



Small States and Tourism: a Resource Curse Phenomenon?

A Study in the Context of Grenada

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Kerricia R. Hobson

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Members of the Examining Committee:

Dr. Murat Arsel

Ms. Carol Hunsberger

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Inquiries:

International Institute of Social Studies
P.O. Box 29776
2502 LT The Hague
The Netherlands

t: +31 70 426 0460
e: info@iss.nl
w: www.iss.nl
fb: <http://www.facebook.com/iss.nl>
twitter: [@issnl](https://twitter.com/issnl)

Location:

Kortenaerkade 12
2518 AX The Hague
The Netherlands

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List of Acronyms

AOSIS	Alliance of Small Island States
CARICOM	Caribbean Community
CPIA	Country Policy and Institutional Assessment
CTO	Caribbean Tourism Organization
CVI	Commonwealth Vulnerability Index
GDP	Gross domestic product
GNI	Gross national income
FAO	Food and Agriculture Organization
MIRAB	Migration, Remittances, Aid and Bureaucracy
NDC	National Democratic Congress
NJM	New Jewel Movement
NNP	New National Party
NRL	national reconstruction levy
OECS	Organization of Eastern Caribbean States
PM	Prime Minister
PRG	People's Revolutionary Government
SIDS	Small Island Developing States
UN	United Nations
WTTC	World Travel & Tourism Council

Abstract

The resource curse theory has used to provide some explanation for the poor economic performance often seen in oil and mineral countries. It suggests that dependence on natural commodities exploitation is has an overall negative effect on economic growth. Small states however are encouraged to embrace tourism, which for SIDS in particular is based on taking advantage of their natural resources. Applying the resource curse theory to small tourism-dependent states have suggested that the specialization in tourism can lead to curse outcomes and suggests a need to either re-evaluate the benefits of tourism dependence in small states or acknowledge the merit in calls for the special and differential treatment of small states.

Relevance to Development Studies

Much of the existing literature recognizes the susceptibility of small states to exogenous shocks but argues that because many of these countries have achieved outstanding levels of economic growth relative to larger countries and as such insist that there is insufficient evidence to necessitate special considerations. In addition, while the mainstream view is that mono-economies are more vulnerable, a gap exists in the literature addressing this call for specialization of an already fragile economy, a move that would appear *a priori* to exacerbate their exposure to shocks while simultaneously reducing their resilience. This paper was prepared on the hope of beginning to correct this inconsistency

Keywords

resource curse, tourism, small states, Grenada, comparative advantage

Chapter 1 Introduction

Global discourse promotes tourism as a viable source for economic growth in developing countries but especially for small states that have limited options associated with size constraints namely a narrow resource base, small domestic market and lack of viable alternatives. In many cases such states are encouraged to eschew traditional agricultural exports and abandon attempts at building a manufacturing sector to embraced services – particularly tourism in tropical states – where characteristics of smallness and isolation are comparative advantages. In this particular situation, these features can be feasibly marketed and sold, specifically when facilitated by global finance and investment (Bertram and Poirine 2007, Prasad 2003). The belief is that if tourism is fostered sustainably, these isolated economies will be integrated into the global economy, which will contribute to local development and facilitate a North-South transfer of capital resources (Gössling 2003).

Tourism is an attractive option for many developing states naturally blessed with amenities such as warm weather and white sandy beaches not typically found in developed countries. For small, capital-deficient countries, the industry provides a means to earn the foreign exchange that is vital for financing imports for consumption. Against this backdrop, the acceptance of the industries as a sector to drive economic growth is unsurprising. This is the case in the Caribbean, which is the largest group of small island developing states (SIDS) in the world (Kida 2005). Many of the smaller tropical islands are blessed with an abundance of ‘sun, sea, sand’ and as such have embraced tourism as the key to development (Caribbean Tourism Research and Development Center 1988). One island, Grenada, is no different in this regard. Figures from the World Travel & Tourism Council (WTTC) suggest that for the year 2012, 52.4 percent of its total exports were derived from tourism with the industry accounting for 21.8 percent of the gross domestic product (GDP). The use of a traditionally non-traded good/service as a successfully export has truly realized economic benefits for these small countries.

The tourism sector is largely based on the exploitation of natural resources and it is this feature that provides the centrepiece of this paper. Exports of primary resources *vis-à-vis* processed goods are held by development economists as unfavourable in the pursuit of development objectives. This is because manufacturing and agro-processing are considered to be key drivers for economic growth (Davis 1995). This assumption underscores the hypothesis of the curse of natural resources, which suggests that natural resources tend to cause an overall economic loss due to the greater value of the negative effects in relation to the positive outcomes (Auty 1993). It is often employed as an analytic to explain why resource-rich countries often underperform while resource-poor countries boast strong economic growth (Sachs and Warner 1995, Sachs and Warner 2001). There are five socioeconomic mechanisms central to its interpretations. The first involves deindustrialisation through the permanent shrinkage of the manufacturing sector, otherwise known as Dutch disease. Secondly, the economy experiences a loss of diversity that causes the third factor, a greater susceptibility to global shocks. The government tends to become overoptimistic about future revenues of the sector and may accrue fiscal debts based on that anticipation.

Finally, there is often widening disparities in income and a reduction in social services provided (Davis 1995, Le Billon 2005).

The above features of the resource curse are generally applied to extractive primary resources like oil and minerals, and is said to arise because of the particular nature of oil and mineral economies (Auty 1993, Brunnschweiler and Bulte 2008a, Gelb 1988). However, studies have shown that small tourism economies do exhibit Dutch disease (Copeland 1991, Sheng 2011). Extending these observations would therefore suggest that small tourism economies may also be susceptible to broader resource curse outcomes. To this end, this paper seeks to investigate if tourism can become a resource curse in the context of a small state economy. To evaluate this question, the curse framework was adjusted to tourism economies and applied to the Grenada to see if the characteristics manifested. Evidence was found to suggest that many of the resource curse factors were indeed present in Grenada's economy, prompting a discussion on whether tourism specialization is actually beneficial to small states. It was the conclusion of this author that the proposed benefits of tourism are negated when the curse is accounted for. However, this is against the backdrop of a universal application of trade rules, without the special circumstances faced by small states. In light of this this author asserts that some reconciliation is needed on the status of small states. If uniform developmental policies are to be applied, then the idea that tourism is a blessing for small states is fallacious. However, to recognize that different policies are needed in the small-state context is to implicated make an argument for the special and differential treatment (SDT) of small states.

The paper is organized as follows: chapter 2 discusses the resource curse theory in depth, focusing on its various characteristics. Chapter 3 engages with the literature on small states and how their inherent disadvantages could be switched to comparative advantage. Chapter 4 attempts to reconstruct the resource curse theory for application in a small open economy, which will provide the framework for analysis in chapter 5. Chapter 6 attempts to synthesize theories and findings of the research to draw conclusions.

Chapter 2 The Curse of Natural Resources

The relationship between an abundance of natural resources and economic development is a topic well explored in the literature. Conventional wisdom suggests that natural resource endowment should be an advantage to countries as it provides a source of foreign exchange and employment; attracts foreign capital and skills; contributes raw materials that can be processed, and a market for manufactured inputs; and above all is the initial source of nearly all development (Le Billon 2005, Mikesell 1997). It also affords an additional route to industrialization that is resource-based (Auty 1993). In recent decades however a debate has ensued over whether or not resource wealth is indeed beneficial to economies, with opponents alleging that natural resources are a developmental ‘curse’.

The theory of the curse of natural resources, also known as the paradox of plenty, describes a strong recurrent tendency for countries bountiful in natural resources be poor economic performers, associating resource abundance with instances of slow growth and negative development, as well as greater risks of civil war and even autocratic political regimes. Popular empirical evidence arose from Gelb’s (1988) study of the effect of windfalls on six oil-exporting countries and Auty’s (1993) work on select mineral economies. The most well-known study however was by Sachs and Warner (1995) who used regression analysis on a large sample of countries to demonstrate how economies with high levels of natural resource exports in relation to GDP in 1971 tended to have lower growth rates in the period 1971-1989, even when controlling for other growth-related variables including initial per capita income; trade policy; government efficiency; investment rates; and terms-of-trade volatility. The economic gains achieved during the periods of revenue windfalls, or resource booms – often due either to a discovery of new resources or an increase in world prices that result in a surge in export income (Mikesell 1997, Sachs and Warner 1995) – usually generated abnormal rents on productive factors (Brunnschweiler and Bulte 2008a, Gelb 1988). However these benefits tended to be nullified when the earnings declined (Davis 1995).

2.1 Conceptualization of the Resource curse

2.1.1 Economic Explanations

According to Ross (1999), development economists of the early 1950s viewed the exploitation of natural resources as favorable, especially for capital-deficient countries with surplus labor. However a wave of structuralist arguments emerged denouncing this premise. Of note are Prebisch (1950) and Singer (1950) who asserted that primary-exporting economies would be at risk of stagnation because prices of primary commodities tended to decline relative to manufactured goods, and the resulting deterioration in the terms-of-trade would widen the income disparity between industrialized and resource-exporting states. Other critics like Hirschman (1958) suggested that natural resource industries were liable to have reduced forward and backward linkage

effects compared with manufacturing and hence would not be growth-stimulating in the rest of the economy, an outcome further enhanced with the dominance of foreign multinational corporations that repatriate profits (Mikesell 1997, Ross 1999). A third criticism from authors like Levin (1960) and Nurske (1958) revolved around the argument that primary commodities markets were susceptible to greater price volatility and instability (Rosser 2006). Empirical validation of these theories however proved difficult, and so developing countries intensified extraction rates and even explored new markets. Furthermore, riding on the expectation of positive outcomes, the 1970s period was also characterized by a wave of nationalizations of resources, strategies for resource-based industrialization and populist booms.

Unfortunately, the 1980s heralded declining world prices for primary commodities and hence deteriorating terms-of-trade for natural resource-exporting countries. This occurrence encouraged a resurgence of the idea that natural resources are in fact detrimental to economic growth, particularly for developing countries (Rosser 2006).

2.1.2 Dutch Disease

The most widely discussed economic explanation is based on a model known as Dutch disease¹, which describes the structural effect of boom-induced growth on economies (Corden and Neary 1982, Sachs and Warner 1995). It is illustrated using the natural resource tradables sector, the non-resource tradables sector and the non-tradables sector, and described as follows: an appreciation of the exchange rate and rise in domestic income due to increased natural resource exports cause a rise in the real exchange rate, which reduces the relative prices for tradables – namely manufactured and agricultural goods – in comparison to non-tradables (construction and services). This causes the reallocation of productive factors – labor and capital – to the natural resource and non-traded sectors. The resulting ‘crowding out’ effect causes the contraction of manufacturing and agriculture and thus a decline in their exports. In addition, the movement of resources to the non-tradables sector will cause price inflation of services (Auty 1993, Boschini et al. 2007, Corden and Neary 1982, Davis 1995, Gelb 1988, Mikesell 1997, Ross 1999, Sachs and Warner 1995).

The two main consequences of Dutch disease are the appreciation that occurs of the real exchange rate² and the reduction of the non-resource traded sector. In accordance with the ‘booming sector’ theory (Gelb 1988, Mikesell 1997), a boom in the natural resource sector will cause a surge in the export of

¹ According to Kremers (1986), the model was named for the experience of the Netherlands in the 1970s when the discovery of natural gas led to its increased production. This resulted in a contraction of the country’s manufacturing sector (Davis 1995).

² Corden and Neary (1982) define the real exchange rate as the ratio of the relative price of non-traded goods to traded goods. An appreciation of the real exchange rate occurs when rises in foreign exports create greater demand for the domestic currency on the foreign exchange market, thus making domestic tradable cheaper in comparison to the non-traded sectors, as well as to imports. Consequently there would be a decrease in imports and a rise in the relative price of non-traded goods.

resource tradables, which prompts an appreciation of the real exchange rate because of the flood of foreign exchange into the market. It also brings about an upswing in the economic returns to capital and labor in that sector. This induces a resource movement effect (Corden and Neary 1982, Gelb 1988). Drawn by the prospects of higher incomes, productive factors shift from all other economic sectors into the booming sector. In the non-resource traded sector, this transfer causes the production costs of manufactured and agricultural outputs to rise, thus increasing their prices. The outcome is a loss of competitiveness both on the domestic and international markets. The impact of rising prices of the domestic tradeables is a swell in substitutable imports for consumption (Sachs 1989), which become more affordable owing to the appreciated exchange rate. When the loss in demand is coupled with an inability of the sectors to attract investment capital there is contraction of the non-resource tradables sector (de-industrialization and de-agriculturalization).

In addition to resource reallocation, a spending effect often occurs (Corden and Neary 1982, Gelb 1988). Rising incomes in the natural resource sector are often accompanied by increased spending on services, which then raises the prices (and incomes) in the non-traded sector in relation to the traded sector, and encourages further reallocation of productive factors from the lagging non-resource traded sector into the non-traded sector. The result is greater exchange rate appreciation and an even larger contraction/suppression of competitive diversification in the lagging sectors.

Dutch disease is considered adverse to growth since the post-boom is often marked by 1) distortions in the economy; 2) decreased competitiveness of tradables on the domestic and international markets owing to the real exchange rate appreciation; 3) declines in domestic savings and investments; and often 4) an increased foreign debt load. Moreover, it was not uncommon to observe instances of unsustainable wage and public expenditure levels.

Many authors have determined that while Dutch disease damage (as well as some of the previous economic arguments) is indeed possible, it is not always present in countries suffering from a resource curse and as such is an insufficient explanation for why some countries are unable to benefit from the economic rents generated from resource booms; it has also been recognized that the model is poorly applied to the contexts of developing countries that have labor surpluses and attract foreign capital and labor with booms (Auty 1993, Davis 1995, Gelb 1988, Mikesell 1997, Rosser 2006). Owing to the fact that the most prominent linkage between resource industries and the economy is fiscal, it is argued that ultimately the gains experienced from windfalls are dependent on the governmental response to the surge in fiscal revenues. This contention is further supported by the indication that macroeconomic policies can mitigate Dutch disease effects and that this knowledge is not absent from state authorities. As Ross (1999) contended of governments:

“they can offset a steady decline in the terms of trade by investing in the productivity of their resource sectors and by diversifying their exports; they can buffer their economies against the vicissitudes of international commodity markets by using commodity stabilization funds and careful fiscal policies; they can use their commodity windfalls to promote upstream and downstream linkages; and they can counteract the Dutch Disease by maintaining tight fiscal policies, temporarily subsidizing their agricultural and

manufacturing sectors, and placing their windfalls in foreign currency to keep their exchange rates from appreciating.” (Ross 1999: 307)

Much of the literature suggests the ‘sterilization’ of excess incomes in an overseas stabilization fund both as a form of savings and as a method of moderating the impact it would have on the currency exchange rate and incomes, and thus expected effect on domestic consumption (Gelb 1988, Mikesell 1997). Another approach is to devalue the currency exchange rate to combat the inflation of non-traded goods and services that contributes to appreciation (Mikesell 1997). A third option involves government investment in income-generating initiatives and not, as Mikesell (1997) argues, in social programs, low-yield infrastructure projects and defense. (Mikesell 1997, Mitra 1994). It is imperative therefore to consider a possible endogenous reason for the resource curse, that is, why governments mismanage windfalls from natural resources and/or delay the adoption of strategies that can reduce, even overcome, the negative repercussions of resource booms. Thus the question remains: why are economies negatively affected, generally, by an abundance of natural resources and an increase in rents from their extraction?

2.1.3 Political Explanations

Numerous authors have attempted to build a political economy of the resource curse centered on theories to explain policy failures and why states appear to have a predisposition to “adopt and maintain transparently suboptimal economic policies” (Ross 1999: 308). Rosser (2006) suggests six broad categorizations under which these viewpoints can be grouped. Behavioralist perspectives emphasize the various irrational and short-sighted reactions of state authorities to ‘easy’ wealth, which contributes to poor economic policies and institutional deterioration, such as excessive spending during resource booms (Mitra 1994, Ross 1999). Rational actor perspectives examine the self-interest of political actors as a consequence of the excess revenues, which may encourage rent-seeking activities and make savings accumulation more difficult (Atkinson and Hamilton 2003). In the public sector, politicians may distribute these rents as patronage or clientism (Kolstad 2009, Robinson et al. 2006); entrepreneurs in the private sector may be attracted to the prospect of higher profits in the resource sector and migrate hoping to access a share of the rents (Kolstad 2009, Mehlum et al. 2006, Torvik 2002). Conversely, structuralist perspectives focus on the role of interest groups or classes in compelling governments to adopt policies for their private gain – even if growth-inhibiting – including lax regulations of the resource sector (Broad 1995) or protectionist policies for the non-resource – mainly tradable – sector (Ross 1999).

Statist theories consider the nature of the state and its capacity to promote economic development, especially as institutions are weakened (Ross 1999, Rosser 2006). This includes proposals on the rentier state, which earns income with little effort and often with minimal interaction with its citizens. As resource rents are accrued, there is little need to tax the populace and so governments become less accountable but have the ability to appease citizens through distributive welfare programs (Moore 2001). The social capital perspective investigates how social conflicts over ownership of resources are

mediated by governments and the impact this has on their ability to enact growth enhancing policies to reduce susceptibilities to shocks (Rodrik 1999). Finally, radical perspectives argue against the structure of power at the global level that forces poor developing countries into subjugation by a capitalist system dominated by wealthier countries and transnational corporations, and within which developing countries do not have autonomy over their resources (Perelman 2003).

For the various political explanations of the resource curse, a clear argument emerges on the key variable governing whether or not, and to what extent, natural resources benefit stakeholders, whether public or private, and their relevance for helping to determine the ability of a country to respond to external shocks (Ross 1999, Wick and Bulte 2009). The institutions of a country seem to play a significant role in determining how windfalls from resource endowments are managed. Policies for expenditure, savings and investment interact to ultimately affect economic variables; therefore government responses are enlightening for the resource curse hypothesis.

Proponents of the resource curse suggest, as a component of the theory, that there is over-optimism within governments of the ability of the resource rents to finance activities indefinitely and generate foreign exchange, and that busts in a cycle would be temporary and compensated for by the booms (Auty 1993). Through taxation or ownership of resources, it was possible for governments to amass substantial portions of the windfalls, though instead of attempting debt repayment or the accumulation of overseas funds – or any of the policies that could ensure that resource rents are a blessing to the economy – there was a propensity for states to dispense substantial portions of the windfalls towards boosting immediate domestic consumption and expanding foreign debt by borrowing against expected future income revenues (Auty 1993, Gelb 1988).

The dilemma of trying to promote government savings and investment in productive activities, and seeking to prevent rapid increases in domestic consumption, is that it is usually challenging to accomplish amidst political pressure to intervene in the economy to alleviate some of the effects of the distortions caused by the surges in incomes (Davis 1995). Auty, in fact argues that a “rich resource base discourages the pursuit of disciplined policies (Auty 1993: 89). As such, there are two notable outcomes that usually transpire. First, the shrinkage of the non-resource tradables sector would be a cause for concern, especially as manufacturing and agricultural industries are posited to be the sectors mainly responsible for driving economic growth, and additionally, declines would have serious implications on employment (Matsuyama 1992, Sachs and Warner 1995). Due to the increase foreign exchange earnings, governments can afford to increase imports to satisfy consumption demands, thereby compensating for the drop in the output of non-resource traded goods (Le Billon 2005). The state response however is often a transfer of part of the windfalls from the booming sector to the shrinking sectors (Auty 1993). This can be achieved through producer protectionist policies of exports subsidization – to relieve some of the effects of inflation – and imports restriction (Davis 1995, Gelb 1988, Le Billon 2005). Yet such actions further depress lagging tradables and reduce international competitiveness, rendering it difficult for the industries to attract the investments needed to regain a share of the market.

The second common observation is a penchant for countries that have accrued immense rents from the exploitation of natural resources to have largely expanded – in size, role and scope – public sectors (Auty 1993, Gelb 1988, Mikesell 1997, Robinson et al. 2006). Governments have a tendency to utilize windfall gains to directly address unemployment and raise social welfare. In a number of cases the implementation of macroeconomic policies directed at these objectives occurred under populist governments³. In addition to direct public sector employment and an expansion in social services, governments may invest in public works programs. Gelb (1988) argues however that many such programs tend to be labor subsidies in that there was no relationship between wage and productivity. He further contended that such projects accelerated the shift of labor off the land – as the wage was often higher than what would be obtained in agriculture – and were simply a means of distributing resource rents to the society's poor. Furthermore, Robinson et al. (2006) noted that since public workers needed to be at least as well off as private workers, a consequence was also the transfer of jobs from the generally more productive private sector to the lower productivity (but more secure) public sector, which has a negative impact on economic growth. Rents were also often deployed for large-scale projects to enhance infrastructure or towards human capital formation, which further strengthened the non-traded sector. Gelb (1988) suggests that such activities were favored due to the minimum decision time and because they did not require any laborious and controversial institutional and political changes. However, failure to productively invest rents in maintenance and enhancement of neither physical nor human capital could promote unsavory behaviors and further entrench resource curse characteristics (Papyrakis and Gerlagh 2004, Papyrakis and Gerlagh 2006).

In some instances, the state secured ownership of the resources to ensure the continued availability of financing for all their undertakings. This led to problems eventually since lack of foreign partnerships often meant it was difficult to access markets especially in developed countries (Gelb 1988). Much of this was also accompanied by policies of consumer subsidization, through price controls aimed at holding down inflation, and with cuts in taxes. The overall effect was appreciation of the real exchange rate and unsustainable domestic consumption levels.

During the periods of downswing in government revenues, instead of cutting jobs or lowering wage rates, abandoning loss-making investments or lifting import restrictions, in short modifying public expenditure to align with the readjusting economy, governments often opted to borrow against their improved financial standing, expanding their foreign debt, and would continue unwise activities (Gelb 1988, Le Billon 2005, Mikesell 1997). Additionally, high state spending in boom years often signified that savings were either not being

³ According to Sachs (1989), populism often occur under charismatic leaders, is generally associated with a set of macroeconomic state policies engineered based on pressure to tackle income disparities in the society and raise living standards, particularly of the poor, in a political system where government tenure is short, and there is an inability to tax or confiscate the property of elites to cover social spending. The period is usually characterised by high inflation; large budget deficits; and foreign debt, all of which tend to cause the economy to succumb to a balance of payments crisis.

accumulated or that it was being done very slowly (Atkinson and Hamilton 2003, Mikesell 1997). This meant that there was no financial cushion for countries when windfalls significantly decrease. Considering the cumulative effects of all the behaviors discussed, it is not difficult to understand how natural resources may indeed become a developmental curse.

2.1.4 Civil War, Corruption and Regime Types

Some scholars of the resource curse literature have investigated the incidence of a causal link between natural resource endowment and the occurrence of civil wars, corruption, or the structure of regime administrations. Proposed arguments include whether or not the incidence of social conflicts is affected by the bountiful presence of primary commodities in the country. A distinction is made over what are considered point, and what are diffuse resources. Point resources are “geographically clustered in space and [are] relatively easy to monitor and control” (Brunnschweiler and Bulte 2008a: 251) and includes resources such as minerals and agricultural crops. Diffuse resources, in contrast, are spread out across a territory and thus are more challenging to control. The premise is that point resources are more strongly related to occurrences of the resource curse, and hence require more robust institutions for regulations (Boschini et al. 2007, Leite and Weidmann 1999, Rosser 2006, Wick and Bulte 2009).

According to Rosser (2006), some academics assert that resource abundance could incentivize rebel organizations dissatisfied with income inequalities, political leadership or other contentious realities in the state to orchestrate a means of appropriating the resource rents to finance rebellions (or simply for greed) or as a mobilizing issue to stir the population to action. There is also a belief that it helps to prolong and intensify unrests, and can signal the purpose of the conflict – that is if the fight is against state control and oppression or for efforts at separatism.

Another body of literature, as stated by Wick and Bulte (2009), connects natural resources to types of regimes. The thesis is that a bias exists for countries that have sizeable rents – such as oil – to be associated with autocratic governments, and that they may actually stymie democratization. Furthermore authors such as Leite and Weidmann (1999) contend that, particularly for point resources (where it becomes more pronounced), there can be incidences of corruption; when corruption is present, natural resources hinder growth in the economy *inter alia* by lowering incentives for investment and innovation.

2.2 Resource Curse Theory Critiques

The resource curse thesis is not without its critics. Skeptics of the phenomenon challenge the very existence and/or fecundity of the curse (Davis 1995). Even if a negative relationship between natural resource abundance and economic performance (or corruption, civil war and regime types) does exist, does the evidence presented thus far make a convincing case of causality? Before an assessment of the criticisms can be made it is necessary to differentiate among three terms. Though seemingly used interchangeably in the literature, there are contrasts among the terms *resource abundance*, *resource rents* and *resource dependence*. Based on definitions in Brunnschweiler and Bulte (2008a), resource abundance is the stock measure of an *in situ* resource wealth; resource rents is the flow of income derived from the resource stock at some point in time; and resource dependence is the degree to which countries do – or do not – have access to alternative sources of income other than resource extraction, again at some point in time (Brunnschweiler and Bulte 2008a: 261). With this consideration, some of the main critiques of the resource curse theory will be highlighted.

In explaining the findings of Boyce and Emery (2008), Wick and Bulte (2009) emphasized their assertion that the view of resource abundance should not foremost be that it boosts economies but income levels, primarily during extraction. To this end, they postulate that, at least in the short term, a rise in incomes is really a benefit, thus casting doubt on the ‘curse’ premise. Furthermore, the paper references the work of Manzano and Rigobon (2001) who employed methods similar to Sachs and Warner, but found that when “fixed effects” were controlled for, the negative correlation between resource abundance and economic growth disappeared (Wick and Bulte 2009: 150). They accredited this to an omitted variable, which they cited as “credit restraints”; once the variable was introduced into the regressions, the curse was no longer observed.

A third argument against the concept of the resource curse, put forward by Brunnschweiler and Bulte (2008a), contends that the empirical evidence for the occurrence of the resource curse presented by Sachs and Warner (1995, 2001) were actually measures of resource dependence and not the stated resource abundance. Their article concludes with a postulation that the resource curse may be a “red herring” as their findings suggest that abundance actually positively affects both institutions and growth (Brunnschweiler and Bulte 2008a: 261). Additionally, after an assessment of the relationship between resource dependence and growth and conflict, they asserted that causality generally does not run from dependence to slow growth and conflict; rather “causality appears to be running from weak institutions and conflict to resource extraction as the default sector, which produces resource dependence as the final outcome” (Brunnschweiler and Bulte 2008b: 617) as a channel for supporting citizens during adverse conditions.

To conclude the criticisms, I consider the arguments that suggest a general problem with the validity of the resource curse literature. Some authors assert that while there are a considerable number of models and hypotheses on the phenomenon, they are rarely tested in such a way so as to exclude others (Kolstad 2009), a point raised specifically by Ross (1999) in relation to the political explanations offered for the curse. However it is undisputable –

judging by the sheer volume and scope of the body of literature, and acknowledging the relevance of trying to understanding how and when natural resources become a 'blessing' on economies notably in developing countries endowed with primary commodities – that the discussion on whether or not the resource curse is a reality or myth is necessary. Also, as an analytic, it offers a sizable and mostly comprehensive framework against which to investigate a country's performance with the deployment of its resources.

Chapter 3 Small Open Economies

Of the 193 states recognized by the United Nations (UN) as sovereign, over one-third have been classified over the years as small and collectively are home to less than 0.4 percent of the global population. The rise of sovereign small nations truly became a phenomenon from approximately the 1960s, and over the years has prompted much debate about what constitutes small; whether ‘small’ states should be separately categorized; and whether special or conditional treatment is merited. To date however, there has been no consensus on a definition of small, and arguments for and against special recognition continue to be proposed.

Orthodox economic theory on appropriate paths to development is illustrated, for example, by the Lewis Model of Industrialization (Lewis 1955) that emphasizes the importance of transitioning towards an industrial sector based on high-productivity manufacturing from low-productivity agricultural activity, with the movement of unskilled and underemployed surplus labor from agriculture to manufacturing, to achieve a corresponding increase in aggregate productivity (Armstrong and Read 2003). The belief was that the larger a territory, the bigger would be the natural resource base and domestic market, and the greater would be its capacity to take advantage of economies of scale (Baldacchino 1993). Likewise, economies needed to be large so that they could be more robust through diversification. Yet, as Armstrong and Read (2003: 102) indicate, such a development strategy is based on the assumptions that there is (1) a large population; (2) a large traditional agricultural sector; and (3) a large agriculture labor force. By Lewis’ own admission, such a model is inapplicable in small state settings where the population is small, even if traditional agriculture is a prominent sector. In addition, for small countries, import-substituting strategies would be limited and often do not achieve the desired results (Briguglio 1995: 1616). Thus, as Baldacchino (1993) asserted, there was a need for an alternative paradigm of ‘development’.

Because small states did not possess the typical economic advantages, such countries *a priori* would be expected to exhibit poor economic performances and be among some of the least developed countries, particularly in relation to larger states (Easterly and Kraay 2000). Paradoxically, a number of small nations have achieved higher levels of per capita income and productivity levels, as well as sustained economic growth and development *vis-à-vis* much larger states (Armstrong and Read 2003, Commonwealth Secretariat 2000, Easterly and Kraay 2000, Read 2002). This reinforced the need for an alternate explanation to account for the success of many small states. The first major obstacle for small state studies however was explaining what was meant by small in relation to states.

3.1 Defining ‘small’

The question of what should be treated as ‘small’ rose in importance due to a number of reasons. It was mainly driven by the increased attention from international bodies in the 1990s – notably the World Bank and Commonwealth – directed at small states, especially amidst calls for such countries to receive SDT in areas such as trade; and the formation of consultative groups (Croes 2013, Crowards 2002, Singh and Prasad 2008, Sutton 2011, Thomas 2004). Furthermore, the development of a Commonwealth Vulnerability Index (CVI) illustrated the susceptibility of small countries to shocks and their diminished capacities to cope (*ibid.*). Even with the rise of such organizations like the Alliance of Small Island States (AOSIS), which in practice includes islands as well as continental countries, and the recognition of SIDS within the UN however, a definition of small has remained problematic. Hence, this has left economists with the freedom to propose their own definitions (Sutton 2011). Sutton (2011) suggested that ambiguity on the definition of ‘small’ may actually be a deliberate political strategy, given that some countries would contest any delineations put forth as contradictory.

Three parameters have commonly been used in the search to appropriately determine what countries would be considered small. The most widely applied criterion has been population, on the assumption it is an appropriate conceptual measure of the size of the domestic market and local labor force and, generally, complete data sets are readily available (Armstrong and Read 2003, Commonwealth Secretariat 2000, Crowards 2002). It is also highly correlated with the other indicators to be outlined and as such is often the preferred measure. However, variances exist on an appropriate benchmark for a small population size, albeit the two most universal were established by the UN (one million) and the Commonwealth (1.5 million). A distinction has also often been observed for states with populations of 0.5 million or less; these are often classified as ‘micro’ states (Crowards 2002: 145).

Some attempts have been made to correlate size with GDP or geographic area (Armstrong and Read 2003, Commonwealth Secretariat 2000). GDP has been proposed as acceptable as it gives an indication of aggregate economic activity of the country, and constitutes an alternate means of evaluating market size. A third measure, geographic area, is offered as an expression of the natural resource endowment, and its variety (Crowards 2002). Some scholars have endeavored to promote the suitability of one parameter over the others, whereas a few, like Crowards (2002), have utilized them all simultaneously. Conversely, some authors simply continue to argue against the usefulness of categorizing states as small, and advocate universal policy advice (Aiyar 2008, Easterly and Kraay 2000).

Despite the various attempts to define smallness, there has been little consensus on a framework to adopt, and as such various conceptualizations – small state, SIDS, small sovereign state, subnational island jurisdiction, small vulnerable economy (Sutton 2011) – of what is considered small still persist. Some authors like Maass (2009) however, have contended that small states studies have benefitted from a lack of definitional clarity, arguing that it reflexes the complexity and layers of smallness that would otherwise be lost through fixed characterization (Maass 2009: 80-81).

3.1.1 Smallness vs. Islandness

A concomitant debate on the topic of smallness revolves around the concept of 'islandness'. Of the nations typified as small, a vast majority are also islands or archipelagic (Bertram and Poirine 2007, Read 2002, Sutton 2011). To this end, arguments deliberating on the feature of insularity – with corresponding concerns for transportation and communication – and extrapolating from naturalists, suggest that they are enclaves for the production of different social systems that also directly reflect upon their size (Armstrong and Read 2003, Dommen 1980). This has introduced another dimension to the proposal of categorizing small states, by the further suggestion of giving separate consideration to SIDS (Selwyn 1980).

Nonetheless, a number of authors question the merit of separately classifying SIDS (Armstrong and Read 2003, Selwyn 1980). For instance, Selwyn (1980) posited that any separate classification of 'island' would only have value if it is useful analytically, predictively and normatively (Selwyn 1980: 945) while Dommen (1980) asserted that size may be a more relevant characteristic *vis-à-vis* insularity, especially with respect to population observations.

Adequate empirical support for a separate classification has not been present in the literature; instead it appears to present a reasonable argument for similar realities in landlocked countries (Armstrong and Read 2003, Selwyn 1980). Still, this has not deterred the formation of AOSIS; the UN recognition of SIDS; or various organizations from holding conferences solely for the purpose of evaluating the situation of island states.

3.2 Characteristics of Small States and Economic Implications

Intrinsic features of small states propel the debate on the many disadvantages they allegedly confront, which negatively impact their potential for economic growth. The following discussions on these attributes of small states are derived from their small size, insularity/remoteness, and proneness to natural disasters – all factors that contribute to exposing small state economies to exogenous shocks, which they often can neither influence nor prevent.

The physical limitations of small countries result in a number of growth-restraining outcomes, a condition that Armstrong and Read (2003) referred to as the sub-optimality of their economies. First, because of small domestic markets, there is limited capacity to support competition domestically, resulting in monopolies and oligopolies, and generally higher priced goods, utilities and infrastructure (Armstrong and Read 2003, Briguglio 1995, Commonwealth Secretariat 2000, Thomas 2004). Furthermore, there is little possibility of supporting large-scale industries because of *inter alia* high infrastructural costs (Aiyar 2008, Briguglio 1995, Read 2002). Secondly, these states tend to have limited and undiversified natural endowments, and lack the capital necessary for exploitation (Armstrong and Read 2003, Read 2002). It is frequently discovered therefore that small state economies are highly specialized, often

occupying niches, and comparatively undiversified in the structure of output and exports as they have such narrow opportunities to expand, a phenomenon that Bertram and Poirine (2007) name ‘speciation’ (Bertram and Poirine 2007, Briguglio 1995, Commonwealth Secretariat 2000, Easterly and Kraay 2000, Read 2002, Streeten 1993). The result is dependence upon a few dominant activities, exports and export markets and exposure to “Dutch disease” (Aiyar 2008, Bertram and Poirine 2007, Prasad 2003, Read 2002).

As small states are not able to produce the range of goods they consume, effectively preventing the pursuit of autarkic growth paths, they must import an extensive volume of products (Easterly and Kraay 2000, Thomas 2004). Accordingly, they are disproportionately reliant on trade to earn the required foreign exchange to finance imports, and on foreign investment to overcome their scale limitations; hence, it is a common feature of these small economies that they are highly open and well-integrated into the international market (Commonwealth Secretariat 2000, Croes 2013, Read 2002, Streeten 1993). In these countries there are also pronounced instances of skilled labor migration as domestic jobs are limited; tasks are highly multidimensional; and remuneration is not comparable with what can be gained overseas. It is also difficult to attract specialists (Briguglio 1995, Farrugia 1993). Additionally, there can be instances of more extreme poverty and uneven income distribution (Commonwealth Secretariat 2000, Streeten 1993). It is therefore not surprising that historically, these countries have experienced higher levels of aid, remittances and foreign development assistance, and are more likely to have expanded public sectors (Aiyar 2008, Baldacchino 1993, Bertram 1986, Bräutigam and Woolcock 2002, Easter 1999, Rodrik 1998).

Bertram and Poirine (2007) note that as islands particularly are only accessible by sea or air, they are “more expensive to invade, occupy and integrate with neighboring territories to form larger units” (Bertram and Poirine 2007: 327). This general remoteness and insularity of small islands – but also of small landlocked states – tends to raise transport and communication costs to major markets or even within the country itself (mainly in archipelagos), and can further be compounded by the uncertainty in supply that can result (Briguglio 1995, Commonwealth Secretariat 2000, Streeten 1993, Thomas 2004). A small size is also indicative of a limited population, which is a constraint on the availability of domestic labor, and may cause high population densities though not necessarily greater degrees of urbanization (Armstrong and Read 2003, Dommen 1980, Read 2002). Small states also endure limited access to foreign investment capital and reduced private sector capacity because of a perception of risk (Bräutigam and Woolcock 2002, Commonwealth Secretariat 2000, Shareef and Hoti 2005).

Finally, many small states are geographically located in areas susceptible to natural disasters – hurricanes, volcanos, earthquakes, floods, and drought – that have an asymmetric impact on their economies and livelihoods relative to much larger countries (Aiyar 2008, Commonwealth Secretariat 2000, Easter 1999). Indeed Briguglio (1995) acknowledges that natural disasters are “expected to be relatively larger in terms of damage per unit of area and costs per capita” (Briguglio 1995: 1617). None of these handicaps faced by small states are within their control but have implications for how they construct development strategies and engage in international relations.

Studies of small states, recognizing the inherent disadvantages of such countries, have emphasized their vulnerability and lack of resilience as unique characteristics of this grouping (Nurse and Moore 2005, Sutton 2011). Vulnerability describes the degree of exposure of a country to exogenous economic and environmental shocks over which it has little, if any control; a country's resilience is determined by its endogenous ability to withstand or recover from the impact (Easter 1999:404). The problem for small countries is that they lack both market power and a domestic resource base to ameliorate the effects of external shocks, especially as they cannot compensate for declining export earnings by increasing export volumes (Read 2002: 174)

Small states engage in many behaviors that increase their vulnerability as a trade-off for achieving growth objectives (Briguglio 1995, Streeten 1993). For instance, the very openness of small economies and heavy dependence on trade causes greater exposure and sensitivity to global markets, and as such, many of these economies – where slight changes in incomes can have large impacts – are plagued by greater volatility in growth rates (Bräutigam and Woolcock 2002, Briguglio 1995, Easterly and Kraay 2000, Hampton and Christensen 2002, Read 2002). Furthermore, many of these states cede their economic sovereignty⁴ – in particular monetary sovereignty – by adopting hard currency, or linking to one, as a tactic to decrease macroeconomic instability and reduce exchange rates (Armstrong and Read 2003). In addition, while small countries are highly sensitive to the impact, they often lack the ability or political power to set the rules that govern globalization (Bräutigam and Woolcock 2002) and are often defenseless against external political pressures (Armstrong and Read 2003, Easterly and Kraay 2000). Environmental vulnerability is also relevant due to the greater susceptibility to natural disasters previously mentioned and environmental degradation from the pressures on natural endowments and fragile ecosystems (Armstrong and Read 2003, Briguglio 1995). In small settings, such events redirect resources from other activities and impose additional costs that are magnified because of the small size (Briguglio 1995)

In an effort to quantify these effects, some attempts have been made to construct vulnerability indices, most notably by Briguglio (1995), as assessment tools. Such an index is mainly expected to provide guidance to multilateral development agencies making decisions on how a country should be treated, principally with reference to access to resources and technical assistance (Easter 1999). Moreover, it is expected to assist states in developing domestic policies and implementing effective development programmes (*ibid.*). However some authors have contested this vulnerability hypothesis and the creation of an index (Armstrong and Read 2003, Read 2002). One example is Armstrong and Read (2002), who argued that the lack of clarity on economic vulnerability has led to the inclusion of openness, which they asserted empirically to be positively correlated with growth; hence their argument has been that the index is mis-specified (Armstrong and Read 2002: 452).

⁴ Economic sovereignty encompasses the “effective level of economic policy formation and implementation, autonomy over revenue-raising (via taxation), expenditure, regulatory environment and monetary, fiscal, trade and exchange rate policies” (Read 2002: 172)

3.3 Comparative Advantages of Small

At this point, it is mostly uncontested that there are inherent shortcomings to small size. Against all odds however, a large number of small countries have managed to attain impressive levels of income and development. This is counterintuitive to the expected dampening effect in such economies on long-run growth and instability around average trends (Read 2002). It would appear that small states have identified some advantages that could be exploited and have successfully strengthened resilience to manage vulnerability. Yet what assets do small states possess that could be useful and how can they combat susceptibility to shock?

Aiyar (2008) suggests twelve advantages attributed almost exclusively to small states. They: (1) have relatively homogeneous populations, which can mean reduced civil conflicts from ethnic tensions; (2) are insulated from spillovers of violence from neighboring territories, especially in the case of SIDS; (3) gain disproportionately larger benefits from foreign investment (one big investment can have a greater impact on the economy than in larger countries); (4) can offset many failings, even if institutions are poor, from a single mineral windfall (5) have the ability to exploit tax arbitrage; (6) can benefit from niches such as military bases and lightly regulated financial centers, (7) receive disproportionately large benefits from migration and remittances; (8) receive asymmetric benefits from tourism; (9) can export goods generally considered nontradables, like water and hydroelectricity in the case of landlocked small states; (10) have greatly benefitted from the Law of the Sea that has, in some instances, allocated maritime boundaries delineating tracts of ocean larger than the terrestrial mass; (11) generally reach more of the population with investments in infrastructure; and (12) receive large trade preferences that achieve rates on exports that are above global market prices (Aiyar 2008: 463). Many of these alleged benefits are supported by other authors in the literature (Armstrong and Read 2003, Easterly and Kraay 2000, Farrugia 1993, Pantin 1999, Poirine 1998, Prasad 2003, Streeten 1993).

It is clear from the aforementioned list of advantages that a major benefit for small countries is that relatively smaller quantities of revenues and investments have comparatively greater repercussions. It also appears that such countries have adeptly exploited niche markets, in some cases creating unique products for export. Subsequently, for small countries, it would seem their comparative advantage emerged by engaging in higher value-added activities that are human capital-intensive and are not conditional upon increasing returns to scale or the availability of low-cost labor (Bertram and Poirine 2007, Read 2002, Streeten 1993). Prosperous SIDS have achieved high levels of growth, and arguably survived, by engaging in rent-seeking behavior and international free-riding (Armstrong and Read 2003, Baldacchino 1993, Bräutigam and Woolcock 2002). Foreign exchange is acquired by specialization primarily in financial services and tourism or through aid and remittances, which Bertram (1986) argues generate rent revenues (Bertram 1986, Prasad 2003, Read 2002, Streeten 1993). Some small states have also been able to profit from the strategic importance of their geographic location (Aiyar 2008, Briguglio 1995, Read 2002). This has prompted many scholars to reassess previous growth theories in light of such lucrative yet highly unorthodox approaches.

There is some consensus in the literature on small state studies that endogenous policies for promoting investment in human capital, innovation and knowledge, and managing the influences of external endeavors, have been a viable strategy for accomplishing the observed growth rates (Armstrong and Read 2002, Armstrong and Read 2003, Bertram and Poirine 2007, Read 2004, Thomas 2004). The extensive openness of the economies to trade for example, causes a multiplier effect that extends the markets, and even incremental increases tend to have higher growth impacts because of the small size (Armstrong and Read 2003). However more liberal economies face greater risks of distortion and volatility (Aiyar 2008, Easterly and Kraay 2000). The need for higher quality institutions is therefore greater in such economies as it has been observed that better policies attract productivity and promote conditions that are conducive for raising higher incomes, and that the risks are outweighed by the potential gains (Aiyar 2008, Bräutigam and Woolcock 2002, Easterly and Kraay 2000). It is also noteworthy that such small economies, although immensely specialized, are perceived as being able to retain flexibility and responsiveness to changes in institutions adopted because of their social capital (Hampton and Christensen 2002, Read 2002, Streeten 1993). This aspect is given huge regard in small countries that seem to have the “social ecology of [an] integrated but open community with highly personalized relationships” (Farrugia 1993:221); enjoy more social cohesion and subsequently greater political stability; and tend to be more democratic (Dommen 1980, Srebrnik 2004, Streeten 1993).

Another common policy in small countries directly relates to the size of the public sector. It is often the case that the size of the government in small states is positively correlated with the degree of openness to trade (Aiyar 2008). This is because administrative structures are intrinsic to an ability to develop, enact and enforce governing institutions (Bräutigam and Woolcock 2002, Farrugia 1993). Moreover, large government expenditure operates as a form of social insurance against risk (Rodrik 1998). The costs of providing these structures however are disproportionately greater for small economies and hence they often face limited capacity, but countries can overcome this obstacle by pooling resources (Aiyar 2008, Commonwealth Secretariat 2000, Streeten 1993). Other practices that are recommended include the promotion of greater savings, and possibly the acquisition of buffer stocks, to mitigate the burden of shocks, and purchasing insurances against natural disasters (Armstrong and Read 2002, Streeten 1993).

3.3.1 Tourism as an Asset

In the development literature, the role accorded to tourism as a sector with the potential to stimulate rapid growth in small economies (Latimer 1985) based on a country's comparative advantage⁵ coincided with the resurgence of neoclassical economic thinking in the 1960s, and a call for an emphasis on export-oriented growth strategies (Brohman 1996, Hampton and Christensen 2007, Seyoum 2007, Zhang and Jensen 2007). Theorists who supported this model argued that economic success in developing countries would be conditional on their ability to gain access to global markets, which they believed tourism could provide (Gössling 2003, Shareef and Hoti 2005). Likewise, adequate policies and the creation of domestic linkages would be necessary to extend the benefits (Brohman 1996). Tourism was promoted as a route to diversification away from traditional (primarily agricultural) exports towards the utilization of more profitable productive factors (Brohman 1996, McElroy 2003). In addition, it offered a viable opportunity to generate the required foreign exchange to finance imports; domestic jobs; and business investments (Croes 2013, Gössling 2003, Shareef and Hoti 2005, Thomas 1988). The industry therefore became an attractive option for many small states, especially SIDS, where resources are scarce; policy choices are limited; and feasible alternatives are lacking (de Albuquerque and McElroy 1992: 619)

Tourism became one of the largest and fastest growing global industries (Ayres 2000, Jackman et al. 2011). This was likely attributed to the rising affluence of the middle class of the 1980s and the simultaneous declines in fuel, and hence transport costs, that made international travel possible for more people (Ayres 2000, de Albuquerque and McElroy 1992). Consequently in particular for SIDS, with comparative advantages *vis-à-vis* temperate developed countries that included warm weather; beaches; and cultural heritage (Bishop 2010, Caribbean Tourism Research and Development Center 1988, Shareef and Hoti 2005, Thomas 1988) tourism became the center of development programs (Croes 2013, Momsen 1998, Pantin 1999). Yet scholars cautioned against the contradictions especially of mass tourism, namely its inclination towards high rates of foreign ownership (mostly large-scale multinational entities); leakages; poor local linkages; low multiplier and spread effects; high income volatility; and environmental degradation (Bishop 2010, Brohman 1996, McElroy 2003, McElroy and De Albuquerque 1998). Social conflicts, they noted, could also arise over competition for access to and control of local resources (Brohman 1996). Furthermore, many of the job opportunities tend to boast poor wage rates and high seasonality (Hampton and Christensen 2007).

In addition to the greater susceptibility of small state economies to external shocks, the above issues introduce crucial questions on the sustainability of the tourism industry in small countries (Bishop 2010, McElroy 2003). Some authors would argue that as it stands, the promotion of this sector in developing countries simply reinforces their dependence on the global North and facilitates foreign leakages (Ayres 2000, Brohman 1996). For these

⁵ Comparative advantage theory is used to predict the potential gains from trade through specialization in particular economic activities based on factor endowments (Goldin 1990).

small nations however, faced with limited development alternatives and amid increasing trade liberalization, they may consider it a rare chance to improve domestic economic performance.

3.3.2 True Comparative Advantage?

The notion of comparative advantages for small states is not without criticisms. As Briguglio (1995) argues, much of their success has been in spite of, not because of small size, and often because the economies have been artificially supported. While small economies for instance may at times exhibit greater resilience to changes, Hampton and Christensen (2002) assert that modern economies appear to experience path dependency because it is difficult to diversify away from activities as countries become locked into relationships based on economic importance, especially when all other sectors lack viability. A shift in economic focus would require reskilling of the labor force, which necessitates a longer adjustment period (Easter 1999). Furthermore, although these societies can be more cohesive, the abundance of intimate cross-linking relationships can complicate policy-making and the implementation of decisions, and may result in nepotism and corruption, in particular when rivalries exist (Farrugia 1993, Streeten 1993). Additionally, even as small economies signify constraints on jobs and opportunities for economic advancement, some authors blame ‘brain drain’ on poor policies, although the potential benefits from remittances are acknowledged (Aiyar 2008, Farrugia 1993). Still, even with the call for better institutions, the demands for more integration often ask for decreased government roles and challenge social safety nets (Bräutigam and Woolcock 2002).

Small state proponents continue to attempt to refocus discussion of finding strategies that address the relevant problems of these economies, namely how to make rent incomes needed to generate foreign exchange for imports more secure, predictable and better allocated (Bertram 1986, Bertram and Poirine 2007). Nonetheless, engaging with the theme is made more challenging by the diametric views on nearly every pertinent question in the debate, but particularly what constitutes small. For the purpose of the paper however, the state under study is categorized as small by every criterion applied, and hence the concept of ‘smallness’ can prove to be a useful analytical tool.

Chapter 4 Tourism as a Resource Curse

As described in the previous chapter, specialization in the services sector has been offered to small countries as a viable means of overcoming size limitations to achieve economic growth. Tourism in particular has been promoted as an industry in which small states, especially SIDS, have comparative advantages that can be exploited. Recommendations to this end have encourage a number of small states to develop tourism-specialised open economies that although acutely susceptible to exogenous shocks, have the potential to positively impact per capita GDP. It is noted however that if poorly managed, any benefits from tourism could be negated, therefore stressing the importance of quality institutions. This caution is applicable to all economies, regardless of size. Therefore, this paper seeks to investigate if tourism, within the context of small state economies, can and does display characteristics of the resource curse.

4.1 Comparison of Tourism and Extractive Resources

The literature on the resource curse has focused predominantly on extractive resources like oil; gas; and minerals, highlighting specific characteristics of these materials that can induce undesirable outcomes. On inspections, some similarities between the nature of extractive resources and tourism are apparent. First, both industries enjoy a certain market power due to a lack of substitutes (Sheng 2011). As Sheng (2011) observed, “a tourism destination arises because of a unique historical heritage, special natural landscape, or otherwise convenient geographical location, just like the sites of the extractive resource economies” (Sheng 2011:1224). Second, the enclave nature of extractive resource sectors can be detected in a number of tourist destinations with large-scale resorts and other products along the chain owned by multinational corporations, in these instances resulting in a primarily fiscal linkage to the domestic economy (ibid.). Third, both sectors require high-quality managerial staff that is often difficult to obtain (ibid.). Finally, a tourism boom can be comparable with a resource boom *vis-à-vis* the revenue windfalls that result from exports (Capó et al. 2007).

Contrasts are also discernable between the two sectors. Most notable is that whereas extractive industries are capital-intensive, tourism is mainly labor-intensive (Sheng 2011). Furthermore, unlike conventional tradables, tourists must visit the exporting country to consume the products (Copeland 1991). Additionally, the tourism product is actually comprised of various goods and services that are consumed as a bundle, together with unpriced natural resources (ibid.).

While it is clear that the nature of tourism product is not strictly identical to extractive resources, there is one striking similarity between them: both industries are capable of generating rents. In small countries where less income has comparatively greater economic impacts, the windfalls from tourism can be significant. Therefore if primary commodity windfalls can result in unfavorable

outcomes, it can be expected that a priori tourism windfalls can also produce adverse effects on a country's economy.

4.2 Tourism and Dutch Disease

Dutch disease effects have been described in tourism-dependent economies, especially small state economies (Capó et al. 2007, Sheng 2011). For a model based on a tourism economy, the three sectors would be as follows: tourism as the booming sector; the non-tradable sector would include manufacturing and agriculture; and the non-tradable sector comprised of services and construction. Capó et al. (2007: 617-618) summarized the process as shown in Figure 4-1. The emergence of the tourism sector causes a demand for labor and an increase in wages. This stimulates a shift in labor from both the non-tourism tradable and non-tradable sectors. However increasing incomes result in a greater demand for services and also induces a shift of productive factors to the non-traded sector. The overall effect is a contraction of the non-tourism traded sector that is compensated for in the economy by rising imports. In traditional Dutch disease conceptualizations, tourism as a domestic non-traded service would be indirectly affected by the rising incomes; however tourism is directly influenced by foreign demand, allowing it to be 'exported', and consequently a boom will directly affect it (Copeland 1991).

Tourism can lead to Dutch disease exposure particularly in small state economies (Read 2002, Sheng 2011). Nonetheless, as many economists view it

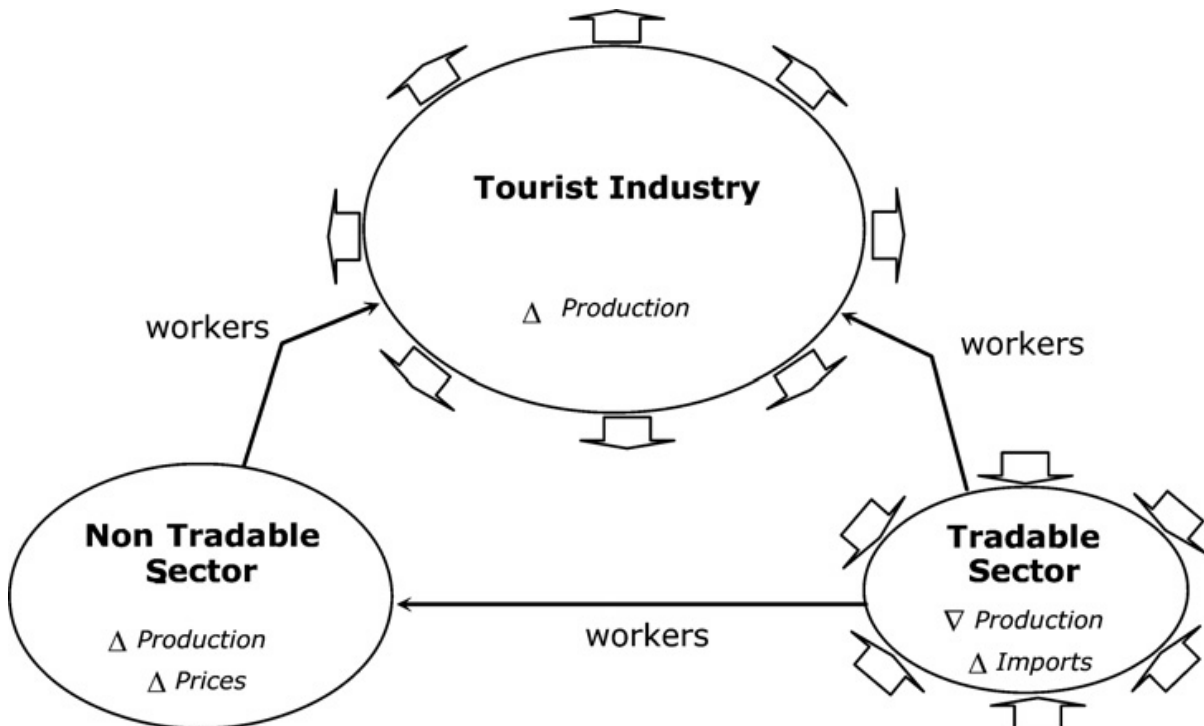


Figure 4-1. The effects of Dutch disease in a tourism economy.
Source Capó et al. 2007

as an economic adjustment to focusing on producing commodities based on comparative advantage, it is often embraced as strategic for resource-deficient economies (Capó et al. 2007). The emphasis is instead placed on the quality of the macroeconomic policies of a country and the effectiveness of management strategies. Dutch disease however is an economic explanation of the short-term effects when a boom is experienced. As Gelb (1988) asserted, boom-and-bust cycles often appear long when considering price fluctuations and buffering but are short for planning and executing major development projects and adjusting to huge swings in revenue and demand (Gelb 1988: 19). The resource curse hypothesis therefore adopts a broader consideration of the consequences of resource booms that, in addition to resource reallocation, includes the burden of adjustment and political pressure (Sheng 2011). For small state economies that already face limited institutional capacity, their long-term responses to price shocks in international tourism could provide useful insights into whether or not these countries will benefit overall from their comparative advantage in tourism.

4.3 Theoretical Framework

The analytic framework for this study will encompass both economic and political interpretations in an attempt to investigate the overall reaction of a small state economy to tourism, modelled against the wider political economy of the resource curse. The underlying premise is that endogenous policy failures and not tourism dependence itself results in the emergence of the resource curse. Various components of the theory will be applied in the context of the small island developing state of Grenada to evaluate if tourism can become a resource curse. In the conceptualization, four main questions should be addressed to truly explore the existence and/or extent of the phenomenon in the proposed setting.

4.3.1 A Tourism Economy?

Before proceeding with the application of the resource curse scheme, it will first be necessary to examine the structure of the proposed country's economy to determine if it can indeed be characterized as tourism-dependent. Auty (1993) expressed a mineral economy as one that generated at least eight percent of its GDP and 40 percent of its export earnings from the mineral sector (Auty 1993: 3). For the purpose of our examination we will define a tourism economy along the same criteria. Therefore, to establish Grenada as a tourism economy for this study, we must first resolve that at least eight percent of its GDP and 40 percent of its export earnings are derived from tourism.

4.3.2 Revenues Predominantly Rents?

A notable element of the resource curse involves rent generation (Brunnschweiler and Bulte 2008a, Gelb 1988). Hence, an exploration of the origin of domestic revenue is critical. One precedent for countries credited with a resource curse experience is that government windfalls are primarily gleaned from taxation of the extractive resource sector and not from other productive enterprises. In a tourism economy therefore, a substantial portion of state revenues should be collected as taxes. It should be noted that due to the uniqueness of tourism exports with tourists actually needing to consume the product within domestic borders, it is challenging to accurately assess the quantity of rents generated in the sector when accounting for indirect activities.

4.3.3 Domestic Response to Boom

Having established the value of endogenous policies in effecting a developmental curse (Wick and Bulte 2009), the next component of a investigating our hypothesis is the government's reaction to the surge in revenues characteristic of a resource boom. A number of considerations become relevant. First, the economy must be scrutinized for any Dutch disease effects (Capó et al. 2007). It is possible in the context of the booming tourism sector that a contraction should be observed in manufacturing and agriculture with the economic adjustments, as well as a strong services sector. In addition, there should be an appreciation of the real exchange rate due to inflation and increased incomes, and the non-tourism traded sector is likely to benefit from subsidization. In such economies, deterioration in the terms of trade should be evident.

Secondly, the government's ability to save and accumulate reserves during booms must be explored. Foreign reserves are desirable to mitigate possible inflationary effects of the influx of earnings on incomes and the exchange rate, as well as to provide some insurance during any downswings in revenues, and it is recommended that public investment should be in income-generating activities (Gelb 1988, Mikesell 1997). Countries that have succumbed to the resource curse however tend to have little to no public savings and instead are commonly identified by increasing public expenditure; expanding public sectors; and investments in welfare and public works programs, and human capital development often with the objective of directly addressing unemployment and boosting social welfare (Auty 1993, Mikesell 1997). Another curse component is the size, and expansion/contraction of public debt. It is not uncommon for the government to undertake overambitious large-scale projects during booms, and often the propensity is to borrow against future expected earnings from the sector.

Finally, though difficult to determine, some investigation should be made of the political responses to windfalls, particularly efforts of patronage and clientism (Mehlum et al. 2006, Robinson et al. 2006). It is probable that politicians will dispense rent incomes within the society for the purpose of 'buying' legitimacy and favour. In addition, it would be enlightening to analyze the power relations between various interest groups and the state to discover if any pressure is exerted for the adoption of growth-inhibiting policies (Broad

1995, Ross 1999). Furthermore, it would be useful to determine if any social conflicts arise over access to and control over resources (Rodrik 1999).

4.3.4 Domestic Response to Bust

While a country's actions during boom periods are important, it is arguably even more critical in the context of the resource curse the responses that occur when experiencing decreasing revenues. Even without having increased spending, sharp declines in government funds impedes the ability of the state to finance its bills. For a country with little to no fiscal reserves, the implications are even more apparent. Doctrinaire policies include adjustments that curb spending such as lowering wages and/or cutting jobs; abandoning non-productive ventures and liberalizing the economy, as calls for currency devaluation (Auty 1993, Gelb 1988). It is typically observed in countries exhibiting curse characteristics however that the state's response to reducing revenues involves increased borrowing and further indebtedness to circumvent the need to adopt any of the above-mentioned suggestions. This tends to exacerbate economic distortions.

The extent to which all, if any of these components manifest within the context of a tourism economy will contribute to investigating the question of whether or not tourism may lead to a resource curse. It is not necessary for any one economy to display all of the given characteristics. However their combined effects will assist in answering the central question of this paper. To properly contextualize our research, the next section will provide an overview of the country used in this study.

4.4 Grenada

The sovereign state of Grenada is located near the southern end of the Caribbean archipelago. With a geographic area of only 344 km² and with a population of just over 100,000, the country is undisputedly small by any criteria used. Located at 12°N of the equator, this island experiences tropical weather with an abundance of white sand beaches, and as such is an ideal tourist destination (Nelson 2005). It is listed with the World Bank as an upper middle income bracket country and has a UN global ranking of 63 in terms of human development. Select indicators are listed in Table 4-1.

Grenada's first European colonizers were the French in the 17th century, who all but eradicated the indigenous inhabitants of the island (Caribbean Conservation Association 1991). The British and French, in the following decades, fought for control of the colony until it was formally ceded to the British by the Treaty of Versailles in 1783 (ibid.). It was from the British Crown that the country finally gained its independence in 1974. The island's demography consists primarily of descendants of African, East-Indian and European origin.

Table 4-1. Select 2013 Human Development Indicators for Grenada

Human Development Index	Ranking 63
Health	Life expectancy at birth (years) 76.1
Education	Mean years of schooling (of adults) (years) 8.6
Income	GNI per capita in PPP terms (Constant 2005 international \$) 9,257
Sustainability	Carbon dioxide emissions per capita (tonnes) 2.4
Demography	Population, total both sexes (thousands) 105.3
Composite indices	Non-income HDI value 0.827
Innovation and Technology	Fixed and mobile telephone subscribers per 100 people (per100 people) 144.5
Trade, economy and income	Income index 0.668

Source. (UNDP database. 2013).

During colonial rule, Grenada boasted a plantation economy that shifted from tobacco, indigo and livestock production under the French to sugar cane in the British period and further to cocoa after emancipation. By independence the major traditional exports included cocoa, bananas and nutmegs (Vincent et al. 1998). Nutmeg in particular, introduced in the 19th century, developed high socioeconomic importance. In fact until 2004, the country was the second largest global exporter of nutmegs, controlling 20 percent of the world market share, and earned the moniker ‘the Spice Isle’ (FAO 1994, UNCTAD. 2013).

As early as the 1930s, efforts began to exploit the natural landscape in Grenada for tourism. However it was not until the post-second world war period that the industry was given serious consideration. The state’s tourism market is primarily drawn from the United States, Europe (mainly United Kingdom) and the Caribbean region, as well as the returning diaspora (Vincent et al. 1998). Today tourism is arguably the most important sector for the economy, contributing 21.8 percent to GDP – both through direct and indirect activities – and producing 52.4 percent of total country exports for 2012 (See Figure 4-2 and Figure 4-3) (WTTC database. 2013). In that year, as shown in Figure 4-4, it was also responsible for 20.2 percent of total employment on the island (ibid.). Based on GDP contribution in relation to the relative size of the nation, the WTTC ranked Grenada 30 out of 184 countries in terms of the industry’s importance. Still, the industry has remained relatively small-scale with a great occurrence of local ownership, and the government has explored options for specialty tourism (Nelson 2005: 132).

Grenada, like many other Caribbean states that receive a large volume of North American visitors, suffered some negative effects following the events of September 11, 2001 (Nelson 2005). Also the global economic crisis of 2008 adversely impacted the country’s economy. Notwithstanding, in attempting to investigate potential resource curse characteristics in the Grenada setting, it is necessary to draw reference to two important past events.

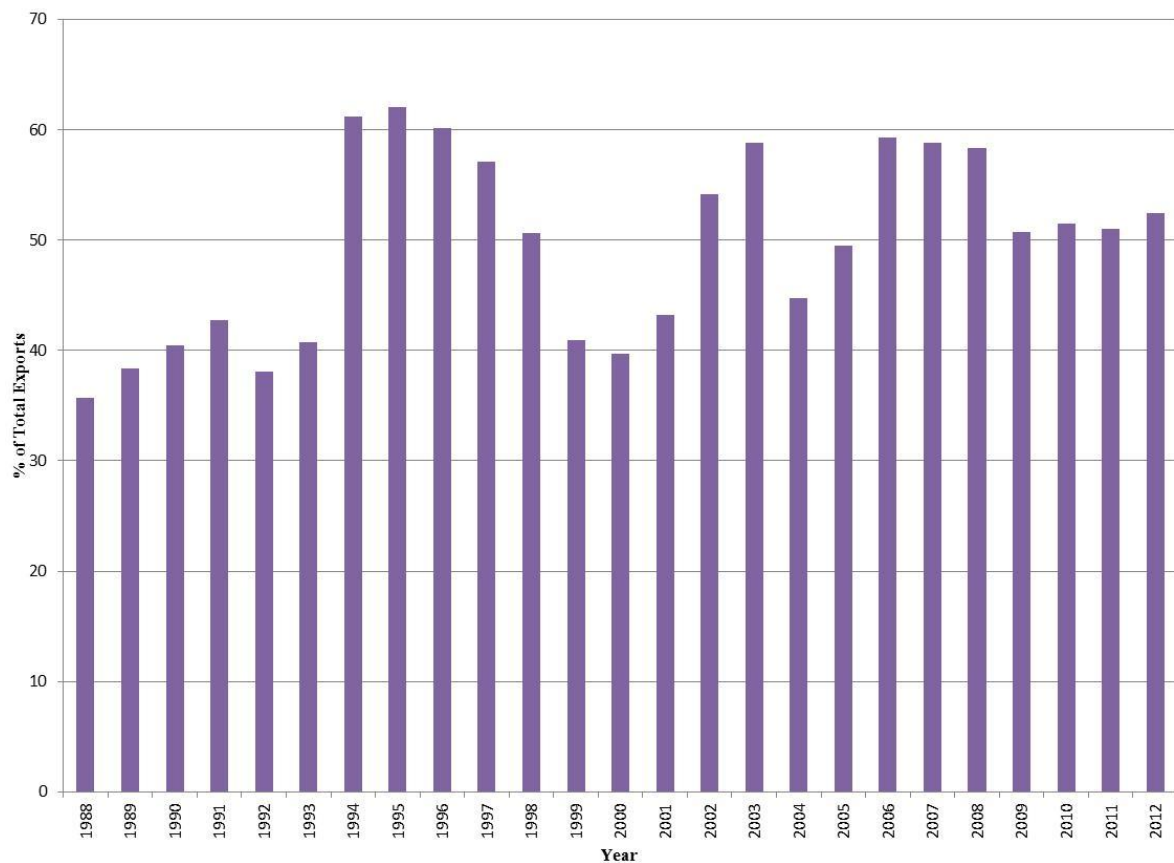


Figure 4-3. Contribution of visitor exports to total exports from Grenada, 1988 – 2012.
Source. (WTTC database. 2013).

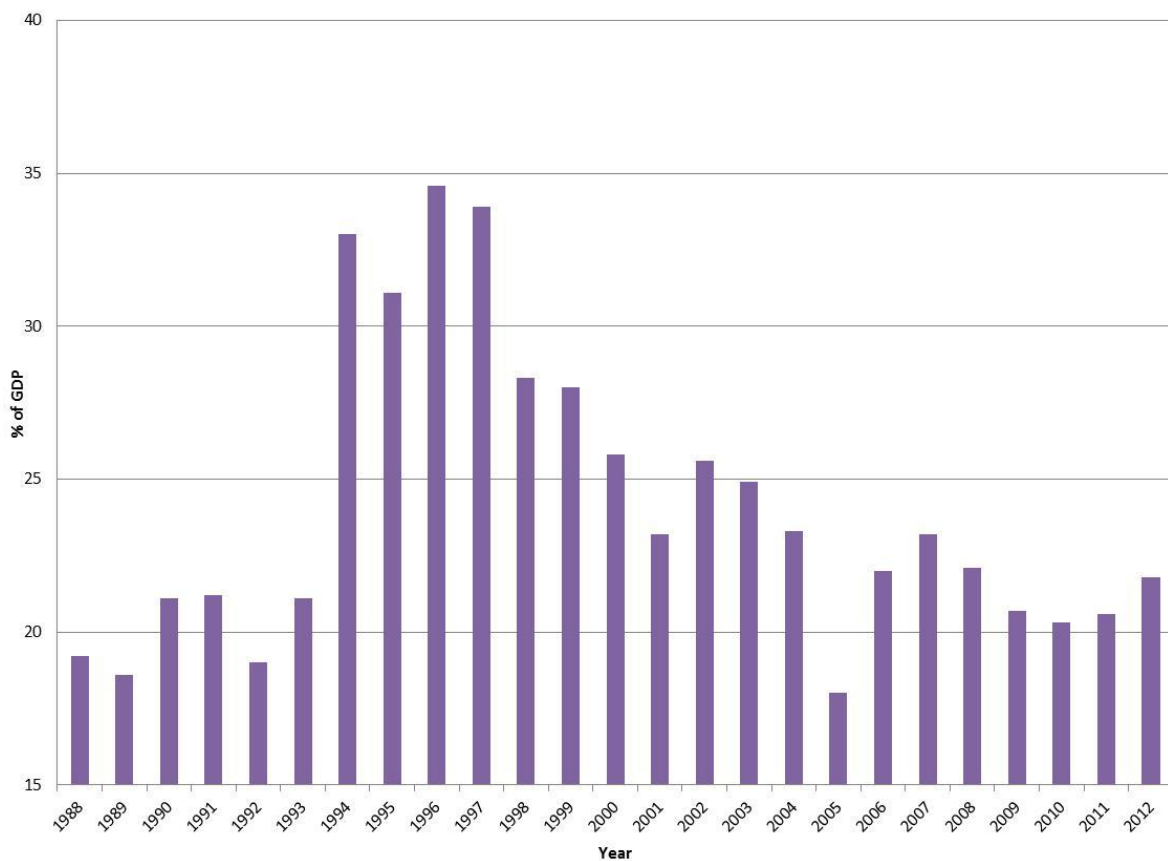


Figure 4-2. Total contribution of travel and tourism to Grenada's GDP.
Source. (WTTC database. 2013).

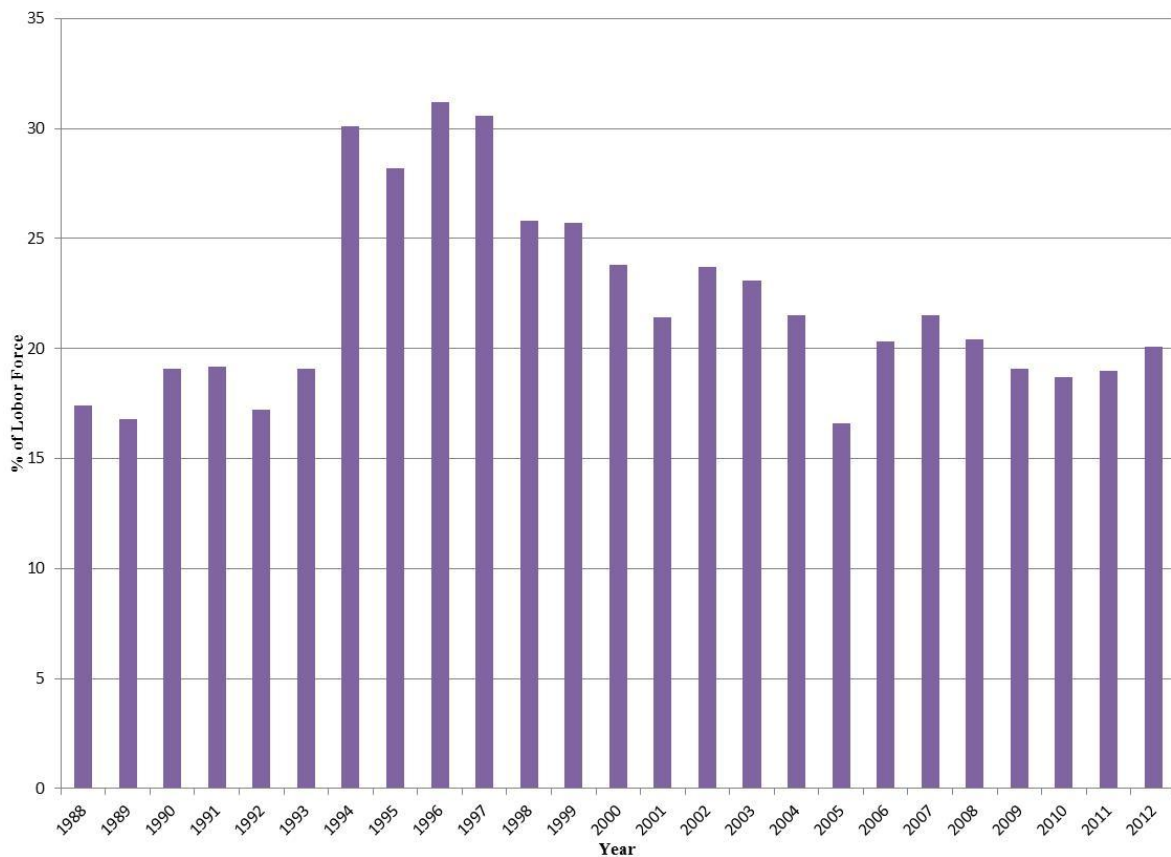


Figure 4-4. Total contribution of travel and tourism to employment in Grenada, 1988 – 2012.
Source. (WTTC database. 2013).

4.4.1 1979-83: Popular Revolution

The first relevant occasion involves the radical events on the island from 1979 – 1983. Grenada is the only Commonwealth Caribbean country to have experienced a disruption to the democratic electoral process when the New Jewel Movement (NJM), led by the opposition leader Mr. Maurice Bishop, staged a nearly bloodless *coup d'état* in 1979 (Srebrnik 2004). The People's Revolutionary Government (PRG) with its socialist-oriented development plan was established and a transformation of the economy was initiated (Kirton 1989, Thomas 1988).

During this period, a significant amount of infrastructural improvements were undertaken by the government – the most significant being a project to build an international airport, which was considered paramount for the expansion of tourism – and much emphasis was given to social services, especially education and health. Additionally, as the aim was towards a state-led economy, an expansion in the public sector would be expected. State appropriation of lands and attempts to establish cooperatives, against the backdrop of the country's colonial experience and inherent distrust of state-led initiatives, in many ways contributed to a decline in the agriculture sector (Thomas 1988). However the rapid expansion of construction chiefly contributed to GDP growth in the ensuing years (*ibid.*). Dissension within the PRG led to the assassination of Bishop with some of his Cabinet in 1983 and resulted in a very brief period civil unrest until the United States (U.S.), in

Table 4-2. Damage Assessment for Grenada from Hurricane Ivan, 2004.

Hurricane Ivan was a 'category 4' hurricane system when it reached Grenada on 7 September 2004. It was accompanied by sustained winds of approximately 140 mph, with gusts exceeding 160 mph. Official damage assessment reported the following:

- 28 persons killed;
- 90% of housing stock damaged totalling EC\$1,381 million or 38% of GDP;
- 90% of hotel rooms damaged or destroyed, totalling EC\$288 million or 29% of GDP;
- telecommunication losses equivalent to 13% of GDP;
- damage to schools and education facilities amounting to 20% of GDP;
- losses in the agricultural sector equivalent to 10% of GDP – the two main commercial crops, nutmeg and cocoa, are expected to make no contribution to GDP or earn foreign exchange for at least 6–8 years;
- damage to electricity installations amounting to 9% of GDP;
- heavy damage to eco-tourism and cultural heritage sites, accounting for 60% job losses in this sub-sector;
- overall damages estimated at EC\$2.2 billion, or two times current GDP.

Prior to the passage of the hurricane, an economic growth rate of 5.7% was forecast. Negative growth of at least –1.4% is now projected.

Source. OECS Macroeconomic Assessment Report (cited in Nurse and Moore 2005)

conjunction with governments of the Eastern Caribbean, led an intervention to restore rule of law.

The PRG's rule was abruptly ended in just four short year, even before the completion of the airport. During the four years of Bishop's leadership therefore, no significant impacts on tourism were observed (Thomas 1988)

4.4.2 Hurricane Ivan, 2004

On September 7, 2004, Hurricane Ivan passed over Grenada. Prior to its passage, the last hurricane to directly hit was Hurricane Janet in 1955. In the aftermath of the system, the island essentially realized complete destruction of its economy as the damage from the storm was extensive. Assessments of the natural disaster put damages at approximately twice that of the country's GDP with over 80 percent of the population affected (Nurse and Moore 2005). All major traded sectors of the economy were affected, especially the nutmeg industry, which was expected to take minimum six years to begin showing signs of recovery. A summary of the effects can be found in Table 4-2.

The devastation in the aftermath of Hurricane Ivan clearly highlights the vulnerability of small states. While in real terms the burdens from the disaster may appear small, relative to the size of the Grenada's economy the damage has been catastrophic. Of particular importance was the loss of nutmeg exports, which were considered the key driver of economic growth (Government of Grenada. 2009). Preceded by the events of September 11, 2001 and followed by the global recession, the challenges for Grenada have been rather daunting. Due to the nature of its agricultural exports, and predictions for a slow recovery in relation to the speed with which the tourism sector could be revived, government focus towards rebuilding tourism was expected. Also, because of the extensive building required in the recovery effort, the construction sector experienced a strong boost in the immediate years.

Having established Grenada as a tourism economy, in the next chapter I will turn my investigation towards whether any characteristics of the resource curse can be observed. The aim of this paper is not to establish that tourism has (or has not) led to a resource curse in Grenada but rather to determine if in the context of a small state tourism has the capacity to become a developmental curse.

Chapter 5 Evidence and Analysis

Our analysis will take place in three stages. First, there is a need to establish the sources of government revenue to determine how the state profits from tourism. Secondly, I will attempt to highlight and explain trends in the government's response to the increase in rents. Finally, I will attempt to investigate the endogenous response to the exogenous shocks particular in the last decade.

5.1 Revenue

The Government of Grenada derives the vast majority of its revenue from taxation, as depicted in Table 5-1 and Figure 5-1. A cursory comparison from 2000 to 2010 suggests the following trends:

- government steadily increased their revenue intake;
- a sizeable portion of revenue is supplied through taxes on international trade/transactions; a steady decline in consumption tax earnings was balanced in part by general rises in import duties and custom service charges;
- revenues derived from taxes on domestic good and services increased sharply from 2009 such that by 2012 the majority of tax revenue was from this category. This increase coincided with the recording of a value added tax;
- property taxes and other non-tax revenue sources contribute comparatively small amounts monies to the government;
- there has been a gradual increase in the contribution of income and profit taxes over the period.

The sources of taxation revenue are an important consideration for the resource curse theory. As already discussed however, the nature of tourism is such that there is an overlap in domestic and foreign tax applications because tourism products can only be consumed in the host country. Attempts will be made to explain the above trends throughout the remainder of this chapter.

5.2 During Tourism Boom

To analyze state responses to tourism windfalls, it is first necessary to locate when Grenada experienced surges in export incomes. Comparing Figure 4-2 and Figure 4-3 (see preceding chapter) with Figure 5-2, which shows GDP growth, a boom can be observed in the mid-1990s. In order to determine if the state's response to the boom is similar to that of the resource curse, we will focus initially on this period.

1995 elections saw a shift in power from the National Democratic Congress (NDC) to the New National Party (NNP), establishing Dr. the Right

Table 5-1.Revenue by Sources for the Government of Grenada, 2000 - 2012

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
CURRENT REVENUE	111.40	104.10	107.67	119.10	110.72	132.41	142.09	157.69	170.97	147.89	152.71	156.69	156.53
Tax Revenue	97.59	93.70	96.58	109.79	102.88	126.57	132.50	148.27	159.66	139.84	143.51	148.34	148.40
Taxes on Income and Profits	19.11	21.11	16.00	17.48	15.83	21.24	20.62	27.54	34.80	32.11	26.94	27.20	27.79
of which:													
Personal	2.43	3.12	3.24	3.71	4.16	5.11	5.03	6.00	8.61	10.39	8.99	9.30	10.29
Company	16.28	17.11	11.97	13.08	11.14	15.57	11.62	16.86	26.20	21.72	17.95	17.90	17.50
Taxes on Property	3.45	3.70	6.64	6.24	6.04	5.65	8.33	10.69	9.56	6.93	6.40	5.49	6.04
Taxes on Domestic Goods & Services	18.80	16.51	18.26	21.73	19.13	22.06	25.40	26.23	28.95	27.96	65.59	69.86	69.74
of which:													
Accommodation Tax	-	-	-	-	-	-	-	-	-	-	-	0.00	-
Licenses	4.07	2.06	4.04	5.35	3.12	5.11	6.09	5.20	6.33	6.02	5.46	5.80	5.71
Stamp Duties	1.62	1.06	1.26	1.52	1.72	2.77	1.77	1.98	2.04	1.57	1.30	1.41	4.71
Consumption Tax	9.72	9.69	9.43	10.39	9.69	10.06	12.05	13.30	15.04	13.81	3.23	0.54	0.12
Value Added tax	0.10	0.06	-	-	-	-	0.00	-	-	-	51.74	58.87	56.18
Taxes on International Trade & Transactions	56.23	52.38	55.68	64.35	61.88	77.61	78.15	83.80	86.35	72.84	44.58	45.80	44.83
of which:													
Import Duties	11.81	11.85	11.65	15.61	14.66	18.45	17.40	18.76	20.62	16.31	17.62	18.22	17.68
Foreign Exchange Tax	-	-	-	-	-	-	-	-	-	-	-	0.00	-
Consumption Tax	32.16	31.16	30.80	34.46	34.24	40.42	38.39	36.84	39.77	31.12	2.31	0.10	0.10
Customs Service Charge	9.27	9.39	9.37	11.67	10.92	16.39	14.78	14.77	16.20	12.27	12.39	13.82	13.12
Non-Tax Revenue	13.81	10.40	11.08	9.30	7.85	5.84	9.59	9.42	11.31	8.05	9.21	8.35	8.13

Source. (Government of Grenada 2013)

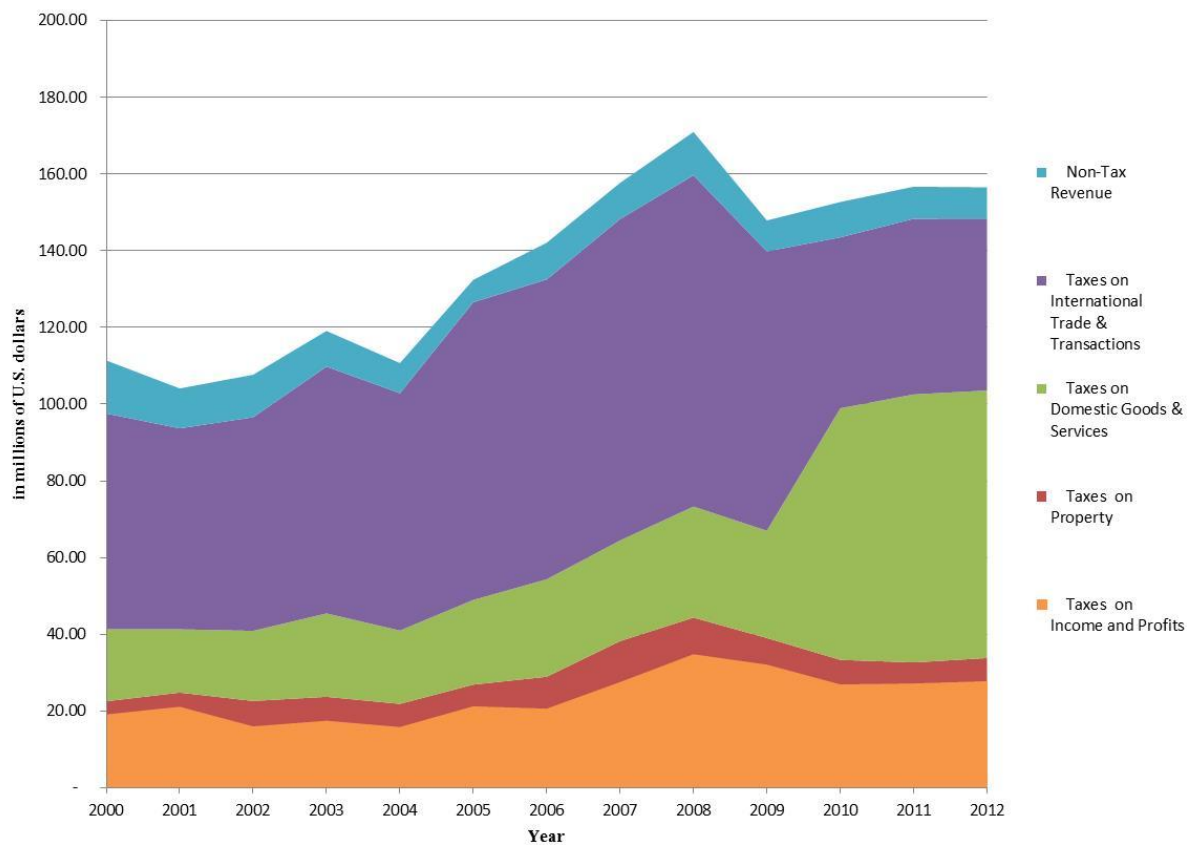


Figure 5-1. Government of Grenada revenue streams, 2000 - 2012.
Source. (Government of Grenada 2013).

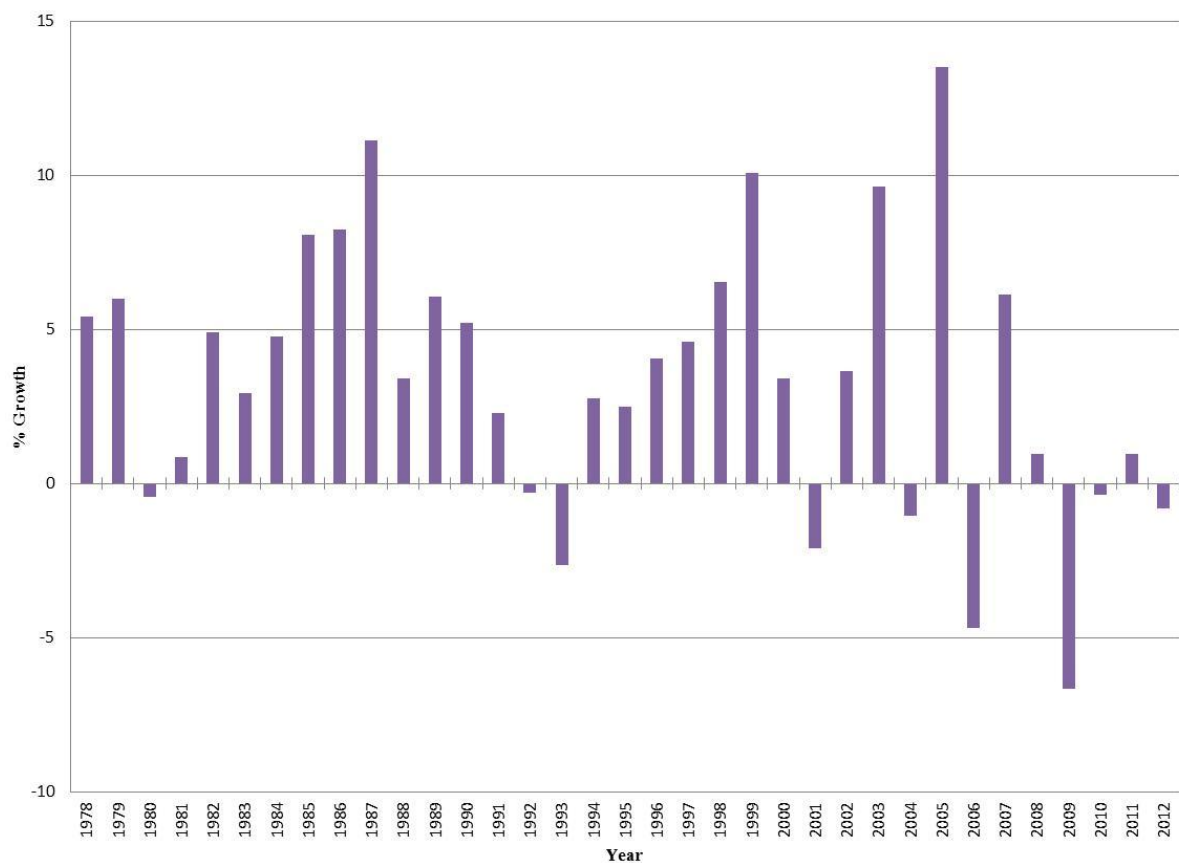


Figure 5-2. Annual GDP growth for Grenada, 1978 - 2012.
Source. (World Bank database. 2013)

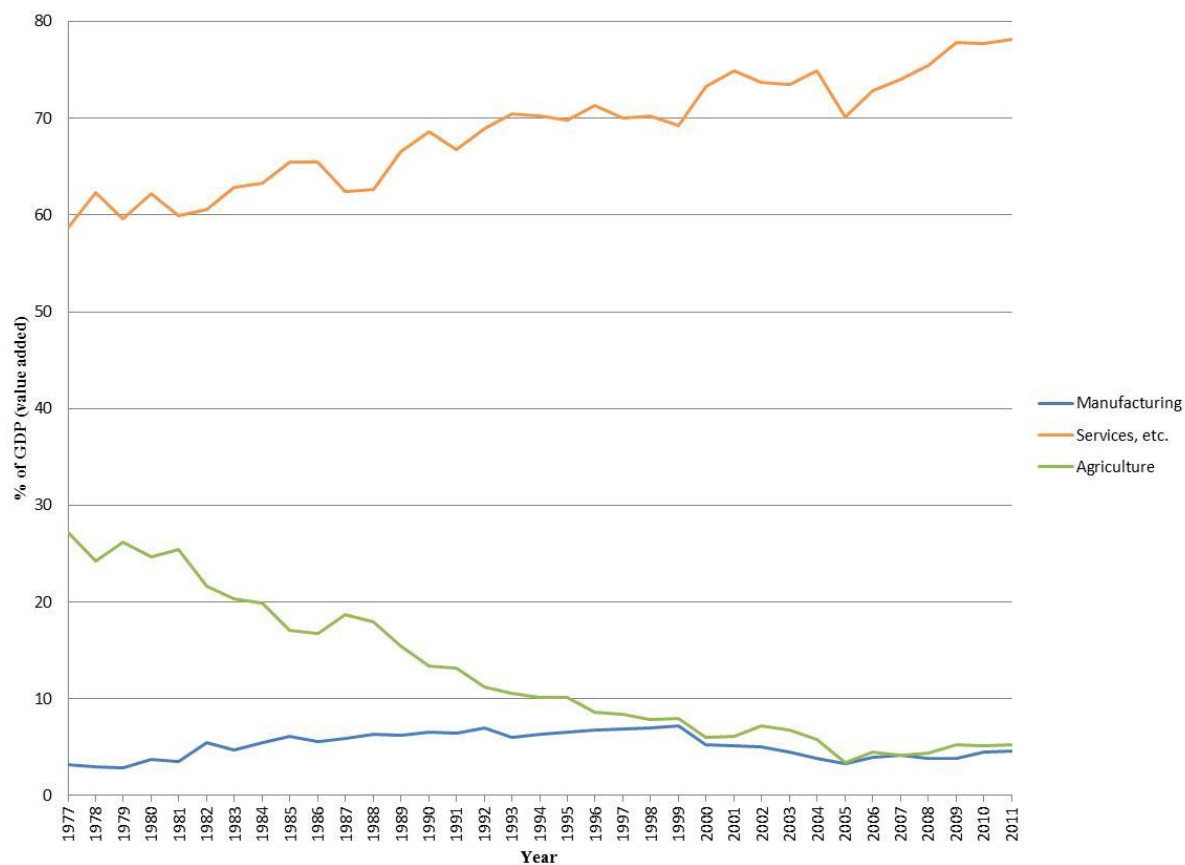


Figure 5-3. Change in contribution of major sectors to GDP, 1977 - 2011.
Source. (World Bank database. 2013)

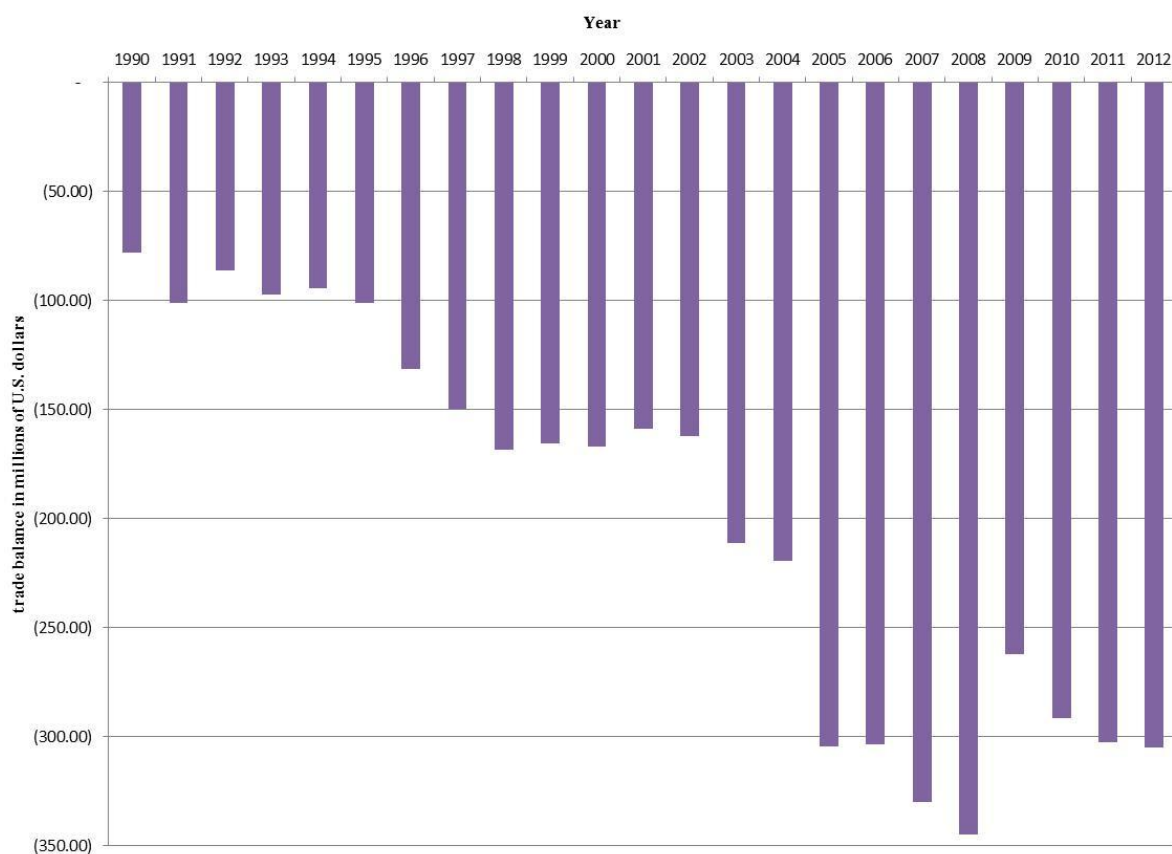


Figure 5-4. Terms of trade for Grenada, 1990 - 2012.
Source. (Central Statistical Office 2012)

Honorable Keith Mitchell as Prime Minister (PM). The NNP and PM Mitchell maintained control of the government for 13 consecutive years, by re-elections in 1999 and 2003 (New National Party. 2011). The party's goal upon election was to steer the country towards a "dramatic and unprecedented program of economic and social development" by undertaking numerous large-scale projects (New National Party. 2011). However during this period, there were also two major economic developments in the Caribbean, including Grenada. The U.S., in an attempt to gain equal opportunities for their exports, successfully protested the preferential trade agreement between the Caribbean and Europe for bananas production covered under the Lomé Convention. This was coupled with a drastic reduction in their financial assistance to the region, which came at a time when the state was being strongly urged to reduce their budget; liberalize the economy; and privatize government companies.

5.2.1 Dutch disease effects?

From as early as 1977, a steady decline in the contribution of agriculture to GDP was observed while there was a gradual positive trend in services (see Figure 5-3). Little change was observed in manufactures, and so it will be largely disregarded in the discussion.

While at first glance it appears as though the theory is relevant, it is difficult to establish a causal link between the rise in services and corresponding decline in agriculture based on Dutch disease effects. As previously stated, preferential agreements for bananas were under threat, and the main agricultural export, nutmeg, was suffering from declining world prices since the 1980s (FAO 1994). It would seem that in the Grenadian context, erosion in agriculture was more a result of exogenous factors than from a tourism boom. Therefore, the contraction of agriculture cannot strictly be attributed to Dutch disease, although it is possible that tourism has some influence on its shrinkage.

5.2.2 Other Macroeconomic Indicators

Review of the terms-of-trade, Figure 5-4, shows a negative trade balance, with evident deterioration from the first year represented. The negative trade balance is not surprising because of the size constraints on the economy. The limited role of manufacturing and the decline in agriculture suggests that consumption demands must be met through rising imports. Of interest however is the worsening of the terms-of-trade, with sizable increases in the deficit from 1995, even as impressive GDP growth rates were recorded. Data on consumption expenditure (Figure 5-6) suggests a sharp increase in private consumption. This phenomenon is similar to that observed in resource curse cases as a direct result of increased incomes, and can account for the further imbalance in the trade account since rising incomes often stimulate greater demand. These observations provide some support towards the resource curse.

Figure 5-5 illustrates the savings, external debt and debt service. Over the period, national savings were minimal or non-existent, and a tendency for foreign debt expansion is noticed, though only a small percentage of gross national income (GNI) was devoted to servicing this debt. In addition to

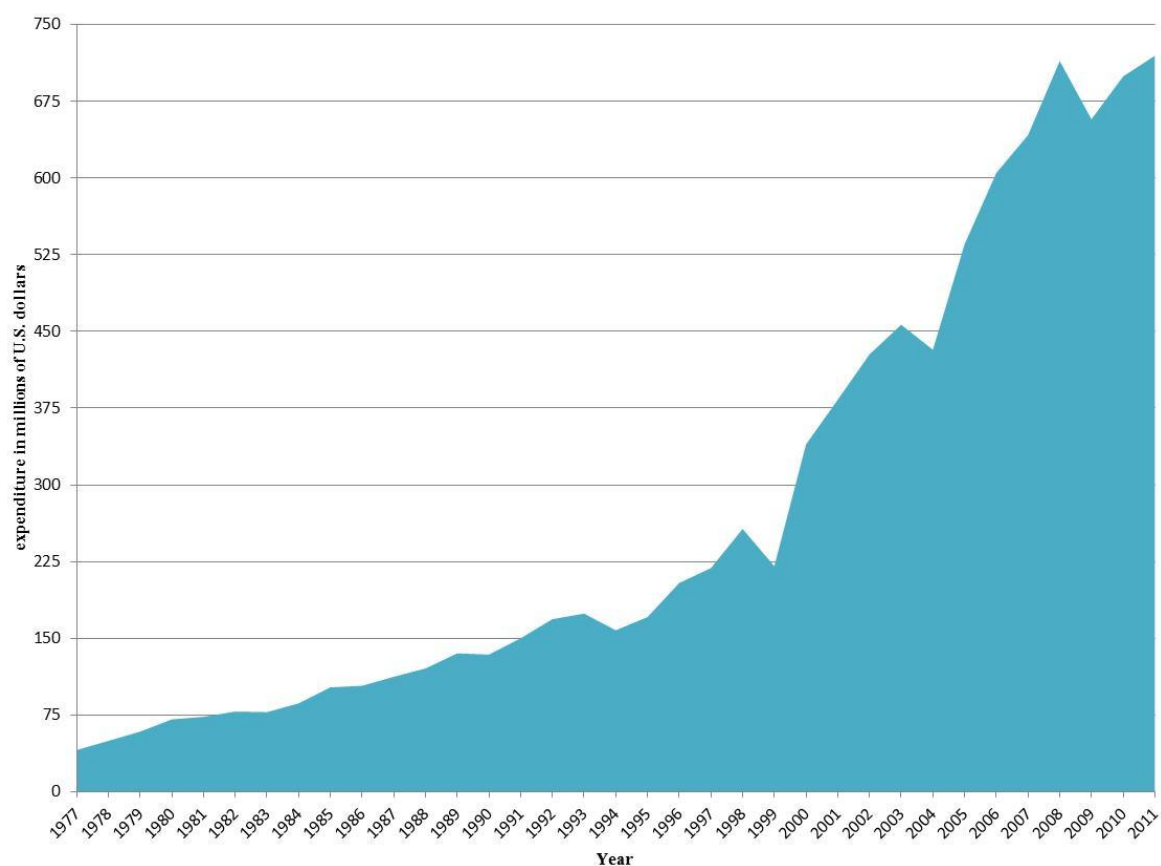


Figure 5-6. Private consumption expenditure, 1977 - 2011.
Source. (World Bank database. 2013).

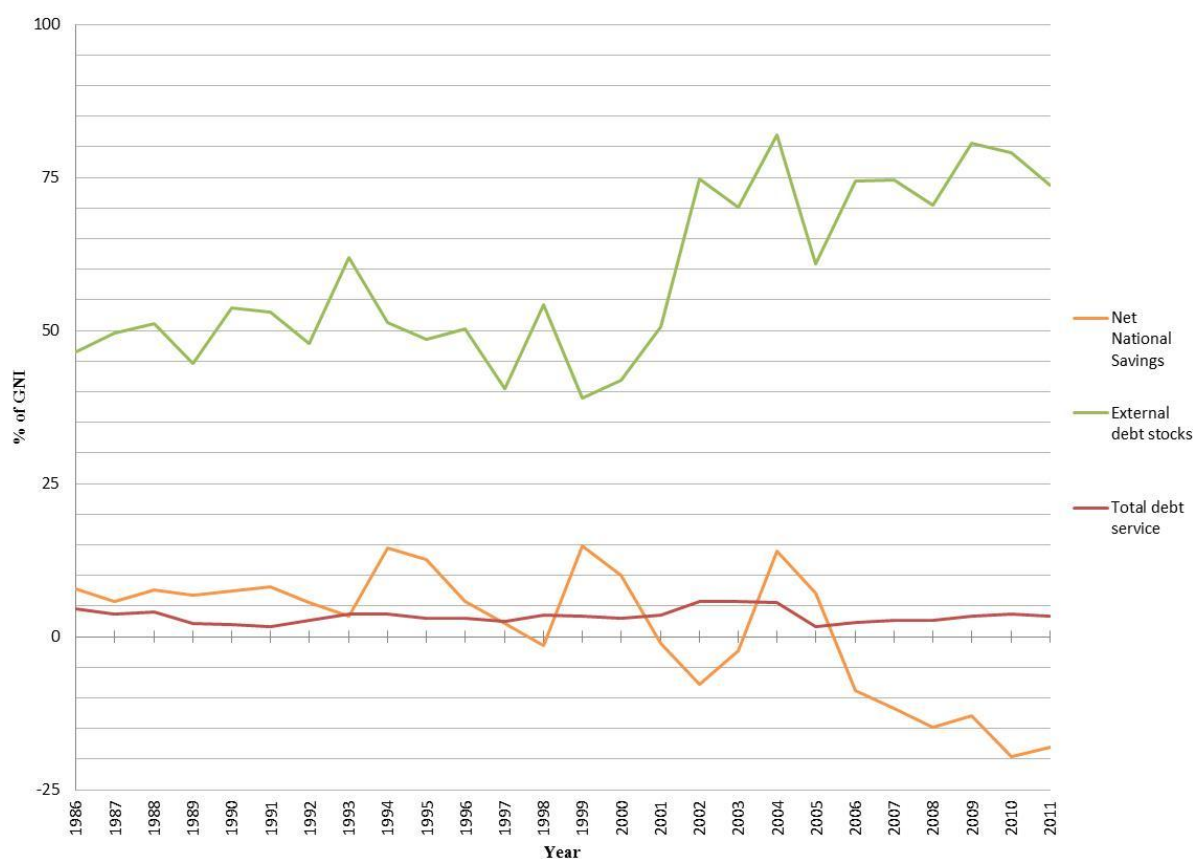


Figure 5-5. Savings and debt as a percentage of GNI, 1986 - 2011.
Source. (World Bank database. 2013).

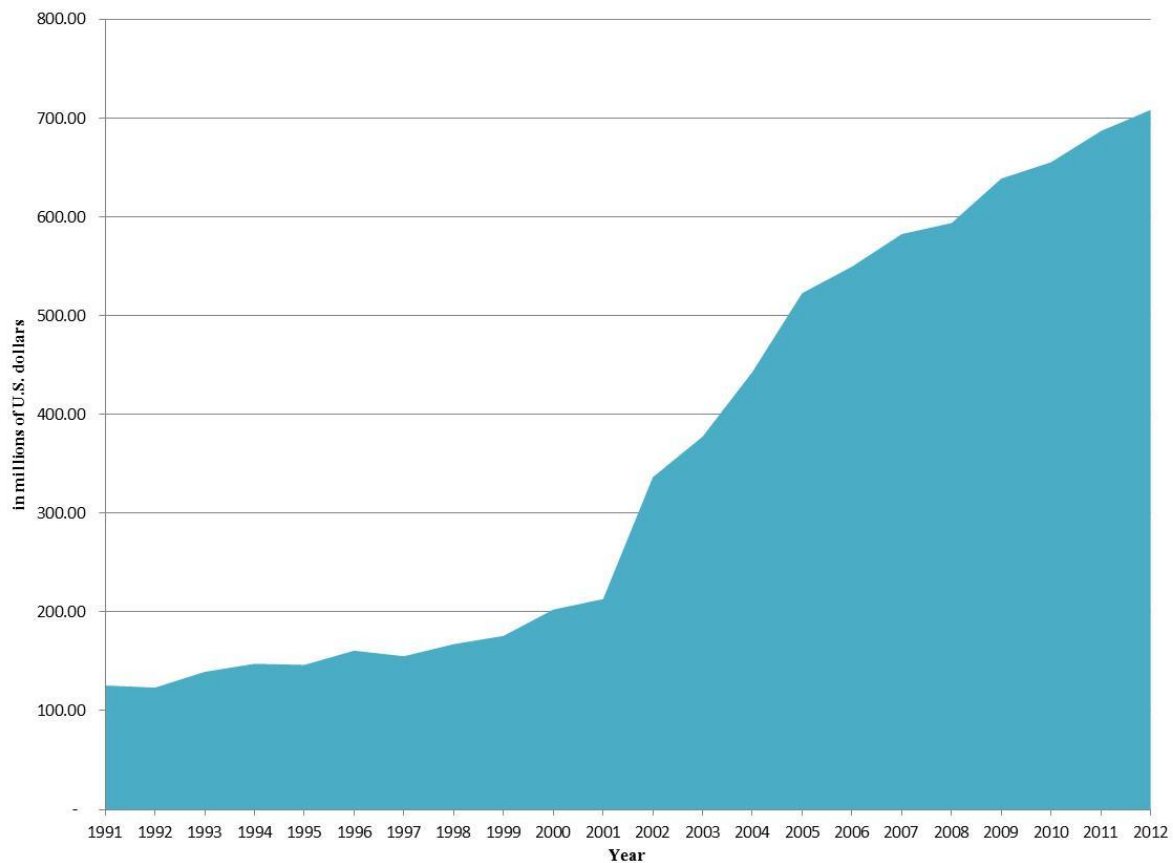


Figure 5-7. Annual total outstanding debt, 1991 - 2012.
Source. (Government of Grenada 2013).

external debt however, the government also held public debt, suggesting that the picture is even more alarming. Figure 5-7 has been included to provide some perspective on the situation in real figures. What is apparent is the shift towards a greater debt burden.

A pattern of widening trade deficits; increased consumption; and now expanding foreign debt would suggest a propensity for overoptimistic government behavior. Such activities, relative to the scale of the domestic economy, produce greater repercussions with smaller changes. Hence even small changes in export earnings for instance would have comparatively larger effects.

5.3 Tourism Downswing

Based on the collective data presented to this point, it appeared as though the tourism boom of the mid-1990s was expected to continue into the early 2000s. However, the events of that decade, principally the devastation from Hurricane Ivan in 2004, closely followed by the 2008 economic recession induced a bust in the cycle. Accordingly, the response of the state during the period from 2004 could provide more crucial insights towards answering the research question.

The analysis for this section draws heavily on budget speeches presented by the Finance Ministers in the House of Representatives in 2003, 2005 and

2009 . These speeches clearly outline the government's response to the economic downturn of that decade.

In the 2003 speech, Minister Boatswain acknowledged the need of government to better manage the national debt (Boatswain 2002). However there appeared little to no emphasis on addressing expenditure levels or increasing revenue streams. In fact in some instances, less revenue was actually generated and the public wage bill continued to be significant. The government did express a commitment to boosting productive sectors. In the area of agriculture, while the government acknowledged the sector's economic and social value, it admitted that the country lacked the capacity predominantly due to size constraints to improve its viability. Likewise, the government heralded tourism as vital for foreign exchange generation and provision of jobs, as well as its potential to stimulate an expansion in agriculture through linkages. One important policy outlined in the speech however was the move to reduce consumption tax as a measure to help the nation's poor. This policy would have direct implication on private consumption and may in fact be a contributing factor to the high consumption levels observed in the decade (see Figure 5-6).

The 2005 budget speech followed the natural disaster of 2004 and highlighted the myriad challenges facing the country while attempting to rally support for a path forward (Boatswain 2005). Some enlightening policies adopted at that time however truly emphasize how a resource curse is also possible in tourism-dependent economies. The government confirmed that damages from Hurricane Ivan amounted to twice the country's annual GDP and recognized the immense threats to domestic livelihoods, although it was noted that there was an over 50 percent increase in cruise passenger arrivals and construction was booming due to rebuilding efforts.

State revenue was severely decreased and so the government acknowledged the challenges it would face in fulfilling many of its financial obligations, such as maintaining a subsidy on fuel. The National Reconstruction Levy (NRL) was introduced as a means of self-financing some of the recovery efforts. Taxes were also raised on select extra-regional imports. However as Minister Boatswain affirmed, "Over the decade, the philosophy of this government has been to maximize the disposable income of workers leaving them to spend their income as they see fit" (Boatswain 2005: 19). Against this backdrop, the government maintained social welfare programs and effected a general reduction in consumption taxes; granted concessions and tax holidays to the private sector, particularly for hotels and restaurants, and manufacturing, as well as to private homeowners, to assist with reconstruction efforts; provided assistance towards rebuilding homes; expanded the list of products subject to price-controls; implemented unemployment benefits for those who lost their jobs due to the natural disaster; and provided support to farmers and fisher-folk to speed their resumption of activities. Nonetheless the most significant action taken was the decision to award pre-agreed-upon public wage increases as unions refused to accept a proposed wage freeze that government felt was necessary under the circumstances. This event clearly highlights the ability of interest groups like workers' unions to put pressure on politicians to adopt sub-optimal policies.

Elections held in 2008 realized a change in government from the NNP to NDC. The 2009 budget speech was highly critical of the past administration

Table 5-2. Country Policy and Institutional Assessment (CPIA) Ratings for Grenada, 2005 - 2012.

CPIA Cluster	2005	2006	2007	2008	2009	2010	2011	2012
Economic Management	3.2	3.3	3.0	3.0	3.0	3.2	3.3	3.0
Public Sector Management and Institutions	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Structural Policies	4.0	4.0	4.0	4.2	4.2	4.3	4.0	4.0
Policies for Social Inclusion/Equity	3.9	4.0	4.0	4.0	3.9	3.9	3.9	3.9
IDA Resource Allocation Index	3.7	3.8	3.7	3.7	3.7	3.8	3.7	3.7

Source. (World Bank database. 2013)World Bank database

and took the opportunity to make accusations of corruption; the lack of transparency and fiscal discipline; and the failure to stimulate productive sectors (Burke 2009). Such an allegation coincided with the issuing of a low credit rating to the country by Standard and Poor because of the high debt levels; lack of progress towards debt reduction; poor fiscal discipline; lack of strategic planning; and lack of political will to address the country's fiscal and structural issues (ibid.). The government expressed a commitment to improving fiscal and economic management, particularly in relation to the national debt, and to improve the business climate on the island. On observing the proposed policies however, debt management efforts appeared to be focused on eliminating what was deemed wasteful spending, so for instance tighter regulations of the use of public vehicles were enacted. Moreover, the previous administration's policy on social welfare was similar to that of the new government, which influenced the type of actions undertaken at the time. The state increased public assistance by proposing the following: it allowed tax- and duty-free importation of two barrels per household between October and December, 2008; it repealed the NRL, arguing that Grenadians had paid their fair share during such 'hard times'; and it increased spending on education and implemented a free text book programme.

At this point it is clear that while government officials have recognized the need for action when faced with worsening economic conditions, the responses have been less than ideal. To avoid the resource curse, states are expected to adjust spending habits to match changing incomes. However, what has been observed in the Grenada context are the typical reactions to decreased revenues, and that has been an increase in public debt; an aversion to cutting jobs and/or wages and the continuation of non-income-generating activities. In fact, according the CPIA ratings of the World Bank, Grenada's scores for economic management and structural policies can at best be described as average and have not changed much over the years. This information can be found in Table 5-2. Giving due consideration to the evidence presented, what conclusions can we thus draw about tourism and its potential to lead to a developmental curse?

Chapter 6 Discussion and Concluding Remarks

In the previous chapter, I attempted to apply the resource curse framework specifically to the economy of Grenada to evaluate whether tourism can and does lead to a developmental curse. Based on the investigation, summarized in Table 6-1, it is apparent that characteristics common to the resource curse are not unique to mineral economies and can in fact manifest in a small tourism-dependent economy. However, determining this suggests a greater need to reconcile the arguments on small states. This is necessary in my opinion because recommendations given to mitigate the curse do not seem applicable in small economies. The discussion presented below is by no means exhaustive, but does highlight the need to focus greater attention on disagreements still prevalent over the need to categorize small states separately.

The use of Grenada as the case for the application of the resource curse framework was not without its limitations. As with many small states lacking in resources and expertise, synonymous data sets were impossible to obtain. This made it difficult to adopt a uniform time period for analysis. In some cases, there was also a change in the methods of data collection and/or recording so that cross comparisons could not illustrate accurate trends. Nevertheless, by studying the period from 1993 – 1999 and then from 2003 – 2008, the use of Grenada has opened up many avenues for discussion. The contextualization would have benefitted from interviews of various stakeholders in and citizens for Grenada, but for the scope of this paper, it is arguably sufficient to identify traits associated with the resource curse in the island's economy to establish an argument of whether the tourism sector in tourism economies can be detrimental by the characteristics outlined in the framework. The findings of this paper must be situated within the current literature.

Table 6-1. Summary of the Presence of Resource Curse Characteristics in Grenada

Research Criteria		Visible in Grenada?
Is Grenada a tourism economy?		
contributes at least 8% of GDP		✓
responsible for at least 40% of export earnings		✓
Is revenue mainly generated by rent-seeking?		✓
Was the government response overoptimistic during boom?		
(of the following):		
Dutch disease damage		inconclusive
deteriorating terms of trade		✓
little to no accumulation of reserves		✓
increasing public expenditure and expanding public sector		✓
investments in non-income generating activities		✓
increasing public debt		✓
other likely resource curse activities		
social conflicts over resources		inconclusive
patronage/clientism		✓
Did the government show a lagged response to bust?		
little to no cuts in jobs and/or wages		✓
continuation of loss-making investments		inconclusive
increase in state borrowing		✓
devaluation of currency		not applicable

Baldacchino (1993) asserts that the conditions of small (in his article) microstates are frequently ignored or neglected because the underlying general and implicit assumption in many aspects of theoretical and applied social science is that what is applied in large states is equally valid, by scaling up or down, in small states, and as such there is no need to address their issues separately. If we follow the group of literature that argues against any special categorization or preferential treatments of small states, and accept the argument that there are no special constraints against them for growth, particularly as many of their income levels are higher relative to larger developing countries, then it is absolutely possible to argue that the macroeconomic policies adopted by small states that result in tourism mono-economies deviate from the ideal. In this situation, small states would be deliberately employing sub-optimal practices that, at least in the long run, would lead to poor economic performance. Given that the mainstream development theory advocates diversified economies, the actions of small

states to the contrary are questionable. Therefore if small states are no different from much larger states, then all policies advocated for larger states should, as many have argued, be adequate for their much smaller counterparts. To this end, if small states are specializing their economies and refusing to revalue currencies to combat the appreciation of their real exchange rates and inflation – even as they adopt even greater trade liberalization – then they are succumbing to the resource curse.

The alternative premise contends that the determinants of growth differ between small and large states, as suggested for example by Armstrong and Read (2003). For this argument, a small state's choice to focus its economy on its comparative advantage in tourism and forego traditional paths to development is one of, if not the only viable option for economic growth available. In this context it is difficult to justify resource curse theory as an adequate analytical tool simply because many of the curse characteristics are simply unavoidable in the context of limited size and by extension capacity. Accepting this premise should make a strong case for SDT of small states that recognize their inherent limitations that necessitates the maintenance of undesirable behaviors.

One key example is the advice that would be given to small-state governments experiencing a resource curse during downswings in an economy. As excessive government spending is often one of the key drivers of the curse outcome, recommendations often include the undesirable proposition of decreasing jobs or at least reducing wages to a more manageable level. This idea is arguably linked to the theory that economic activities should be led by the more productive private sector and government's role should be minimal. As previously described however, because of limited scale in small states, it is common to find the government taking a more active role in activities. There is a strong necessity for such especially in tourism, which indirectly influences myriad other activities in the country. Furthermore, as destinations need to be marketed to aid in attracting consumers, tourism suggests a need for greater state participation. As Capó et al. (2007) noted "In tourism economies, support by the public sector must compensate for insufficient private initiatives in these fields in order to guarantee increased productivity. Greater efficiency requires active economic development initiatives by the public authorities, rather than neutral behavior, with a view to encouraging an influx of capital to strengthen productivity. In this sense we should not ignore the importance of efficiency by the public authorities and the appropriate use of public resources." (Capó et al. 2007: 625).

Another useful consideration within the context of small states and tourism relates Dutch disease and the state of the terms-of-trade. Dutch disease has two main consequences, namely the appreciation of the exchange rate and a deteriorating terms-of-trade because of the need to import almost all consumption goods. The effect on foreign exchange was not investigated for Grenada because they share a currency with the countries of the OECS. Of greater relevance however is the negative trade balance associated with specialization in tourism as evidenced in Grenada (Figure 5-4) but is common in many small states. Since small states are incapable of producing all the goods they would need to consume, it is expected that their quantity of imports would vastly outweigh the exports. To this end it is difficult to attribute the existence of worsening trade balances to tourism it would exist anyway. What

could be useful for analysis is the extent to which the trade balances have degraded.

6.1 Conclusion

The principal intent of this paper has been to apply resource curse characteristics to a small tourism economy to ascertain if the doctrinaire theory of the benefits to small states from the exploitation of non-traditional exports – in this case tourism – exempts such countries from falling prey to the curse much like other predominantly developing countries experience with extractive natural resources.

I have shown that although not strictly identical in nature to primary resources like oil and minerals, the state of smallness, coupled with the hyper-specialization of these economies because of the lack of viable alternatives and an inability to support greater internal competition, induces a situation where a tourism industry can display peculiar features that parallel those of extractive commodities, and create the conditions within which the windfalls obtained from the industry have an overall negative effect on the country. Furthermore, I have argued that once these circumstances exist, it becomes even more crucial for a government of a tourism economy – much in the same way as those of mineral economies – to adopt quality institutions to manage the effects of the revenues generated from the tourism sector. Moreover, a cautious macroeconomic approach is necessary in both instances as prices of their respective products suffer from volatility, although I have contended that prices are even more unpredictable for tourism because of destination competition. Finally, I have also suggested that in the context of a small state, this price instability has an even greater implication since relatively smaller changes in national incomes have comparatively larger effects on the domestic economy.

Applying some of the main components of the resource curse theory to the small-island state of Grenada, preliminary observations suggest that numerous curse characteristics are indeed present to varying extents in the country. This revelation can have numerous implications for both small state studies and the conceptualization of the resource curse. A more robust study is necessary however, and it would be interesting to see if such characteristics can be successfully applied to other small tourism economies, and if the given observations are limited to such countries or relevant to all tourism-specialized states.

If indeed the resource curse phenomenon described in this paper can and does exist for small tourism-dependent countries, my assertion is that the idea of tourism as a ‘silver bullet’ for small states based on comparative advantage would need revision, especially amidst a global narrative that emphasizes diversification for greater robustness. This would create another quandary for development theorists. Proving that the resource curse exists in small tourism economies will render the advice given to small tourism states to specialize as detrimental to their overall economic growth potential and may lead to the conclusion that *a priori* such countries should be pursuing more diversified economies. If the arguments continue to support hyper-specialization in tourism for instance of small states, then it is my belief that the successful

application of the resource curse to small economies strengthens the argument for a separate set of rules to govern small state interactions in the world trade market.

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