

# Foreign Direct Investment, Services Trade Negotiations and Development

## *The case of Tourism in the Caribbean*

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This paper examines whether and how developing countries can use services trade negotiations to increase the amount of inward FDI conducive to development, with a focus on the tourism sector in the Caribbean. The importance of tourism services to the Caribbean economy is generally acknowledged, though there is some debate on the varying effects of different types of tourism (cruise boat/eco/mass/cultural forms of tourism are all present in the Caribbean).

The paper starts by reviewing the evidence and views on whether and how services trade rules (supply of services mode 3 relates to cross border investment) can affect inward FDI, with specific attention to inward FDI (mainly in hotels and restaurants) and the regulatory framework in the tourism sector in the Caribbean. It complements this with a simple statistical analysis, presenting panel data (1997-2003) on inward FDI in the tourism sector in 9 Caribbean countries and correlate these with data describing the regulatory framework committed in fora such as the WTO General Agreement of Trade in Services, and controlling for other factors affecting inward FDI (using panel data, robust and instrumental variables techniques). From the totality of the above evidence it aims to obtain indications on whether services negotiations are conducive to attracting inward FDI.

The concluding sections discuss options in current trade negotiations on trade in services to attract tourism FDI. In multilateral trade negotiations (GATS), Caribbean countries may want to signal openness to inward FDI while maintaining a degree of flexibility in the use of policy measures; in current negotiations on Economic Partnership Agreements with the EU, the focus could be on liberalising sensitive services sectors as well as on making use of the development dimension of EPAs such as the inclusion of support measures for investment in tourism conducive to the competitiveness of local economic players.

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## 1 Introduction

This paper examines whether and how developing countries can use services trade negotiations to increase the amount of inward FDI conducive to development, with a focus on the tourism sector in the Caribbean.

The importance of tourism services to the Caribbean economy is well known. Tourism is the most important services sector in the Caribbean. It takes different forms in different countries, ranging from mass tourism (e.g. Barbados) and cruise ships (for which Islands compete intensively) to eco-tourism (e.g. Belize). There are debates as to which tourism strategies are best suited to address development concerns,<sup>2</sup> but it is clear that tourism has become increasingly important for the Caribbean in their diversification process away from commodities. Using Tourism Satellite Accounts, which present the impact throughout the economy not just the sector itself, travel and tourism services currently contribute 15% in Caribbean GDP and 16% in employment<sup>3</sup> (see World Travel and Tourism Council, 2004).

Investment is critical for further development of the tourism sector, so it is important to understand what drives investment. One possible determinant includes a secure and transparent framework that reduces risk (Dixit and Pindyck, 1994; World Bank, 2004), sometimes called a welcoming investment climate. International trade rules can help to make the investment climate more transparent and secure through enshrining the international commitments that countries make on the basis of their domestic reforms. However, most studies that examine the effects of commitments in international trade negotiations assume that it raises FDI inflows (e.g. Dunlop, 2003; PwC, SIA, 2005), and do not test this assumption. This paper tries to test whether the assumption can be validated by an examination of FDI in tourism in the Caribbean.

Caribbean countries are currently dealing with a complex set of negotiations which contain discussions on services: *Internal*: CSME – the Caribbean Single Market and Economy which include a negative list on services (i.e. it has a list of restrictions which member states will remove according to a fixed schedule until 2005). *Regional*: FTAA – Free Trade Area of the Americas which includes a draft chapter on services. *Regional*: CARIFORUM-EC Economic Partnership Agreement (EPA) negotiations until end of 2008 which can include services. *Bilateral*: e.g. CARICOM-Costa Rica/Canada/Dominican Republic. *Multilateral*: GATS 2000 which is part of the Doha single undertaking. So far, St Kitts and Nevis, Suriname, Guyana, Grenada and Barbados have made offers, all have received requests. This paper aims to inform international trade negotiations such as GATS and EPA services negotiations on how the Caribbean countries can take advantage of these.

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<sup>2</sup> There are concerns as to whether and how cruise ships affect the local economy, but CHA (Caribbean Hotel Association) argues that it is important and as such should be included in a GATS definition on tourism.

<sup>3</sup> These numbers are 52% and 58% for Barbados and 48% and 48% for St Lucia. Travel is the most important services category accounting for a quarter of export of services in Suriname, half in Barbados (with 531,000 stay-over arrivals and 559,000 cruise passenger arrivals in 2003) and three-quarters in St Lucia (with 277,000 stay-over and 393,000 cruise passenger arrivals in 2003). Specifically, the Carnival alone contributes 12% of tourism receipts in Trinidad and Tobago, the Jazz Festival in St Lucia contributes 6%.

The structure of the paper is as follows. Section 2 will discuss the theory on services negotiations and inward FDI and discuss the pattern of services commitments by Caribbean countries. Section 3 presents the empirical strategy of examining the effects of trade negotiations on inward FDI, and section 4 provides evidence on the basis of regression analysis. Section 5 discusses the implications of the new evidence for two of the trade negotiations, GATS and EU-CARIFORUM services negotiations. Section 6 concludes.

## **2 Commitments in services negotiations and inward FDI in tourism: theory and evidence so far**

### *Theory: GATS and inward FDI*

Trade in services rules are an important, but hitherto largely neglected in the empirical literature, way in which WTO membership may enhance trade performance through their potential effects on inward FDI. The GATT/WTO included for the first time in 1995 commitments on treatment of foreign providers of services in the General Agreement of Trade in Services (GATS). Countries can commit any of around 160 sub-sectors and four modes.<sup>4</sup> Mode 3 in particular relates to the conditions under which foreign firms have access to particular services sectors, and which conditions apply after their establishment.<sup>5</sup>

In theory there are three types of effects. First, countries can offer market access to foreign providers of services, though in practice GATS commitments have gone little beyond existing liberalisation. Hence, GATS is scarcely used as a liberalising tool.

Second, the set of trade rules contained in GATS (especially mode 3 on investment) provides for a transparent framework conducive to private sector activities, reducing uncertainty and encouraging investment. Uncertainty can have significant negative

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<sup>4</sup> Mode 1: Cross-border supply of services; Mode 2: Consumption abroad; Mode 3: Commercial presence; Mode 4. Temporary movement of natural persons.

<sup>5</sup> A country's obligations under GATS can be divided under two headings: (1) General obligations and (2) Specific Commitments. General obligations apply directly and automatically to all members and services sectors. Under these members are required to accord (a) Most Favoured Nation Treatment (Art II) to all the WTO members (a country has to extend immediately and unconditionally to services or service suppliers of all members treatment no less favourable than that accorded to like services and suppliers of any other country) and maintain (b) Transparency which requires members to publish all measures of general application and respond to other members' queries. Specific commitments are commitments laid down in individual country schedules and concern specifically designated sectors. The scope of these commitments may vary across countries and sectors. Specific commitments concern (a) Market Access (Art XVI) which states that 'members give no less favourable treatment to the services and service suppliers of other members than is provided in its schedule of commitments' and (b) National Treatment (Art XVII) which implies that members do not discriminate between foreign and domestic services or suppliers. Art XVI specifies the following six measures affecting free market access that may not be applied to foreign services or suppliers unless they are clearly specified in the schedule – limitations on (1) the number of service suppliers (2) the total value of services transactions or assets (3) the number of services operations or the total quantity of service output (4) the number of persons that may be employed in a particular sector or by a particular sector (5) measures that restrict or require supply of the service through specific types of legal entity or joint venture (6) percentage of participation of foreign capital or total value of foreign investment. (WTO website)

effects on investment, when investment involves large sunk and irreversible costs and there is the option to delay the decision to make the investment until further information becomes available (Dixit and Pindyck, 1994; Collier and Pattillo, 2000). This is also the sentiment of firms (e.g. EC, 2000).

Signalling is the third effect. Countries that make offers and requests to GATS are willing to seriously consider development of the services sectors, sending positive signals to potential investors. Singh (2004) contrasts negotiation capacities and commitments in Costa Rica with those in Belize and finds that Costa Rica has started much earlier in prioritising and developing services sectors and taking commitments with obvious success, Belize took much longer.

### *Effects of GATS on inward FDI*

Empirical studies have considered only to a limited extent whether WTO rules can affect inward FDI and trade in services.<sup>6</sup> This seems to be a significant gap in the literature. WTO rules that lead to a more predictable investment climate should lead to more private finance and this may affect trade in goods and services. Te Velde and Bezemer (2005) show that regional trade and investment rules may lead to more inward FDI from outside the region. Halward-Driemeier (2003) and Tobin and Rose-Ackerman (2002) shows that bilateral investment treaties (BITs) raise FDI slightly but only act as a complement rather than as a substitute for weak political and legal institutions. Salacuse and Sullivan (2005) find a strong correlation between BITs and FDI flows.

Table 1 provides a summary of a number of recent studies that relate to GATS negotiations and FDI in the tourism sector. Most studies *assume* that there is a link between mode 3 commitments and increased inward FDI (Sauvé, 2005; PwC, SIA, 2005), and some are cautious (Dunlop, 2003) suggesting that GATS is but one factor in the host of factors explaining FDI. One study for Turkey (Perrin, 2001) suggested that GATS commitments did raise inward FDI. This paper aims to provide evidence for the Caribbean.

### *Current patterns of GATS commitments*

The appendix reviews domestic regulation and GATS commitments and current offers in the tourism sector in most Caribbean countries. Most of the Caribbean countries have specific laws regulating the tourism sector in general and the hotels industry in particular, with the exception of Suriname and St Kitts and Nevis. Although the latter countries do not have specific laws, they have alternative systems in place governing the sector with variable success. For instance, St Kitts has specifications regarding the

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<sup>6</sup> There is evidence emerging on the effects of WTO rules on trade in goods. Rose (2004a) uses a gravity model of bilateral merchandise trade over 50 years and for 175 countries and finds that membership of GATT/WTO has not significantly affected trade patterns. Rose (2004b) argues that this may be because WTO members may not have more liberal trade policies. Subramanian and Wei (2003) estimate the effects of WTO membership in a gravity model of imports and find a positive impact when they distinguish between developing and developed countries, and amongst sectors. There is little econometric evidence on the effects of WTO rules on services trade. Mattoo *et al.* (2001) construct an index of financial services and telecommunications openness on the basis of GATS commitments and liberalisation, which has a positive sign in an equation explaining GDP per capita growth.

ownership of hotels in terms of foreigners or domestic nationals with restrictions on foreign participation in hotels depending on the number of hotel rooms. Suriname has an integral Tourism Development Programme and is considering a new tourism law.

**Table 1 Studies on the links between GATS and investment in Tourism**

Study	Focus	Links between GATS and FDI
Hoed (2002)	Outlines GATS, examines its legal principles, explains the arguments of supporters and critics, and considers the potential impact of GATS on tourism and sustainability and on issues such as local community participation and tourism governance.	Argues that the reason why many countries, both developing and otherwise, have supported GATS is in the expectation that it would lead to increased investment in tourism (p. 225)
Perrin (2001)	Aims to identify and assess potential environmental and social effects of trade liberalisation policies on the tourism sector and specifically the role played by trade liberalisation policies in supporting or constraining opportunities for sustainable development in the tourism sector. Increased inward investment is seen to have positive and negative effects on the sustainability of tourism.	GATS can lead to increased investment because GATS is in many respects both a multilateral investment agreement and an agreement to liberalise services( p. 20). GATS has important implications for investment through commitments concerning mode 3, but further research necessary to assess the sustainability implications of the investment provisions in GATS on tourism. <u>Case study of Turkey</u> -GATS agreements and liberal domestic regulations in tourism sector in Turkey has led to increased foreign investment in the sector. Foreign investment in the tourism sector in 1997 constituted 14% of the total FDI. Increased inward investment has led to a generation of employment opportunities though the jobs generated are poorly paid and seasonal. Tourism investment in Belek, Turkey concentrated mainly on the beach front and negatively affected eco system.
Sauvé (2005)	Focuses on how developing countries can maximise the development benefits from international liberalisation of trade in services.	Greater liberalisation in mode 3 in the services sector would enable developing countries via increased FDI inflows to develop an export capacity in a number of professional, financial, transportation or even health and education services (p. 12).
PwC Sustainability Impact Assessment (2005)	Assesses the economic, social and environmental impact on the Caribbean tourism sector as the result of an EU-ACP economic partnership agreement.	Assumes, as a result of the simulations conducted, that further mode 3 liberalisation would lead to an increase of 10% of the physical capital of the tourism sector. This in turn would lead to an increase of 2% in total investment.
Kolstad and Villanger (2004)	Uses industrial level data to estimate the determinants of FDI in the service sector as a whole and the major service industries.	FDI in services linked to FDI in manufacturing. FDI in services sector is market seeking and uncorrelated to host country openness (trade openness measured as the sum of imports and exports as a percentage of GDP). FDI in the transport sector correlated with institutional quality.
Dunlop (2003)	Sets out a regional negotiating strategy on tourism services in external trade negotiations and proposes negotiating recommendations to execute this strategy.	Challenge for negotiators is in striking the right balance between encouraging new foreign investment into the sector while maintaining local community involvement in tourism related activities. One of the challenges facing CARIFORUM tourism sector is low rate of return on investment which discourages new inward FDI (p. 2) Argues that the WTO officials often overplay the importance of GATS on investment. According to the WTO officials the existence of GATS commitments in tourism related sectors can increase domestic and foreign investment by ensuring greater stability and predictability of government regulations and policies affecting tourism. But this paper points out that the existence of GATS commitments is just one of many factors that will encourage a foreign investor to enter the market. More important factors are argued to be return on investment, political stability, currency fluctuations, ability to repatriate profits, revenue per available room, operating costs, national taxation and incentives provided by the government.(P. 24, box 1.5)
World Tourism Organisation (2004)	Comprehensive paper on FDI to the tourism sector focusing on definitions, trends, measurement and assessment of impact of FDI to the tourism sector.	Recent growth in FDI in the tourism sector is largely due to the creation and approval of a regulatory framework including international treaties and agreements, laws, decrees, standards, as well as aid policies and incentives for FDI within countries.( P. 56)

In terms of treatment of foreign investors in hotels, the only country that discriminates against foreigners and places limitations on their investment in terms of minimum number of hotel rooms is Antigua and Barbuda. St Kitts and Nevis also places limitations on foreign ownership for hotels having less than a certain minimum

number of rooms. All the other countries such as Barbados, Belize, Dominican Republic, Guyana, Haiti, Jamaica, Suriname, Saint Vincent and the Grenadines, Saint Lucia, Grenada and Dominica grant national treatment to foreign investors in their domestic laws.

Several countries have recently stepped up their efforts at reforming regulation of the Tourism sector. Belize has introduced two new acts since 1995: The National Tourism Council Act in 1999 and the Hotels and Tourist Accommodation Act in 1997. Other countries such as Barbados, Dominican Republic, Guyana, Antigua and Barbuda, and Saint Lucia have introduced a single new tourism act in the period 1995–2003. But countries such as Haiti, Jamaica, Suriname, Saint Vincent and the Grenadines, Saint Kitts and Nevis, Granada and Dominica have not introduced any new laws in the tourism sector since 1995.

GATS commitments in the tourism sector (sector 9 out of the 12 main GATS sectors) can be divided into four sub sectors (A–D) as indicated below:

9. Tourism and Travel Related Services.
  - A. Hotels and Restaurants (incl. Catering)
  - B. Travel Operators and Tour Operators
  - C. Tourist Guide Services
  - D. Other

In terms of existing GATS commitments Barbados and Belize have not included any commitments in the tourism sector. All the other countries such as Dominican Republic, Guyana, Haiti, Jamaica, Mauritius, Suriname, Antigua and Barbuda, Saint Vincent and the Grenadines, Saint Lucia, Saint Kitts and Nevis, Grenada and Dominica have made GATS commitments in the tourism sector but they vary by mode, and national treatment and market access conditions. Guyana, Suriname and Jamaica have commitments in the sub sectors 9A and 9B with Guyana and Suriname placing no restrictions and Jamaica having some limitations in place. All the other countries have commitments only in the sub sector 9A with some limitations except in the case of Haiti and Dominican Republic who have placed no limitations.

There are several observations. First, several barriers to market access and national treatment of foreign firms remain possible because they are not enshrined in international trade commitments, so countries have not even committed the status quo. Second, because there are still trade barriers (in GATS) in all countries (max score is 4 out of 8), there is scope for progress for all countries. Third, because the scope of commitments varies considerably by country (ranging from 0–4), this presents a good basis for testing the effects this might have on inward FDI.

St Vincent and the Grenadines is the only Caribbean country with new GATS offers in the tourism sector. St Vincent has liberalised market access in some sub-sectors. Barbados, Dominican Republic, Dominica, Grenada Guyana, Jamaica, Suriname, Saint Lucia and Saint Kitts and Nevis have made new offers but not within the tourism sector. No new offers have yet (as per July 2005) been made by Haiti, Belize and Antigua and Barbuda in any sectors.

While we focus on the tourism services sector (9) in GATS, it should be borne in mind that tourism is not a separate GATS category. Outside GATS, tourism comprises several services such as travel and transportation services, while the cruise ships industry does not fall under GATS tourism services. It is also related to e.g. health services exports (health tourism). The importance of health tourism (surgery in combination with cruise holidays, mode 2) is well documented in the case of the Caribbean (Gonzales, *et al.*, 2001). It is also interlinked with cultural services. An important issue for health tourism is the extension of portability of national health insurance (see e.g. Mattoo and Rathindran, 2005) to the Caribbean; for example, the UK does not seem to have an agreement on this with St Lucia.

### 3 Empirical Strategy

The empirical specification takes a simple FDI model with standard explanatory variables and includes additional variables measuring the degree of GATS commitments and available domestic regulations. In this way we can isolate a separate effect of GATS (provision)

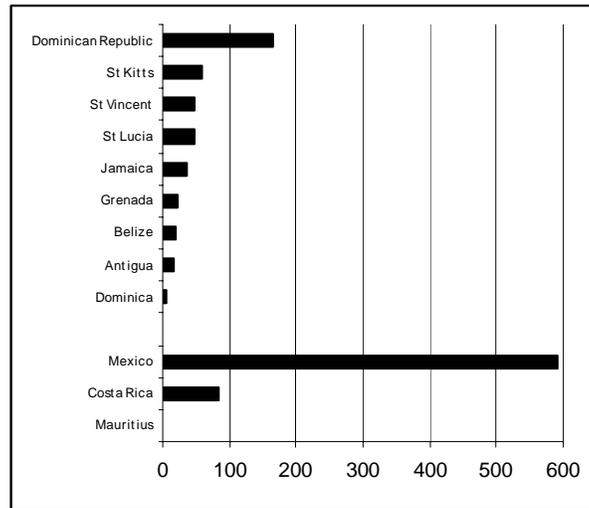
$$(1) \quad FDI_{ijt} = f(HOST_{ijt}, DOMREG_{ijt}, GATS_{ijt})$$

where FDI is the real flow of FDI,  $i$  is the host country,  $j$  is the sector,  $t$  time. *HOST* country factors includes a measure for market size, but can in principle include a host of country specific variables. Dunning (1993) and Carr *et al.* (2001) provide a rationale for including variables such as infrastructure, human capital and market size. This paper limits the choice of key determinants of FDI to avoid overparameterisation, but acknowledges that there could be additional factors that we cannot deal with. *DOMREG* includes measures of domestic regulation, while *GATS* includes a measure of GATS commitments, the main variable that this paper is interested in. (GATS) Rules that are expected to raise FDI would appear in the regression with a significant and positive regression coefficient.

#### *Measurement of variables*

The dependent variable is the flow of inward FDI in the Tourism sector and uses a variety of detailed sources on sectoral FDI flows: ECCB, UNCTAD and domestic sources. Chart 1 plots the average annual inflow of FDI over the most recent 5 years for the 9 Caribbean countries that we are interested in: Antigua and Barbuda, Belize, Dominica, Dominican Republic, Grenada, Jamaica, St Kitts, St Vincent and St Lucia. There are data over 1997–2003, but with a few gaps, there is a maximum of 55 data points.

**Chart 1 Tourism FDI inflows (mn USD, annual average of recent 5 years)**



Source: East Caribbean Central Bank, UNCTAD, and domestic Central Banks. Data refer to the sector 'Tourism', or usually hotels and restaurants.

The appendix table, column 10 describes GATS commitments (variable *GATSnum*) calculated as the sum total of scores for commitments in each of the four sub sectors and can run from 0-8. For each of the sub-sectors 9A-D:

- 0 = No commitments in sub sector.
- 1 = Commitment in sub sector subject to some limitations.
- 2 = Commitment without limitations.

We also include a variable *Offers*, a 0/1 dummy indicating whether the country has made an offer in tourism in the current GATS round.

Domestic regulation is seen as an important control variable (e.g. World Tourism Organisation, 2004). We use two measures for domestic regulation (taken from Trade Policy Reviews, see appendix):

HA – Country specific variable on Hotel Act, ranging from 0-3:

- 0 = No Act in tourism sector.
- 1 = No Hotels Act but acts in other tourism sub sectors.
- 2 = Hotels act granting access equally to domestic and foreign firms but access to foreign firms limited by the size of rooms.
- 3 = Hotels act granting equal access to domestic and foreign firms.

RA – Country specific variable on Recent Hotel acts, ranging from 0-2:

- 0 = No changes in laws affecting Hotels/Tourism, 1995-2003.
- 1 = One new Hotel Act over 1995-2003.
- 2 = More than one change to Hotel Acts over 1995-2003.

The other data we include is market size. Normally, national income (real GDP) is used as the market size variable in regressions explaining FDI (Dunning, 1993). However, this is not always clear in the case of investment in tourism which may not

only depend on the general market but also the potential for the tourism market, such as tourism arrivals or real exports of services. We will experiment with all three measures; but need to acknowledge measurement of ‘market size’ is more difficult than for say market-seeking manufacturing FDI. The data comes from the World Development Indicators 2005, and from UNCTAD on exports of travel services. The deflators used to make the market size and FDI variables constant is the GDP deflator. We introduce a one-year lag for all market size variables, thus avoiding a possible endogeneity between market size and FDI. We use the sum of Tourism FDI in all Caribbean countries as regional tourism FDI.

#### 4 New Evidence

##### *First look at the evidence*

Casual observation of the data is informative on how GATS commitments might be related to inward FDI (Table 2). The countries that attract most inward FDI also have a higher score on the GATS commitments variable (Dominican Republic, and Mexico and Costa Rica for countries outside CARIFORUM), while a country such as Belize with relatively little in FDI has not made any commitments so far. Furthermore, St Vincent has made a recent GATS offer in tourism and is also receiving relatively large FDI inflows. These are signs of a positive relationship between GATS and FDI.

**Table 2 Tourism FDI inflows and GATS negotiations**

Country	FDI (mn USD, average of recent 5 years)	GATSnum	Number of trade negotiators in Brussels/ Geneva	Number of country representatives –Singapore	Number of country representatives – Doha	Number of country representatives – Cancún
Mexico	592	3	8	13	27	90
Dominican Republic	165	4	3	12	10	9
Costa Rica	83	4	4	4	8	8
St Kitts and Nevis	60	1	1			3
St Vincent and Grenadines	47	1	1			5
St Lucia	47	1	4			8
Jamaica	37	2	3	5	4	19
Grenada	23	1	1	1	2	3
Belize	19	0	1	4	2	19
Dominica	6	1	2	2	2	2

*Sources:* Authors’ Own calculations, appendix and chart 1, (WT/MIN(96)INF/7/Rev.1,2 January 1997), (WT/MIN(03)INF/14, 10 September 2003), (WT/MIN(01)INF/15,9 November 2001), and Constantine Michalopoulos (2000), ‘The participation of the developing countries in the WTO’.

##### *Results from regressions*

Table 3 presents the results in a more formal way on the basis of regressions. In the first column we explain the real flows of inward FDI pooled over 9 Caribbean countries by the variable GATS commitments, and as expected on the basis of the

simple evidence above, *GATSnum* is a significant and positive explanation for inward FDI. We use a random effects panel estimator so that there might be country-specific effects but these are randomly distributed and the mean is not significantly different from zero. The interpretation is that more GATS commitments in the tourism sector would raise inward FDI. The rest of the table includes more regressors allowing for control variables.

Column II includes country specific fixed effects using a robust OLS estimator, while column III includes a time trend. These variables allow for a trend in FDI over time common to Caribbean countries and account for unobserved fixed effects on FDI. In both cases GATS commitments in the tourism sector would raise inward FDI.

**Table 3 Regression results explaining FDI in Caribbean Tourism**

	ln (FDI) Pooled over 9 Caribbean countries, 1997-2003								
	I	II	III	IV	V	VI	VII	VIII	IX
<b>GATS variables</b>									
<i>GATSnum</i>	0.78 (3.32)**	0.69 (6.86)**	0.73 (7.09)**	0.68 (2.94)**	0.71 (2.14)**	0.69 (1.62)*	0.60 (1.31)	0.72 (8.01)**	0.72 (6.69)**
<i>Offers</i>				3.41 (2.89)**	3.36 (1.59)	2.85 (1.30)	3.04 (1.37)		
<b>Domestic Regulation</b>									
<i>Hotel Act</i>				0.68 (1.80)*	0.66 (0.98)	0.49 (0.69)	0.55 (0.76)		
<i>Recent changes</i>				0.56 (2.16)**	0.58 (1.64)*	0.54 (1.26)	0.50 (1.16)		
<b>Market size</b>									
Ln (vol XSER) <sub>-1</sub>				0.14 (0.57)	0.11 (0.45)				
Ln (tourist arrivals) <sub>-1</sub>						0.16 (0.39)			
Ln (GDP) <sub>-1</sub>							0.20 (0.57)		
Ln (Region FDI)								0.63 (1.65)*	0.63 (1.64)*
Country fixed effects included		Yes	Yes					Yes	Yes
Time trend included			Yes					Yes	Yes
No of observations	55	55	55	54	54	54	55	55	55
R-squared	Na	0.52	0.53	0.44	Na	Na	Na	0.54	0.54
Method of estimation	Panel-Random Effects	OLS robust	OLS robust	OLS robust	Panel-Random Effects	Panel-Random Effects	Panel-Random Effects	OLS Robust	IV,instr <i>Negotiators</i>

*Notes:* A constant is included in all regressions (but not reported), t-statistics are between parentheses. 9 Caribbean countries included with some gaps in data.

\*\* (\*) denotes 5% and 10% significance level. The regressions were done in Stata.

Columns IV–VIII include more explanatory variables, ranging from GATS offers to domestic regulation and market size. Column IV uses a robust OLS estimator. The variable *offers* is highly significant but simply refers to the offer made by St Vincent and Grenadines – and the effects are large. If these observations were right – which

may not be so given the few offers – it would put into perspective the paucity of offers in the tourism sector. We include the real exports of travel services as the market size variable, but this is insignificant. The two variables on domestic regulation, the type of Hotel Act (HA) and the number of recent changes in domestic regulation, are significant (at the 10% level in the case of HA). Column V employs the random effects model (allowing for randomly distributed country intercepts – in contrast to robust estimation which addresses potential heteroscedasticity and serial correlation in the error terms) and finds similar results in terms of magnitude of effects though the coefficients are lower or not significant. Columns VI–VII experiment with different market size variables, the number of tourist arrivals and real GDP. One issue that becomes apparent is that while the variable *GATSnum* is often significant, the market size variable never is. This reinforces the problem posed before: it is not clear how best to measure the relevant market size variable in the context of tourism.

Column VIII provides regression results using an alternative way to capture market size: regional tourism FDI. This is basically an allocation model where investors first allocate FDI to tourism in the Caribbean, and then decide to allocate it to individual countries on the basis of some criteria, including GATS rules. To capture variation in size across countries we include country specific dummies. The results indicate that the regional FDI variable is a better measure of market size, though there is still a problem of low significance.

Finally, column IX uses instrumental variables estimation in the same specification as in column VIII. We use this technique because it is often said that while GATS commitments may raise FDI, it could also be that more FDI raises the possibility that a country has more GATS commitments. In general it is difficult to find a valid instrument that affects the ability to make GATS commitments but FDI only through GATS commitments. However, this paper argues that there are two candidates: number of permanent negotiators, and a weaker one, the number of country representatives at WTO ministerials (see Table 3). The more WTO negotiators a country has the more likely it is that the country takes its services sector seriously. There is a significant correlation (pairwise correlation coefficient is 0.53) between numbers of negotiators and more advanced GATS commitments. The results show that using such an instrument in estimation does not change the main results. We have also explored other instruments (ministerial attendants) and in the other equations in the table, but the coefficient remain mostly significant. We suggest that this is an interesting use of instruments which can be used in further similar equations.

The results are indicative of a positive relationship between GATS commitments and inward FDI. There are several caveats that may make the results more tentative: there are 55 observations and the results could be more credible if there was a larger sample (more countries and/or more data over time); several papers find different determinants of FDI and unfortunately we cannot include all of them due to overparameterisation; finally, the variable *GATSnum* is still quite crude, though more detailed than anything tried thusfar in this context.

## 5 Implications for negotiation strategies

The main findings of the analysis in the previous section suggest that being actively involved in services negotiations (in the form of commitments or offers in GATS) is a good thing for attracting more FDI into tourism, but it is easy to overestimate the results: they are not always significant or clear, and other determinants may still be much more important. We also pointed out the limited sample size. There is a further issue: services negotiations need to be a tool for development, and an increase in FDI may be welcome but its positive impact on development is not always secured. There is a rather large literature on FDI policies, but here we concentrate on how services negotiations can attract Tourism FDI and make this work for development.

### *GATS*

As reviewed in Section 2, several studies have examined options for the Caribbean in services trade negotiations. A study by the Caribbean Regional Negotiating Machinery (Dunlop, 2003) discussed tourism with respect to trade negotiations. This has led to a set of recommendations,<sup>7</sup> a set of possible offers in trade negotiations: a) liberalise services sectors that help tourism (utilities, insurance); b) reduce tariffs on goods used by tourism; c) facilitate movement of visitors and tourism professionals; and a set of requests: a) access to developed markets for tourism students, and for tourism professionals, who should be included in the category professionals, and whose qualifications should be recognised fully; b) extend portability of developed country health insurance to the Caribbean, and a set of other demands.<sup>8</sup>

The Caribbean Hotel Association (CHA), representing more than 800 hotel members, responded and among others confirmed to a) use trade negotiations to attract FDI in tourism, and remove services limitations to hotels with more than 75 rooms (different from 100 rooms common in some countries); b) secure mutual recognition agreements for tourism qualifications; c) enhance mode 4 market access (for tourism professionals and hospitality students) and d) examine schemes to extend insurance cover to Caribbean Hotels.

The European Services Association also lists GATS commitments as one (but only the 7<sup>th</sup> most important) of the factors on list of determinants affecting inward FDI in the Caribbean.

Thus, it seems that, on the available evidence and policy statements, removing additional trade and investment barriers through negotiations in GATS should help to

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<sup>7</sup> Encourage public/private dialogue and trade/tourism ministries dialogue; Develop encompassing definition of tourism Develop regional policy on cruise tourism; Introduce Tourism Satellite Accounts (TSAs) to measure impact.

<sup>8</sup> Review health and safety standards used by developed country tour operators, and compensate Caribbean Hotels when the tour operators become insolvent; Encourage conferences to be held in Caribbean through tax incentives and reduce taxes on travellers to Caribbean, and increase their duty-free allowances; Build regional hospitality services programmes; Introduce market access points for Caribbean Tourism Services providers; Introduce Caribbean airlines in global reservation systems; Establish internet marketing strategies for small business/hotels, introduce TSAs; Facilitate Caribbean commercial presence abroad; Encourage partnership programmes in hospitality institutes; Increase air services to small countries.

increase more FDI and exports of services in the tourism sector. GATS seems particularly appropriate because it can be used to signal openness to FDI through effective offers in mode 3 (in the Caribbean) and it can be used to get more credible access in export markets through requests in mode 4. The credibility of GATS commitments comes in part from an effective dispute settlement mechanism.

While GATS flexibility can itself be used as a means of special and differential treatment (SDT), some would argue that GATS provisions (or indeed Regional Services Trade Agreements) could be made more directly development friendly. A Dominican Republic's proposal for a new Tourism Annex to the GATS includes three such provisions: need for multilateral competitive safeguards to counter anti-competitive practices in the international tourism sector; the need to promote sustainable tourism development in the GATS, and the need to expand the definition of tourism under the GATS agreement. Thus, one possibility is to include provisions on competition policy so that the Caribbean can make a case when large tour operators operating from developed country markets behave uncompetitively.

It is also possible to attach conditions to increased market access offers in GATS. For instance, for political economy reasons countries can commit the hotels sector subject to an economic needs test (e.g. minimum occupancy rates). This is unlikely to go down well with investors, as it can be a way to protect an inefficient local industry.

Current GATS negotiations are not only about sectoral commitments, but also about GATS rules, including rules on subsidies. Unlike in the case of goods, where the Agreement on Subsidies and Countervailing Measures makes discriminatory subsidies that affect export performance illegal, subsidies (e.g. tax free concessions) are still permitted, and they are being used by the Caribbean. While little is known about the effects of subsidies on investment as the effects are not properly monitored, the Caribbean may want to consider whether it wants to keep the possibility of using discriminatory subsidies (general subsidies are possible) for services development.

### *EPAs*

Potential negotiations on services EPAs are different for at least three reasons. First, these are Regional Trade Agreements (RTAs) and are therefore not the most efficient way of liberalisation: opening up the tourism sector for the EU investors alone would leave out potentially more efficient investors. That said, RTAs are well placed to deal with liberalising sensitive services sectors such as Mode 4 which would get too little attention at multilateral level.

Second, EPAs are less credible because they are not backed up by effective dispute settlement mechanisms. EU agreements have so far not included any rules on investment in relation to protection. Its investment agreements are in essence investment promotion agreements.

Third, the EU sees EPAs as WTO compatible trade parts of the Cotonou agreement with the inclusion of Special and Differential Treatment for ACP (African, Caribbean and Pacific) suppliers. SDT can include trade options (which may economically not be the most efficient) and aid options. The Cotonou agreement (CPA), and before it successive Lomé conventions, has coincided with aid funds. These aid funds can also

be used for the development of services sectors (when they are part of the EU indicative programmes) and hence can be used to improve the effects of liberalisation of the services sector.

CPA Article 24 deals with tourism: 'Cooperation will aim at the sustainable development of the tourism industry in ACP countries and sub-regions, recognising its increasing importance to the growth of the services sector in ACP countries and to the expansion of their global trade, its ability to stimulate other sectors of economic activity, and the role it can play in poverty eradication.

Cooperation programmes and projects will support the efforts of ACP countries to establish and improve the countries' legal and institutional framework and resources for the development and implementation of sustainable tourism policies and programmes, as well as *inter alia*, improving the competitive position of the sector, especially small and medium-sized enterprises (SMEs), investment support and promotion, product development including the development of indigenous cultures in ACP countries, and strengthening linkages between tourism and other sectors of economic activity.

Concrete examples that address CPA. Art. 24 to promote sustainable tourism, i.e. tourism that contributes to the local economy, include support for a heritage trail in St Lucia and an integrated tourism programme in Suriname (Te Velde, 2005). There is a discussion as to whether and how different types of tourism contribute to the local economy. One part of this debate is the extent to which local suppliers are connected to big (foreign-owned) hotels whose numbers may increase after more commitments in GATS. The extent of such linkages usually depends on good quality and timely supplies. However, access to finance is another factor. Discussions in St Lucia suggested that big hotels do not pay small local suppliers of flowers on time, so that access to credit is one of the constraints to further profitable tourism.

Another example would be to ask for measures to support an integrated tourism policy to make tourism work for development. While attracting large hotels or being linked in with large tourism operators seems desirable to expand the market, there are also problems. Tourists tend to go to all-inclusive resorts with little linkages with the local economy and the possibility of profit repatriation. One way of dealing with this is to support local economic activities (e.g. cultural services, restaurants) which require support for human resource development that can deliver a change in the mind-set of many Caribbeans away from seeing commodities as a career towards seeing the hospitality sector as a career path. The CPA may be helpful.

## **6 Conclusions**

This paper examined whether and how developing countries can use services trade negotiations to increase the amount of inward FDI conducive to development, with a focus on the tourism sector in the Caribbean.

The paper reviewed the evidence and views on whether and how services trade rules (supply of services mode 3 relates to cross border investment) can affect inward FDI, with specific attention to inward FDI (mainly in hotels and restaurants) and the

regulatory framework in the tourism sector in the Caribbean. There were several observations. First, several barriers to market access and national treatment of foreign firms in the Caribbean remain possible because they are not enshrined in international trade commitments, so countries have not even committed the status quo. Second, because there are still trade barriers (in GATS) in all countries (maximum score is 4 out of 8), there is scope for progress for all countries. Third, because the scope of commitments varies considerably by country (ranging from 0–4), this presents a good basis for testing the effects this might have on inward FDI.

The paper then performed a simple statistical analysis, presenting panel data (1997–2003) on inward FDI in the tourism sector in 9 Caribbean countries and correlated these with data describing the regulatory framework committed in fora such as the WTO General Agreement of Trade in Services, and controlling for other factors affecting inward FDI. From the totality of the evidence (statistical, theory and statements) we conclude that GATS negotiations are likely to attract inward FDI.

The final section discussed options in current trade negotiations on trade in services to attract tourism FDI. In multilateral trade negotiations (GATS), Caribbean countries may want to signal openness to inward FDI while maintaining a degree of flexibility in the use of policy measures; in current negotiations on Economic Partnership Agreements with the EU, the focus could be on liberalising sensitive services sectors (e.g. mode 4) as well as on making use of the development dimension of EPAs such as the inclusion of support measures for investment in tourism conducive to the competitiveness of local economic players.

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## Appendix

Domestic Regulations and GATS Commitments in the tourism sector.										
Domestic Regulations				Existing GATS Commitments in Tourism						New GATS offers made.
Countries	Domestic Regulatory Framework on Tourism <sup>9</sup>	HA <sup>10</sup>	RA <sup>11</sup>	GATS Commitments <sup>12</sup>	9A-Hotels and Restaurants(Incl Catering)	9B-Travel Agencies and Tour operators services	9C-Tourist Guides Services	9D-Other	Num <sup>13</sup>	GATS Offers <sup>14</sup>
Barbados	<u>Hotel Aids Act (1967)</u> —Concessions to hotels. <u>Sustainable Tourism Bill(2001)</u> -Stimulate investment to tourism sector. <u>Income Tax Act-Concessions to tourism projects</u> .	3	1	(Not Scheduled)					0	New offers made but none within this sector.
Belize	<u>Belize Tourism Board Act (1990)</u> - Tourism board authorised on tourism issues. <u>Belize National Tourism Council Act (1999)</u> - Belize National Tourism Council as a policy making entity for tourism. <u>Hotels and Tourist Accommodation Act (1997)</u> regulation for the operation of hotels and accommodations	3	2	(Not Committed)					0	No new offers yet
Dominican Republic	<u>Tourism Development Law (Law No. 158-01)</u> — <u>Development law</u> -promotes tourism development. <u>Foreign Investment Law-</u>	3	1	Yes, scheduled commitments depend on sub-schedule, and vary	<u>Hotel and similar accommodation services --MA-Mode4-Unbound, except as indicated in the horizontal section.NT-Mode 4-Unbound, except as indicated in the</u>	MA- Mode 4- Unbound except as indicated in the horizontal section.			2	New offers made but

<sup>9</sup>Source - WTO Trade Policy Review

<sup>10</sup> HA- Country specific variable on Hotel Act. [Variable ranging from 0-3]. 0 = No Act in tourism sector. 1= No Hotels Act but acts in other tourism sub sectors. 2 = Hotels act granting access equally to domestic and foreign firms but access to foreign firms limited by the size of rooms. 3= Hotels act granting equal access to domestic and foreign firms.

<sup>11</sup> RA- Country specific variable on Recent Hotel acts. [Variable ranging from 0-2]. 0= No changes in laws affecting Hotels/Tourism, 1995-2003. 1= One new Hotel Act over 1995-2003. 2=More than one change to Hotel Acts over 1995-2003.

<sup>12</sup> Source- GATS Initial offers for the countries.

<sup>13</sup> GATS Numeral- Codifies existing GATS Commitments in the sector. Calculated as sum total of scores for commitments in each of the four sub sectors and can run from 0-8, 0 indicating no commitments in any sub sectors and 8 indicating total commitment in all 4 sectors.[ Sub sector scores - 0= No commitments in sub sector. 1= Commitment in sub sector subject to some limitations. 2=Commitment without limitations. ]

<sup>14</sup> Source-GATS Initial offers.

	Foreign investors granted national treatment. <u>Law on Environment and Natural Resources-</u>			by mode, and NT/MA.	horizontal section.					none within this sector.
Guyana	<u>Guyana Tourism Authority Act (2002)</u> -The Tourism Authority oversees tourism, and licences operations. No distinctions between nationals and foreigners.	3	1	Yes, scheduled commitments depend on sub-schedule & vary by mode, and NT/NA.(Sub-schedule A and B. B has full commitments)	MA-MODE 4- Unbound except as indicated in the horizontal section. NT-MODE 4- Unbound except as indicated in the horizontal section.	MA-Mode 4 Unbound except as indicated in the horizontal section. .NT-Mode 4- Unbound except as indicated in the horizontal section.			4	New offers made but none within this sector.
Haiti	<u>Law of 28 March 1975</u> - management and exploitation of tourism investments. All tour operators must be Haitian nationals (though not applied in practice).	1	0	Yes, scheduled commitments depend on sub-schedule, and vary by mode, and NT/MA.(Sub-schedule A)	<b>MA</b> -Mode 4-Unbound except for measures affecting natural persons in the categories: managers, senior executives, specialists who possess knowledge essential to the provision of the service. <b>NT</b> -mode 4-Unbound except for measures affecting natural persons in the categories: managers, senior executives, and specialists who possess knowledge essential to the provision of the service.				2	No new offers yet.
Jamaica	No specific tourism law. <u>Hotel Incentives Act</u> -10 year relief provided from taxes and duties.. <u>Resort Cottages Act</u> -7 year income tax relief on new resort cottages. <u>Jamaican Legislation</u> - Allows total foreign control of hotels, resort cottages or tour operators but licensed.	3	0	Yes, Scheduled commitments depend on sub schedule and vary by mode and NT/MA(Sub schedule A&B)	MA-MODE 3-registration, licensing required. MODE 4- Unbound except for horizontal commitments. NT-MODE 4-Unbound except for horizontal commitments.	MA-MODE 3-registration, licensing required. MODE 4-Unbound except for horizontal commitment.NT-MODE 4-Unbound except for horizontal commitments.			2	New offers made but none within this sector.
Suriname	<u>Integral Tourism Development Programme</u> - Involves projects relating to the improvement of the legal and institutional framework, tourism product development, and marketing support, and human resource development. A new tourism law is under consideration.	0	0	Yes, scheduled commitments depend on sub-schedule, and vary by mode, and NT/MA.	MA-MODE 4- Unbound except as indicated in the horizontal section. MA-MODE 4- Unbound except as indicated in the horizontal section.	MA-MODE 4- Unbound except as indicated in the horizontal section. MA-MODE 4- Unbound except as indicated in the horizontal section.			4	New offers made but none within this sector.
Antigua and Barbuda	<u>Tourism Development Act of No. 6 (1997)</u> ;- Foreign investment in hotels allowed under the Hotel Proprietor Act. However, hotels under 50 rooms are reserved for local investors. <u>Hotel Proprietor Act</u> -Created by the Tourism Act in 1997, The Tourism Development Corporation regulate and market all aspects of the A & B tourism industry.	2	1	Yes, scheduled commitments depend on sub-schedule, and vary by mode, and NT/MA.(Sub-section A)	MA-MODE 3- Hotel Proprietors Act. MODE 4-As indicated under horizontal commitments.NT- MODE 3- Hotel Proprietors Act.				1	No new offers yet.

Saint Vincent and the Grenadines	<u>Hotel Aid Act No. 16 (1988)</u> -incentives granted for the improvement by repair, renovation, or replacement of existing facilities of a hotel.	3	0	Yes, scheduled commitments depend on sub-schedule, and vary by mode, and NT/MA. (Sub-schedules A-C; 'B' is fully committed).	MA-MODE 3- Subject to Commercial code, Exchange Control Act, Hotels Proprietor Act. MODE 4-Limited to managerial and specialist levels, subject to work permit and immigration regulations as indicated in the horizontal commitments.				1	Further liberalisation in MA in certain sub sectors in tourism.
Saint Lucia	<u>Tourism Incentives Act No. 7 (1996)</u> -The Ministry of Tourism is responsible for policy formulation. Tourist Board is in charge of advertising, promoting, and marketing tourism activities.	3	1	Yes, scheduled commitments depend on sub-schedule, and vary by mode, and NT/MA. (Sub-section A)	MA-MODE 3- Hotel and resort development and operation in excess of 100 rooms.. MODE 4-Limited to managerial and specialist levels subject to horizontal limitations concerning Work Permit Regulations.				1	New offers made but none within this sector.
Saint Kitts and Nevis	The restriction for foreign ownership applies for hotels of less than 30 rooms; in practice, there is no restriction for foreign ..incentives package for both local and foreign investors for establishments of at least ten rooms.		0	0	Yes, scheduled commitments depend on sub-schedule, and vary by mode, and NT/MA.(Sub-section A)				1	New offers made but none within this sector.
Grenada	<u>Tourist Board Act (Cap. 321- Grenada Board of Tourism</u> , charged with developing all aspects of the tourism industry. <u>Hotels Aid Act (1954)</u> - incentives for tourism activities.	3	0	Yes, scheduled commitments depend on sub-schedule, and vary by mode, and NT/MA.(Sub-schedule A).	MA-MODE 3-Subject to alien landholding regulations, exchange control regulations. Limited to the developments of hotels in excess of 100 rooms. Hotel development of less than 100 rooms may be subject to an economic needs test. MODE 4-Limited to managerial and specialist skills levels and as in the horizontal section. Subject to work permit and immigration regulations. NT-MODE 3-Subject to withholding tax.				1	New offers made but none within this sector.
Dominica	<u>Hotel Aid Act</u> as amended by the <u>Hotel Aid (Amendment) Act No. 21 of 1991</u> - 20-year relief from income tax and import duties .- <u>Income Tax Act No. 37 (1982)</u> <u>Aid to Development Enterprises Act.</u>	3	0	Yes, scheduled commitments depend on sub-schedule, and vary by mode, & NT/MA.(Sub-schedule A)	MA--MODE 3)-Subject to alien landholding regulations, exchange control regulations. Limited to the development of hotels in excess of 50 rooms. Hotel development of less than 50 rooms may be subject to an economic needs test. MODE 4)-Limited to managerial and specialist skills levels and as indicated in the horizontal section. Subject to work permit and immigration regulations.				1	New offers made but none within this sector.