	482
Transport, storage, & Communication	135	198	245	280	382
GDP Services	1,318	1,773	2,355	2,422	3,263
Total GDP	1,990	2,646	3,440	3,483	4,777

Source: Barbados Statistical Services and 1999 Central Bank of Barbados Annual Statistical Digest

**The Contribution of the Service Sector to GDP
Offshore Included - 1998
Nominal Estimates (BD\$ MILLIONS)**

Sector	Contribution	Percent of Total
Wholesale & Retail Trade	702	14
Government Services	675	13.3
Finance, Insurance, Real Estate, & Business Services	716	14.2
General Services	180	3.6
Electricity & Water	126	2.5
Tourism	482	9.6
Transport, storage, & Communication	382	7.6
Offshore Banking	1,772	35.2
Total GDP Services	5,035	100

Source: 1999 Central Bank of Barbados Annual Statistical Digest

APPENDIX 5. Pairwise Granger Causality Test

Null Hypothesis	Obs	F-Statistic	Probability
EMPLOYEES does not Granger Cause GDP	6	123.717	0.06344
GDP does not Granger Cause EMPLOYEES		2.20570	0.42988
BANKS does not Granger Cause GDP	15	21.0555	0.00026
GDP does not Granger Cause BANKS		2.76122	0.11097
BANKS does not Granger Cause GDP	12	1.75029	0.51620
GDP does not Granger Cause BANKS		1.19434	0.59785

* In all cases the Null Hypothesis is accepted.

APPENDIX 6. Chart 8.

Employment in Information Services Industry



Source: Barbados Investment and Development Corporation

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