

Country Risk Ratings of Small Island Tourism Economies

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Summary

Over the last twenty years, there has been a growing fascination within public and academic circles about the livelihood of islands with small populations and territory which are present in each of the world's great oceans. The Small Island Tourism Economies analysed in this paper vary profoundly in their size, land area, and location. Moreover, they have depended heavily on financial aid from their former colonists for infrastructure development, which has declined dramatically since the collapse of Communism. These economies also differ in their narrow natural resource bases on land and in water, in their prospects for self reliance in economic development, and their overwhelming reliance on tourism as a source of exports. These economies are developing countries which need a consistent inflow of foreign direct investment to maintain economic growth. Such sovereign island economies differ in the extent to which they are home to a multitude of ethnic diversity, political systems, historical experience, economic and environmental vulnerability, ecological fragility, the types of risks facing private investors, and in the extent to which they are perceived as, or perceive themselves to be, insular and peripheral. In spite of the vast diversity as well as similarities, researchers are fascinated by the world of small island economies, and are intrigued by their unique features which cannot be addressed through a generalised set of rules. This paper analyses the geographical, historical, economic, tourism-oriented and institutional characteristics, as well as vulnerability to changes in the international economic, financial and political climates, of twenty Small Island Tourism Economies. The snapshot images provide a comparative assessment of the international country risk ratings, and highlight the importance of economic, financial and political risk ratings as components of a composite risk rating for Small Island Tourism Economies.

Keywords: Small size, Tourism, Volatility, Vulnerability, Country risk ratings, Economic risk, Financial risk, Political risk, Composite risk

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1. INTRODUCTION

Over the last twenty years, there has been a growing interest in the livelihood of small states, particularly island economies, around the world. Islands with small populations are also very small territorially, and these two aspects of their size tend to be connected. These island economies differ in the extent to which they are home to different ethnic minorities, their political cultures, historical experiences, and their vulnerability to external interventions and natural disasters; in their ecological fragility; and their perception of insularity and its underlying consequences. Such sovereign island economies have commonalities such as small populations, very little productive capacity, similar ecological surroundings, and pleasant climates which foster tourism.

Small Island Tourism Economies (SITEs) are developing countries with small populations, narrow productive capacities, and a consistent inflow of Foreign Direct Investment (FDI) in order to facilitate economic growth. When such economies have access to capital markets, they can smooth out consumption over time while absorbing adverse domestic production shocks. A common feature of SITEs is that they have to rely intensively on international development assistance, particularly from their former colonists, mainly for infrastructure development expenditures. This assistance has declined since the collapse of communism in Europe in the early 1990s. To compensate for the decline in development financing, SITEs have turned toward the international financial community. It is difficult for SITEs to borrow from the international capital markets, because they are perceived to suffer from frequent natural disasters, to be susceptible to adverse macroeconomic shocks, and to have high risk. The main impediments to lend to small island economies are considered to be the costs of obtaining information and country risk.

The Decolonisation Process during the latter half of the 20th Century gave rise to the political expectations and independence of the world's smallest islands, and led to the consolidation of their positions in the United Nations. This has prompted a variety of island-related research programs worldwide to address the special problems of, and the opportunities for, these small island economies in a period of vast globalisation.

Country risk has become a topic of major concern for the international financial community over the last two decades. Various risk rating agencies employ different methods to determine country risk ratings. They combine a range of qualitative and quantitative information regarding alternative measures of economic, financial and

political risk into associated composite risk ratings. For six SITEs, international country risk ratings compiled by the International Country Risk Guide (ICRG), which is the only rating agency to provide consistent monthly data for an extended period for a large number of countries, are compared for 1984-2002.

The plan of the paper is as follows. Section 2 defines Small Island Tourism Economies (SITEs) and the implications of being a SITE. An analytical review of the economic characteristics of SITEs is given in Section 3. A comparison of Country Risk Ratings compiled by the ICRG for six representative SITEs from 1984 to 2002 is given in Section 4. Some concluding remarks are presented in Section 5.

2. SMALL ISLAND TOURISM ECONOMIES (SITEs)

2.1. Small Size

In the literature on small economies, several attempts have been made to conceptualise the size of an economy, yet there has been very little agreement to date. The issue of size first emerged in the economics of international trade, where the small country is the price taker and the large country is the price maker with respect to import and export prices in world markets. According to Armstrong and Read (1998, p. 566), ‘this definition therefore lacks focus in its inclusion of small ones; most countries are regarded as small in spite of their relative largeness—Australia, Canada, Switzerland, etc.’

Size is a relative rather than an absolute concept. In the literature on small economies, size deals with quantifiable variables, where population, GDP and land area are the most widely used. Some notable examples in emphasising size are Kuznets (1960), where a country with a population of 10 million or less is regarded as small. By this measure, the World Bank’s World Development Indicators (WDI) 2002 data show there are 130 small economies. In Robinson (1960), a population threshold of 10 to 15 million is used. The United Nations uses a threshold of 1 million in its studies on small economies, UNCTAD uses 5 million, and the Commonwealth Secretariat uses 1.5 million. According to Liou and Ding (2002, p. 1290), population as a size measure is ‘currently used by the United Nations related institutes (e.g., UNIDO and the World Bank) and other international development institutions (e.g., the Commonwealth Secretariat).’ Armstrong and Read (1998) argue that population is often used because it is convenient and provides information about the size of the domestic market and labour force. Clearly, there is debate as to the definition of what

constitutes a ‘small’ country. It is difficult to substantiate why a particular population threshold is used, and there have been variations in the level of thresholds, which also seem to be chosen arbitrarily.

Table 1. Common Size Measures of SITES

| SITE | Mean 1980-2000 | | 2000 | | Surface Area (km ²) |
|----------------|----------------|---------------------------|-------------|---------------------------|---------------------------------|
| | Pop. (m) | GDP per capita ('000 USD) | Pop. (m) | GDP per capita ('000 USD) | |
| Antigua | 0.06 | 6.6 | 0.07 | 9.1 | 440 |
| Bahamas | 0.26 | 13.1 | 0.30 | 13.9 | 10,010 |
| Barbados | 0.26 | 7.1 | 0.27 | 8.3 | 430 |
| Comoros | 0.44 | 0.5 | 0.56 | 0.4 | 2,230 |
| Cyprus | 0.69 | 10.0 | 0.76 | 14.1 | 9,240 |
| Dominica | 0.07 | 3.4 | 0.07 | 3.4 | 750 |
| Dominican Rep. | 7.06 | 1.5 | 8.37 | 2.1 | 48,380 |
| Fiji | 0.73 | 2.3 | 0.81 | 2.4 | 18,270 |
| Grenada | 0.09 | 2.6 | 0.10 | 3.8 | 340 |
| Haiti | 6.54 | 0.5 | 7.96 | 0.4 | 27,560 |
| Jamaica | 2.40 | 1.7 | 2.63 | 1.8 | 10,830 |
| Maldives | 0.21 | 1.3 | 0.28 | 1.9 | 300 |
| Malta | 0.37 | 7.0 | 0.39 | 10.2 | 320 |
| Mauritius | 1.07 | 2.9 | 1.19 | 4.4 | 2,030 |
| Samoa | 0.16 | 1.2 | 0.17 | 1.4 | 2,830 |
| Seychelles | 0.07 | 5.9 | 0.08 | 7.0 | 450 |
| St Kitts | 0.04 | 4.5 | 0.04 | 6.8 | 360 |
| St Lucia | 0.13 | 3.1 | 0.16 | 4.0 | 610 |
| St Vincent | 0.11 | 2.1 | 0.12 | 2.8 | 390 |
| Vanuatu | 0.15 | 1.2 | 0.20 | 1.2 | 12,190 |
| Total | 20.9 | | 24.5 | | 147,960 |

Source: WDIs/World Bank 2002

Note: For Dominica population is 2000 only

In determining the choice of countries for this paper¹, neither a population nor a GDP threshold is used. This is because some of the SITES in the sample, particularly Dominican Republic, Haiti, Jamaica, and Mauritius, have populations above 1 million, and yet share

¹ The data presented in this study are taken from the World Development Indicators (WDI) 2002, World Bank.

numerous features of being small. Undesirable outcomes are inevitable when a population, GDP or a land-area threshold is chosen since countries can overshoot it but still feature ‘smallness’.

In a ground-breaking contribution to the subject of small states, Armstrong et al. (1995) probably best explains the size of an economy by using the concept of sub-optimality in a macroeconomic framework. The principle behind this framework is the incorporation of the interaction between production and trade through minimum efficient scale² (MES). For small economies, in particular, the level of GDP is determined by the MES, the shape of the average cost curve below the MES, and transportation costs. This approach to conceptualise size provides a more precise understanding of the implications of being small.

Viewing the populations of the 20 SITEs analysed in Table 1 above, the SITEs are home to more than 24 million people, which is less than one percent of the total population of all the developing countries combined. They range in size from micro economies, like St. Kitts and Nevis, with only 41,000 people, to mini economies like Antigua and Barbuda, Dominica, Grenada, and Seychelles, with populations between 50,000 and 100,000. Furthermore, The Bahamas, Barbados, Maldives, Malta, Samoa, St. Lucia, St. Vincent and the Grenadines, and Vanuatu have populations between 100,000 and 500,000. This is the population range into which most SITEs fall. Cyprus and Fiji have populations between 500,000 and 1 million. The remaining four SITEs are Dominican Republic, Haiti, Jamaica and Mauritius, each with populations of more than one million.

Comoros and Haiti were French colonies, while Dominican Republic was a Haitian colony. The remaining seventeen SITEs profiled in this paper are former British colonies, which gained independence in the latter half of the 20th Century. The above mentioned seventeen SITEs are now in the British Commonwealth. Haiti has the longest history of independence, having gained it from France in 1804.

The per capita GDP (in constant 1995 US Dollars) in these countries also ranges widely. There are two low income (< US\$756) SITEs, namely Comoros and Haiti, and three high income (> US\$9,265) SITEs, which are The Bahamas, Cyprus and Malta. The rest are either low or high middle income SITEs, where their per capita GDP ranges from US\$756 to US\$9,265. SITEs in this paper are in four geographic regions of the world, with 11 of

² This is the level of output of goods and services at which production is feasible.

them in the Caribbean Sea, 3 in the Pacific Ocean, 4 in the Indian Ocean, and 2 in the Mediterranean Sea.

2.2. Island Economies

Dommen (1980, p. 932) argued that ‘not all free-standing land masses are islands’ and ‘an island is not a piece of land completely surrounded by water.’ This had been established through comparing and matching economic, social and political indicators, and not on account of the geological nature of land formations of the countries chosen. However, the SITEs profiled in this paper are sovereign island economies because of their geological nature. They are all archipelagic, have risen from the ocean through volcanic activity and lie along the weaker parts of the earth’s crust. Two of the countries in this sample, namely Haiti and the Dominican Republic, are not entirely surrounded by water. Since they are two different countries on the Hispaniola island, their inclusion in the sample is warranted. Visitors normally reach these economies by air, and freight is usually carried by sea.

These island economies have the world’s most delicate ecosystems, and are consistently threatened by natural disasters as well as the effects of environmental damage. According to Briguglio (1995), all islands are insular but not situated in remote areas of the globe, while insularity and remoteness give rise to transport and communications problems. In this regard, Armstrong and Read (2002, p. 438) reiterate that ‘both internal and external communication and trade maybe very costly and implications for their internal political and social cohesiveness as well as competitiveness.’ Most of these SITEs are in regions where they are frequently affected by unfavourable climatic conditions, which typically affect the entire population and economy.

2.3. Reliance on Tourism

Tourism plays a dominant role in the economic well-being of SITEs, and tourism earnings account for a significant proportion in the value added in their national product. The fundamental aim of tourism development in SITEs is to increase foreign exchange earnings to finance imports. As can be seen in Table 2, the SITEs examined in this paper have an overwhelming reliance on tourism as a source of exports. In economic planning, tourism has been given a predominant emphasis in the SITEs where the climate is well suited for tourism development and the islands are strategically located.

Table 2. Structure of the Economy: Mean Percentages 1980-2000

| SITEs | Agriculture* | Industry* | Manufacturing* | Services* | Exports* | Tourism Repts** |
|--------------|---------------------|------------------|-----------------------|------------------|-----------------|------------------------|
| Antigua | 4.6 | 18.5 | 3.4 | 76.9 | 77.6 | 67.0 |
| Bahamas | 2.2 | n.a. | n.a. | 83.8 | 65.5 | 59.0 |
| Barbados | 6.8 | 20.6 | 10.2 | 72.6 | 57.5 | 51.0 |
| Comoros | 38.4 | 12.0 | 3.9 | 49.7 | 17.5 | 22.2 |
| Cyprus | 7.4 | 28.0 | 15.2 | 64.6 | 48.2 | 36.8 |
| Dominica | 24.7 | 19.6 | 7.3 | 55.7 | 47.6 | 23.3 |
| Dom. Rep. | 14.4 | 29.5 | 16.6 | 56.1 | 27.4 | 31.7 |
| Fiji | 19.8 | 23.3 | 11.5 | 56.9 | 54.1 | 25.3 |
| Grenada | 14.6 | 18.9 | 6.1 | 66.5 | 46.1 | 41.9 |
| Haiti | 31.1 | 17.1 | 9.0 | 51.8 | 13.3 | 23.3 |
| Jamaica | 7.3 | 36.7 | 17.3 | 55.9 | 48.3 | 32.8 |
| Maldives | 13.9 | n.a. | 4.6 | n.a. | 48.1 | 51.6 |
| Malta | 3.9 | 39.6 | 28.2 | 56.5 | 84.1 | 24.3 |
| Mauritius | 11.5 | 30.7 | 21.9 | 57.8 | 58.8 | 14.0 |
| Samoa | 18.8 | 30.9 | 18.8 | 50.4 | 32.6 | 41.5 |
| Seychelles | 4.9 | 18.4 | 10.6 | 76.7 | 61.8 | 40.2 |
| St Kitts | 8.2 | 25.2 | 12.4 | 66.5 | 55.7 | 57.4 |
| St Lucia | 12.3 | 19.4 | 7.8 | 68.3 | 65.7 | 59.3 |
| St Vincent | 15.8 | 24.9 | 9.6 | 59.3 | 59.1 | 37.2 |
| Vanuatu | 21.6 | 10.5 | 4.5 | 67.7 | 44.6 | 46.4 |

Source: WDIs 2002/World Bank

*Mean % of GDP and ** Mean % of Exports

A large proportion of what is being earned through tourism leaves the economy, almost instantaneously to finance imports to sustain the tourism industry. Tourism-related imports are comprised mostly of non-indigenous goods. Meat and dairy products feature heavily in the Caribbean, while imports of construction material for building tourism-related facilities feature more in the Maldives. Labour is also imported for employment in tourism, which results in substantial foreign exchange outflow.

In SITEs, tourism facilities are mostly enclave developments, and their effects on the domestic economy can sometimes be very limited. Tourism requires careful planning in

order to maintain its sustainability and limit environmental damage. While tourism development has contributed to economic development in many SITEs, they should be managed responsibly in order to secure their long term sustainability.

Research on pairwise correlations among international tourist destinations in terms of tourist arrivals or earnings provides some background for national policies of SITEs. When the correlation coefficients are negative, destinations are generally neighbouring countries, and are regarded as substitutes. In contrast, when correlations are positive, the destinations are complementary to each other. In Figure 1, all of the pairwise correlations are positive, except for Haiti.

2.4. Implications of being a SITE

The most prominent feature of SITEs is their narrow production base and the small domestic market. Many of these SITEs are necessarily and relatively undiversified in their production of exports. In order to tackle this problem, they have to rely on international trade and foreign direct investment.

SITEs do not have advanced capital markets to hedge against adverse macroeconomic shocks. Access to international capital markets is difficult because SITEs are considered to be risky entities. The absence of reliable institutional frameworks in SITEs makes the distribution of income more uneven and results in higher levels of poverty. Until 1990, SITEs had enjoyed a steady flow of aid from their former colonists towards an advancement of social infrastructure such as schools and hospitals, which has reinforced their economic development records.

There are substantially qualitative differences about per capita incomes and economic growth rates between SITEs and other relatively large developing countries. A possible explanation for this outcome is because SITEs have relatively large natural resource abundance, which fosters tourism and offsets the inherent disadvantages of being small. Some key social indicators such as the formal education attainment of population, access to better health care, and safe drinking water in SITEs, are highly favourable. That is a clear reflection of sound domestic policies in these SITEs on their social front.

Most SITEs are in remote areas of the globe. Exports and imports are equally uncompetitive in the world and domestic markets, respectively, due to higher

transportation costs. Therefore, there is no incentive to improve efficiency or to prop up modernisation.

The incidence of natural disasters is very high in most SITEs, where there is severe economic disruption, while development opportunities are regularly forgone. Some SITEs have a high incidence of HIV/AIDS, particularly in Haiti. The population estimates for Haiti, given in Table 1, explicitly accommodate the effects of excess mortality due to HIV/AIDS. This has resulted in lower life expectancy, higher infant mortality and death rates, lower population and growth rates, and greater changes in the distribution of population by age and sex, than would otherwise have been expected.

It is widely claimed that, due to the increased emissions of greenhouse gases, there will be widespread global warming. The subsequent rise in sea levels would increase by a metre over the next one hundred years, which would result in complete extinction of SITEs such as the Maldives. Moreover, other SITEs would experience widespread soil erosion, which could result in the disappearance of the world's most popular beaches.

There is diversity among SITEs if, for instance, one compares the stages of development among SITEs. Therefore, one could not draw up a single set of policy prescriptions for all SITEs, but should address their domestic and regional circumstances as each SITE is inherently unique.

3. ECONOMIC CHARACTERISTICS

3.1. High Volatility of Real GDP Growth

The squared deviation from the mean of the GDP growth rate is known as the volatility of GDP growth. In SITEs, the volatility of GDP growth rate tends to be very high. The real GDP growth rate and its volatility are given in Figure 2. The number of observations varies among SITEs according to the availability of data. Eleven SITEs have data from 1977-2000, five SITEs have data from 1978-2000, and the four remaining SITEs have data from 1979-2000, 1980-2000, 1981-2000 and 1985-2000. The lowest mean volatility of real GDP growth rate recorded was 8.1 for Malta, while the highest mean volatility was for 56.9 for St. Lucia. The highest individual volatility figure recorded was 555.1 for Dominica.

The high volatility of the GDP growth rate recorded among SITEs is due to three main reasons. SITEs are so open to the rest-of-the-world markets due to the high dependability of imports and exports, and are more susceptible to changes in the rest-of-the-world market

conditions. Moreover, SITEs have a small range of uncompetitive exports and limited options to avoid losses. Finally, SITEs are prone to natural disasters, which affect every activity within the economy. The significance of the above vary quite differently among SITEs because smallness is associated with relatively high levels of specialisation in production and trade.

3.2. Narrow Production Base

There is less incentive to diversify industry when the domestic market is small. It is quite prominent in SITEs to have one dominant economic activity and, when it starts to decline, another dominant economic activity replaces it rather than the economy becoming more diversified. During the last decade, merchandise exports among SITEs have plummeted, while tourism-related earnings have soared.

3.3. International Trade

In SITEs the range of production of goods and services is small, but a broad range of goods and services is consumed for the purposes of international trade. Hence, the proportion of trade to GDP is relatively high among SITEs.

Small island economies are highly open to world markets and adheres to the same rules and regulations as larger economies. In that regard, such small island economies hold much greater stake in the international market place because of their smaller proportion of world trade. Moreover, SITEs do not necessarily receive preferential treatment, except for a few former British colonies with regard to banana exports. In this regard, the terms of trade of SITEs do not exhibit irregular changes when compared with other larger developing countries.

The reliance of SITEs on their import tariff receipts as a major source of government revenue can be hampered in any trade liberalisation measure. This could also result in unsustainable government debt in SITEs.

3.4. Capital Market Accessibility

SITEs need a consistent inflow of foreign capital to smooth out consumption over the long run, while compensating for any adverse shocks to domestic production. A common feature of SITEs is that they depend heavily on foreign aid to finance development. Aid flows have dropped sharply during the last decade of the 20th Century, due to the collapse

of communism in Europe. Aid from donor countries has been diverted towards former Soviet allies. SITEs have experienced a dramatic decline in per capita aid of around US\$145 in 1990 to less than US\$ 100 per capita in 2000. They have very limited access to commercial borrowings because these are perceived to suffer from frequent natural disasters or for other reasons considered to be high risk.

Even though SITEs have relatively low levels of indebtedness, they have difficulties in borrowing on commercial terms. The costs of obtaining information on the economy and country risk issues are the major impediments to borrowing. Difficulties in prosecuting illegal activities in SITEs makes enforcing contracts very costly for investors. This is one of the main reasons why the costs of borrowing for SITEs are relatively high. As a result, the integration of SITEs into international financial capital markets is more difficult than would otherwise be the case.

3.5. Foreign Direct Investment

Foreign direct investment plays an important role in linking SITEs to the developed world. Entrepreneurship from the outside world is an important source of knowledge and expertise in creating efficiency and improving management control in the private sector. Moreover, this would also bring in state-of-the-art technology, and increase market opportunities for local firms.

3.6. Poverty Prevalence

Although SITEs have achieved high average per capita GDP relative to the larger developing countries, poverty continues to be an unabated challenge. Generally, with the increase in per capita GDP, there has been a decline in poverty. However, there are a number of small economies that have higher poverty rates than are reflected in their per capita incomes, primarily because SITEs are island archipelagos. In such SITEs, a large proportion of the economic activity is confined to the capital, while the dispersed communities remain poor. Poverty prevalence becomes high with the uneven distribution of income. The high volatility of GDP, together with the population's inability to absorb negative shocks to their incomes, mean that inequality is further aggravated and hardship is intensified.

3.7. Institutional Distinctiveness

The public sector has played a dominant role in economic activities. There is limited institutional capacity in the public sector, particularly in SITEs in which there are considerable internal transport costs, with islands scattered across miles of ocean, which is often difficult to navigate.

3.8. Vulnerability

Vulnerability means exposure to exogenous shocks over which the affected country has little or no control, and low resilience to withstand and recover from these shocks. Small states are less likely to be resilient to these shocks, given the narrow economic structures and limited resources. In the literature, vulnerability can exist in the form of economic, strategic and environmental factors. Economic vulnerability examines the narrow productive base, the susceptibility of the economy to external shocks, and the high incidence of natural disasters. Strategic vulnerability accounts for the political vulnerability to their colonial history, as well as their larger neighbours. Environmental vulnerability explains the intensity of the fragility of the delicate ecosystems of SITEs.

4. COMPARISONS OF ICRG COUNTRY RISK RATINGS

The concept of country risk became a topic of major concern for the international financial community in the early 1980s when Poland and the Eastern Bloc countries had debt repayment problems, and also when Brazil and Mexico defaulted on their debts.

4.1. Country Risk and Country Risk Ratings

Country risk refers to the inability of a sovereign country to honour obligations to repay its debt. There are many country-specific factors which affect country risk ratings. However, the literature addresses factors which are categorised into three main components, namely economic, political and financial risks, and are considered to be interrelated (see Hoti (2001) and Hoti and McAleer (2003)).

The Third World debt crisis in the early 1980s prompted country risk rating agencies such as Moody's, Euromoney, S&P, Institutional Investor, Economist Intelligence Unit, International Country Risk Guide, and Political Risk Services, to compile sovereign indexes or ratings. These ratings are considered as benchmarks by which credit risks associated with sovereign countries can be established at a given point in time. Hoti (2002)

notes that the risk rating agencies have attempted to provide an independent analysis of country risk and a consistent method of risk assessment on a timely basis. These agencies provide qualitative and quantitative country risk ratings, combining information regarding alternative measures of political, economic and financial risk ratings to obtain a composite risk rating. The International Country Risk Guide (ICRG) is the only international rating agency to provide detailed and consistent monthly data over an extended period for a large number of countries.

Table 3. Descriptive Statistics of Risk Ratings

| SITE | Economic | | Financial | | Political | | Composite | |
|----------|----------|-----|-----------|------|-----------|------|-----------|------|
| | Mean | SD | Mean | SD | Mean | SD | Mean | SD |
| Bahamas | 74.2 | 3.8 | 75.9 | 7.5 | 72.8 | 7.0 | 73.9 | 3.3 |
| Cyprus | 79.0 | 3.0 | 83.3 | 7.1 | 69.0 | 9.6 | 75.1 | 6.3 |
| Dominica | 67.5 | 8.7 | 56.6 | 16.3 | 60.7 | 8.1 | 61.4 | 10.0 |
| Haiti | 58.6 | 4.3 | 40.2 | 19.2 | 38.0 | 10.8 | 43.7 | 9.9 |
| Jamaica | 59.1 | 5.9 | 68.9 | 12.3 | 68.5 | 6.8 | 66.3 | 7.1 |
| Malta | 81.4 | 8.0 | 76.3 | 9.1 | 73.5 | 13.1 | 76.2 | 7.5 |

Source: International Country Risk Guide

4.2. Trends and Volatilities in Country Risk Ratings

From 1984 to date, the ICRG has been compiling economic, financial, political and composite risk ratings for over 140 countries on a monthly basis. As given in Hoti (2002), the ICRG rating system is composed of 22 variables which correspond to three major components of country risk, namely economic, financial and political. These variables essentially represent risk-free measures. There are 5 economic and 5 financial variables, while political component is based on 12 variables. Using each set of variables, a separate risk rating is created for the 3 components. The 5 economic variables for the economic risk assessment are weighted equally to give a score of 50 points: the 5 financial variables, for financial risk assessment are weighted equally to give a score of 50 points, and 12 political variables for political risk assessment are weighted equally to give a score of 100 points. The composite risk rating is obtained by dividing the sum of the 3 components of risk ratings by 2: the economic and financial components account for 25% each, and the political component accounts for 50% of the composite risk rating. The lower (higher) is a

given risk rating, the higher (lower) is the associated risk. In essence, the country risk rating is a measure of country creditworthiness.

There are six representative SITEs. The Bahamas, Dominica, Haiti, Jamaica, in the Caribbean, and Cyprus and Malta in the Mediterranean, are selected to provide snapshot images for the period January 1984 to May 2002, which is the longest period for which data are available. In the literature on small states, SITEs are perceived to be of high risk. However, except for Haiti, all of the small island economies profiled here have relatively higher risk ratings in each of the four categories, showing an associated low risk. Table 3 above provides the means and standard deviations of the economic, financial, political and composite risk ratings for the six SITEs.

In the case of the Bahamas, while exhibiting high risk ratings, the means across the ratings for the four categories are reasonably close. Dominica and Haiti have shown the lowest risk ratings, while Cyprus and Malta have the highest risk ratings in all four categories, apart from a slight depression in the political risk rating for Cyprus.

The snapshot images of the four country risk ratings, denoted ECO-R, FIN-R, POL-R and COM-R, and their associated volatilities, denoted ECO-V, FIN-V, POL-V and COM-V, for the six SITEs are given in Figures 3-6.

Both Jamaica and Dominica have increasing trends in economic risk ratings, while the Bahamas, Cyprus and Haiti generally show no trends. Haiti has experienced widespread associated volatilities. At first, the financial risk ratings for Cyprus and Jamaica increase and then stabilise. Meanwhile, Haiti shows an impressive increase in the ratings for almost a decade. The Bahamas, Dominica, and Malta have showed mixed results over the sample period. Their associated volatilities have shown a mixed degree of variation, with Haiti showing extremely high volatility. All six SITEs have shown increasing trends in their political risk ratings, with Haiti having a major slump in middle of the sample. The associated volatilities for the Bahamas show an increasing trend, while all the other SITEs have shown considerable variations.

As a weighted sum of the three indexes, the composite risk ratings for all six SITEs have increasing trends, except for the Bahamas and Haiti. The composite risk rating for the Bahamas is not noticeably influenced by any one component rating. For the other five SITEs, it is quite apparent that the political risk rating has a substantial influence. The

associated volatilities for the Bahamas and Cyprus have been quite stable, whereas there have been varying fluctuations for the rest.

The geographical region of SITEs seems to influence the behavioural patterns of the risk ratings. However, the risk rating agencies do not explicitly accommodate geographical location in compiling the risk ratings.

5. CONCLUDING REMARKS

This paper evaluated the economic, social and political characteristics of 20 sovereign states, which are small island economies, where international tourism earnings dominate the value added in their national incomes. Moreover, Country Risk Ratings compiled by the ICRG for 6 representative Small Island Tourism Economies from January 1984 to May 2002 were compared. An evaluation of the salient properties, coupled with the comparison of country risk ratings for Small Island Tourism Economies, warrants a critical assessment of the relevance and practicality of theories pertaining to international tourism earnings, economic growth and country risk.

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Figure 1: Pairwise Correlations of International Tourism Receipts (ITRs) for 20 SITES

| | ATG | BHS | BRB | COM | CYP | DMA | DOM | FJI | GRD | HTI | JAM | KNA | LCA | MDV | MLT | MUS | SMW | SYC | VCT | VUT |
|----------------|------|------|-----|------|------|------|------|------|------|------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| Antigua | 1 | | | | | | | | | | | | | | | | | | | |
| Bahamas | 0.9 | 1 | | | | | | | | | | | | | | | | | | |
| Barbados | 0.8 | 0.8 | 1 | | | | | | | | | | | | | | | | | |
| Comoros | 0.9 | 0.7 | 0.7 | 1 | | | | | | | | | | | | | | | | |
| Cyprus | 0.9 | 0.8 | 0.8 | 0.9 | 1 | | | | | | | | | | | | | | | |
| Dominica | 0.9 | 0.8 | 0.8 | 0.9 | 1.0 | 1 | | | | | | | | | | | | | | |
| Dominican Rep. | 0.9 | 0.8 | 0.9 | 0.9 | 1.0 | 1.0 | 1 | | | | | | | | | | | | | |
| Fiji | 0.8 | 0.7 | 0.7 | 0.9 | 0.9 | 0.9 | 0.9 | 1 | | | | | | | | | | | | |
| Grenada | 0.9 | 0.9 | 0.8 | 0.9 | 1.0 | 1.0 | 1.0 | 0.9 | 1 | | | | | | | | | | | |
| Haiti | -0.5 | -0.2 | 0.0 | -0.3 | -0.3 | -0.2 | -0.1 | -0.1 | -0.3 | 1 | | | | | | | | | | |
| Jamaica | 0.9 | 0.9 | 0.8 | 0.9 | 1.0 | 1.0 | 0.9 | 0.9 | 1.0 | -0.3 | 1 | | | | | | | | | |
| Maldives | 0.9 | 0.8 | 0.8 | 0.9 | 1.0 | 1.0 | 0.9 | 0.9 | 1.0 | -0.2 | 1.0 | 1 | | | | | | | | |
| Malta | 0.9 | 0.7 | 0.5 | 0.8 | 0.8 | 0.8 | 0.7 | 0.7 | 0.8 | -0.4 | 0.9 | 0.9 | 1 | | | | | | | |
| Mauritius | 0.9 | 0.8 | 0.9 | 0.9 | 1.0 | 1.0 | 1.0 | 0.9 | 1.0 | -0.1 | 0.9 | 1.0 | 0.7 | 1 | | | | | | |
| Samoa | 0.6 | 0.6 | 0.7 | 0.5 | 0.7 | 0.7 | 0.7 | 0.6 | 0.7 | 0.1 | 0.7 | 0.7 | 0.6 | 0.7 | 1 | | | | | |
| Seychelles | 0.9 | 0.8 | 0.9 | 0.9 | 1.0 | 1.0 | 1.0 | 0.9 | 1.0 | -0.1 | 0.9 | 1.0 | 0.7 | 1.0 | 0.7 | 1 | | | | |
| St Kitts | 0.6 | 0.6 | 0.9 | 0.7 | 0.8 | 0.8 | 0.9 | 0.8 | 0.8 | 0.1 | 0.7 | 0.8 | 0.4 | 0.9 | 0.6 | 0.9 | 1 | | | |
| St Lucia | 0.9 | 0.8 | 0.8 | 0.9 | 0.9 | 1.0 | 0.9 | 0.9 | 1.0 | -0.2 | 0.9 | 1.0 | 0.8 | 0.9 | 0.7 | 1.0 | 0.8 | 1 | | |
| St Vincent | 0.9 | 0.8 | 0.9 | 0.9 | 1.0 | 1.0 | 1.0 | 0.9 | 1.0 | -0.1 | 1.0 | 1.0 | 0.8 | 1.0 | 0.8 | 1.0 | 0.8 | 1.0 | 1 | |
| Vanuatu | 0.7 | 0.5 | 0.6 | 0.9 | 0.8 | 0.9 | 0.8 | 0.8 | 0.8 | 0.0 | 0.9 | 0.9 | 0.8 | 0.9 | 0.7 | 0.9 | 0.7 | 0.8 | 0.8 | 1 |

Figure 2 (a): Real GDP Growth Rate and Their Respective Volatilities for 10 SITES

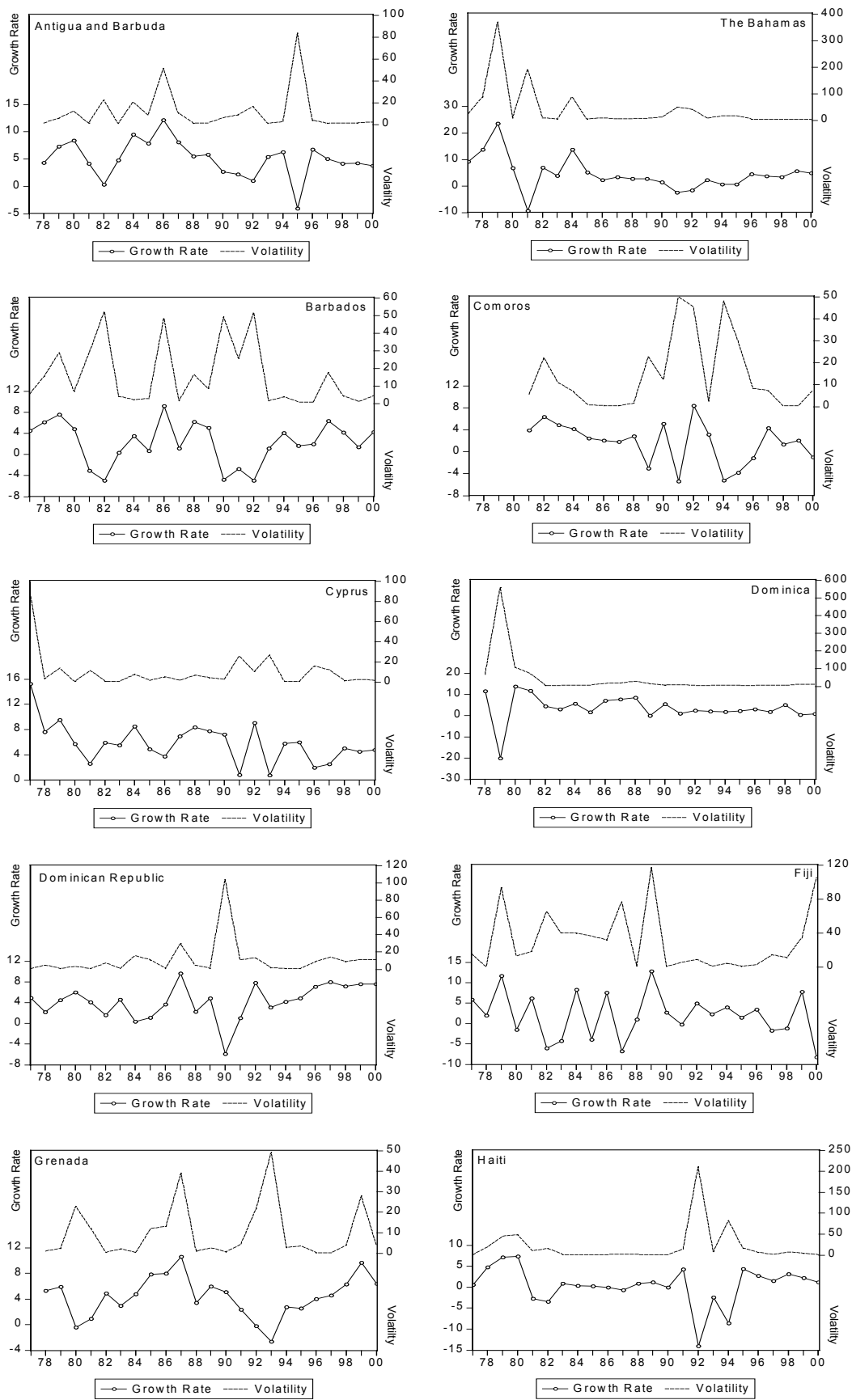


Figure 2(b): Real GDP Growth Rate and Their Respective Volatilities for 10 SITES

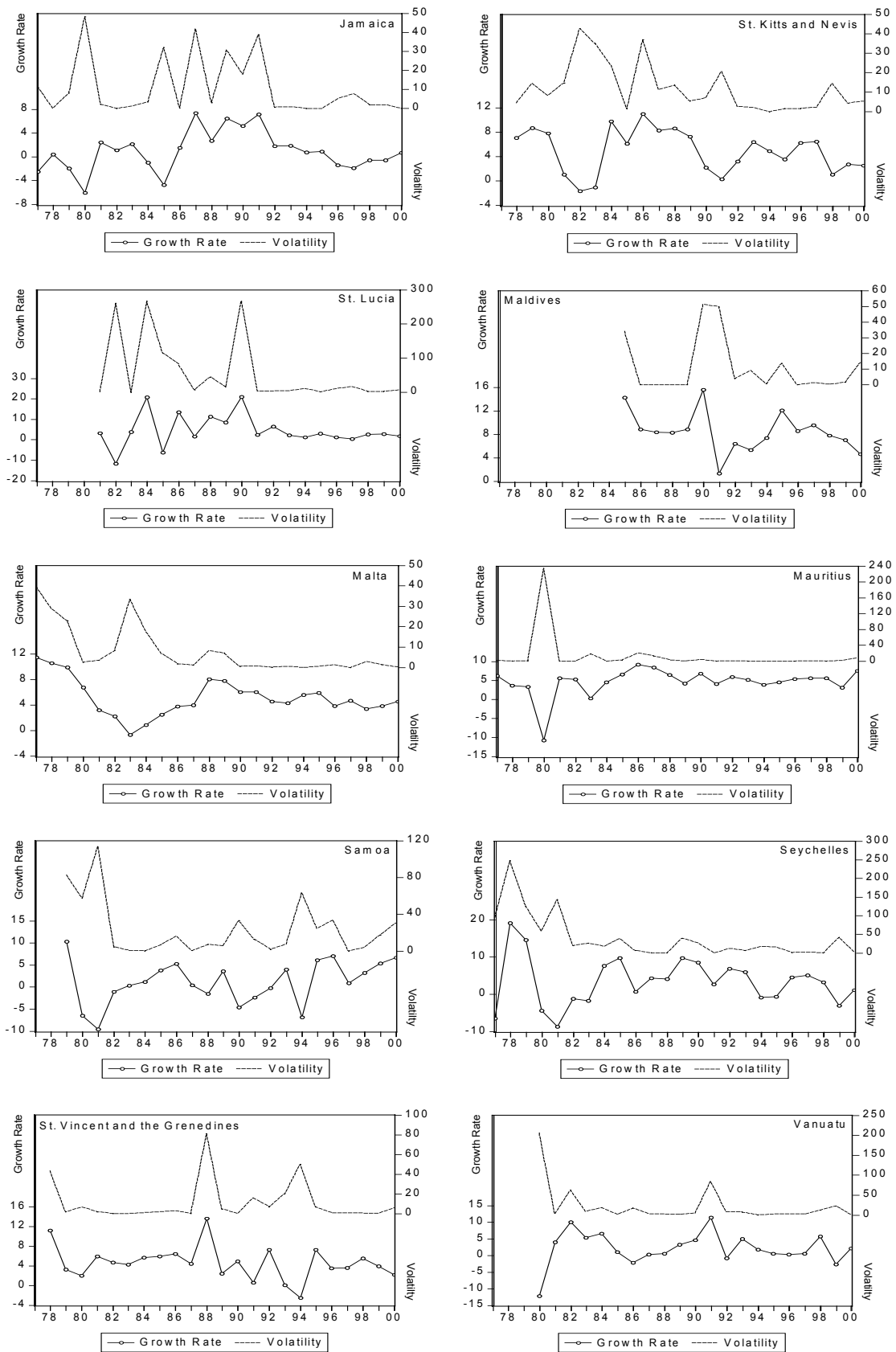


Figure 3: Economic Risk Ratings and Their Respective Volatilities for 6 SITES.

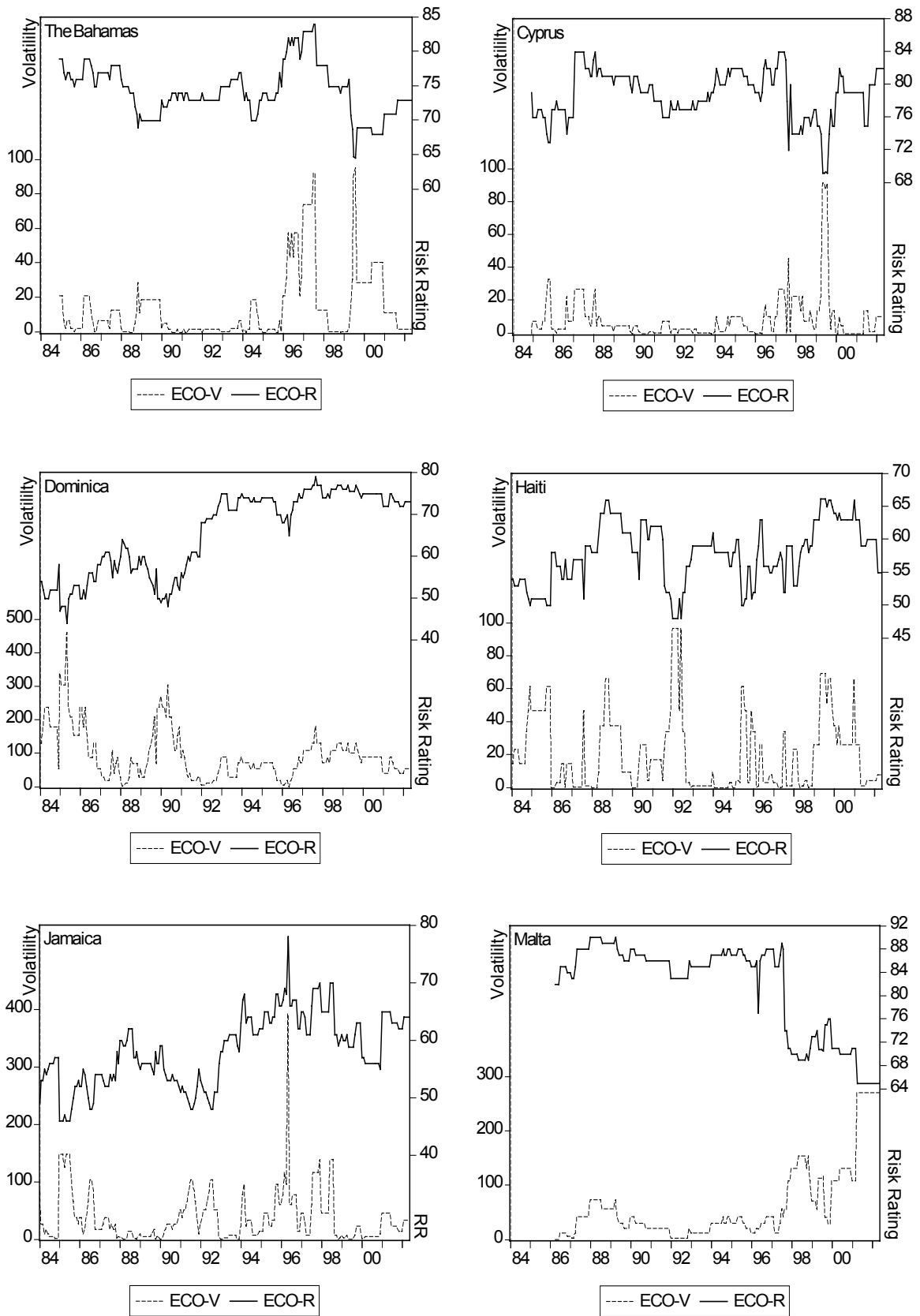


Figure 4: Political Risk Ratings and Their Respective Volatilities for 6 SITES.

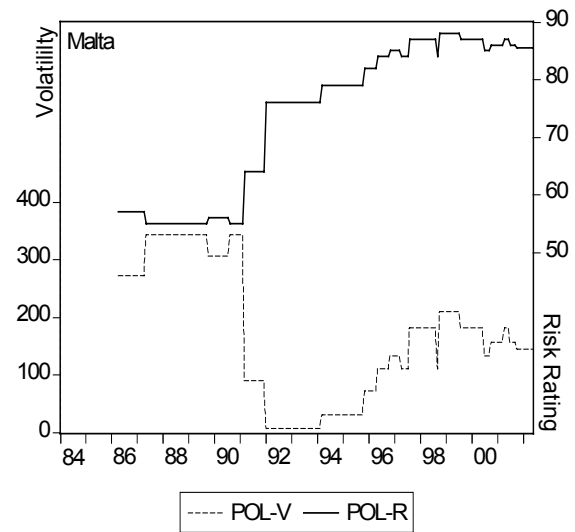
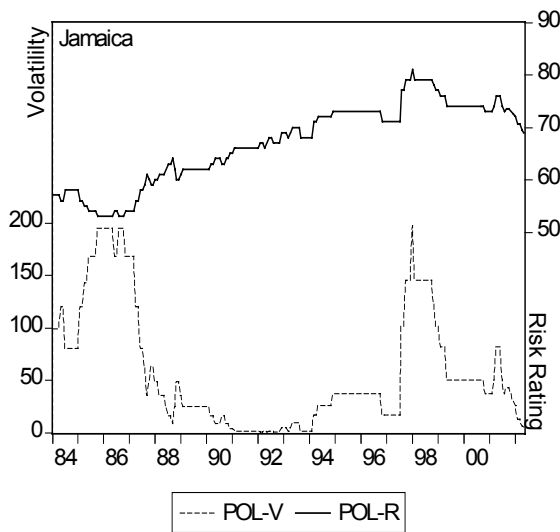
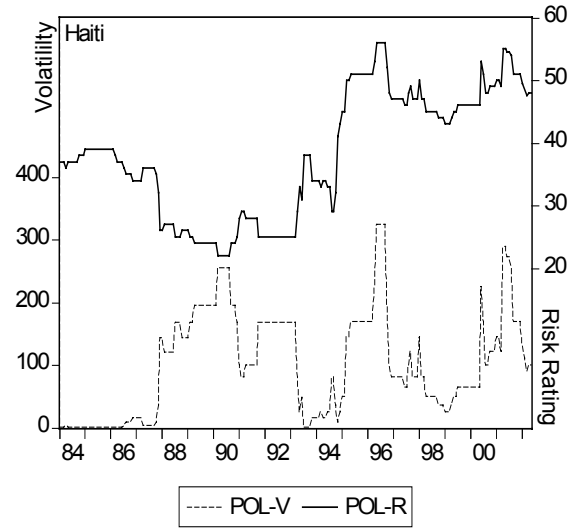
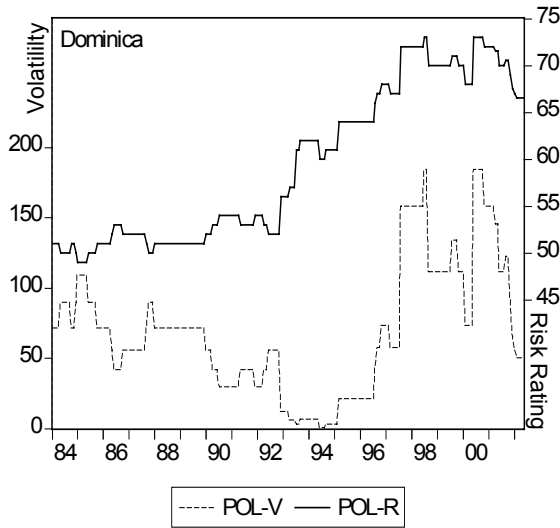
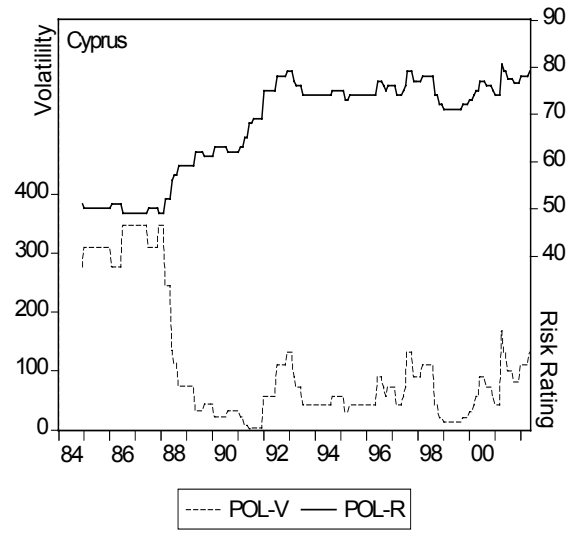
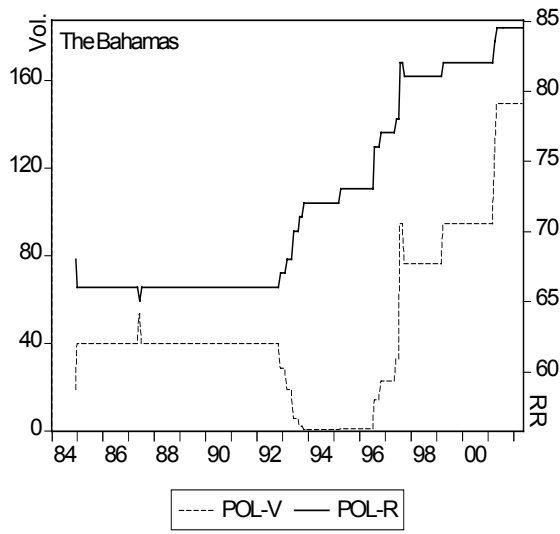


Figure 5: Financial Risk Ratings and Their Respective Volatilities for 6 SITES.

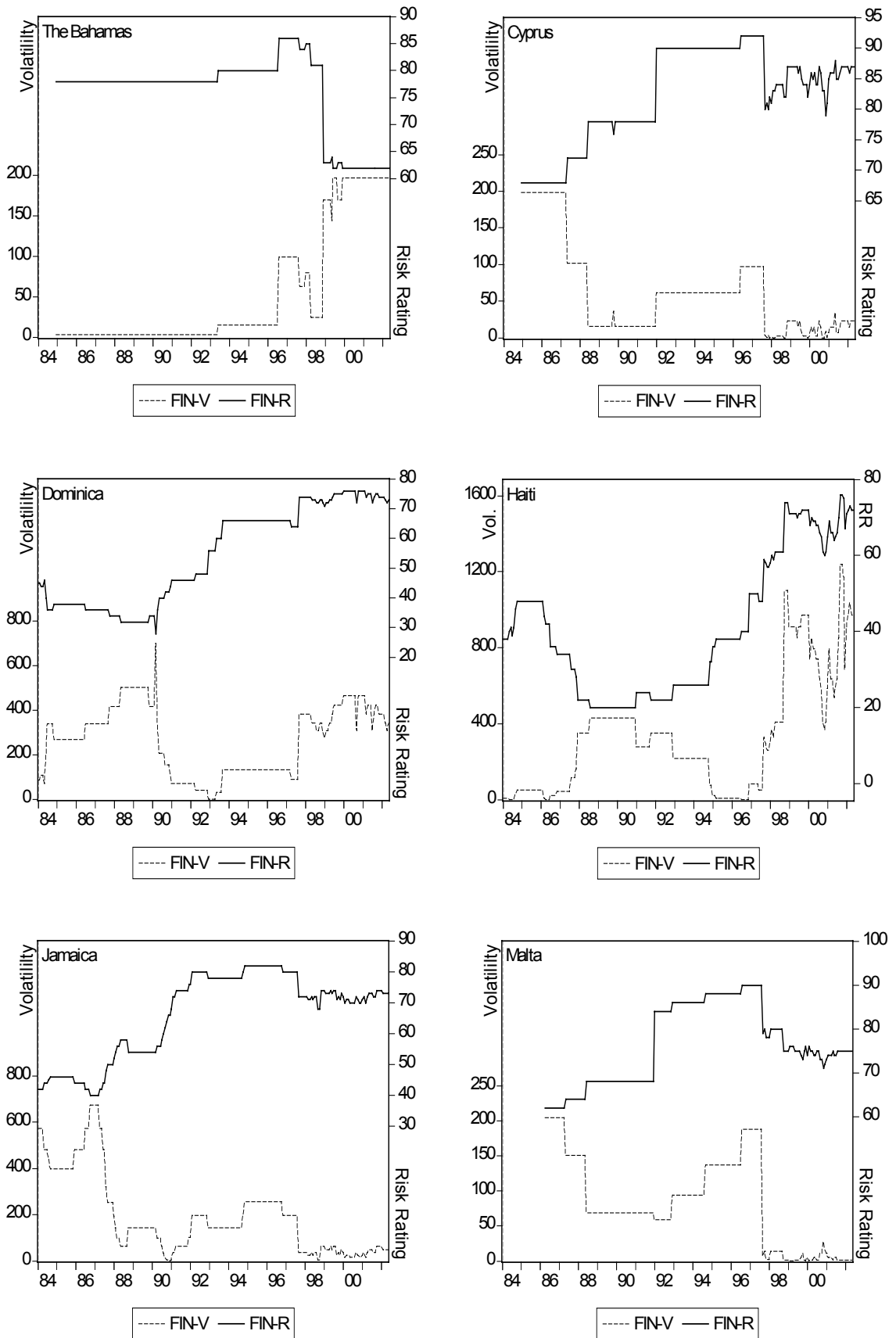
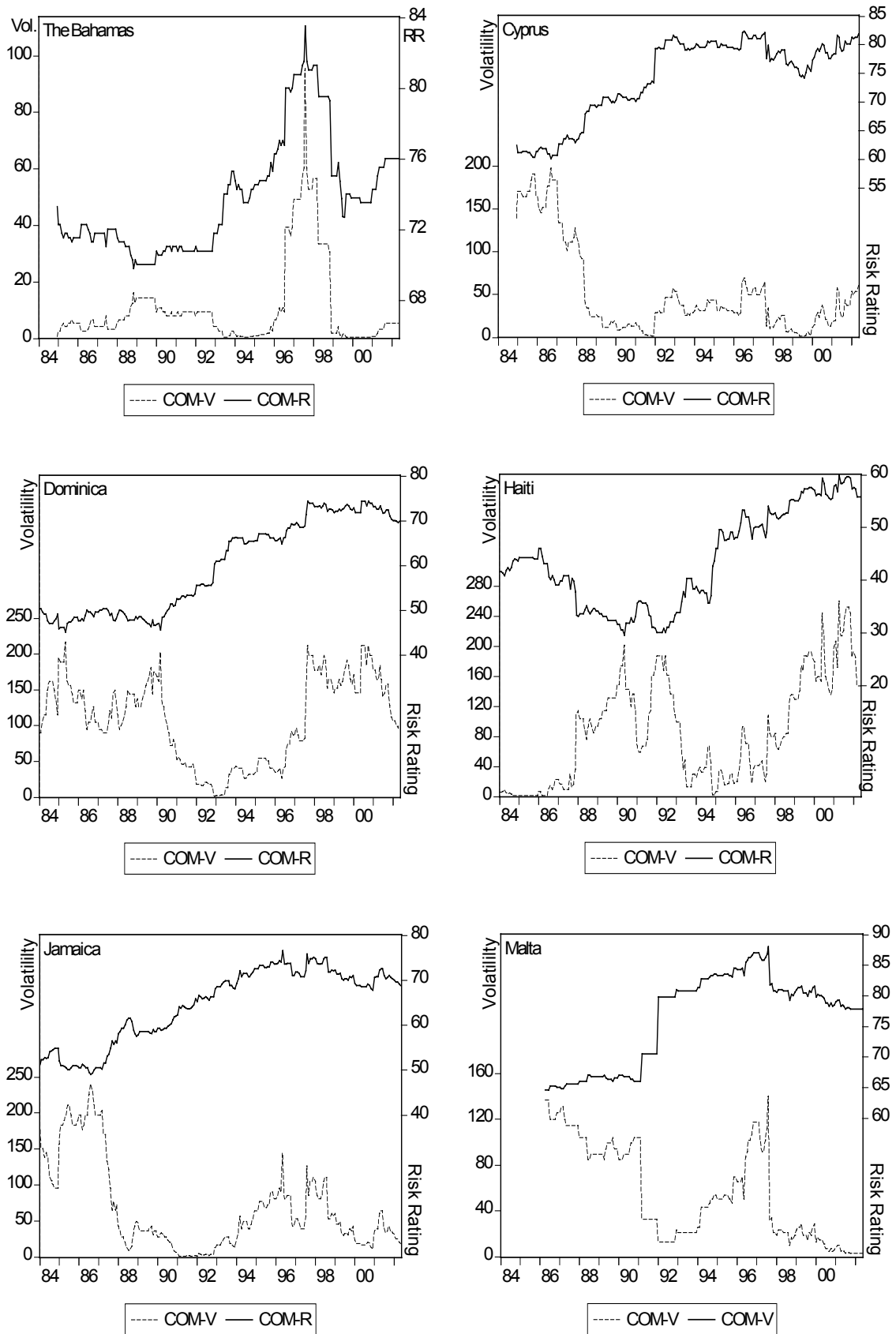


Figure 6: Composite Risk Ratings and Their Respective Volatilities for 6 SITES.



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- (lix) This paper was presented at the ENGIME Workshop on “Mapping Diversity”, Leuven, May 16-17, 2002
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- (lxi) This paper was presented at the Eighth Meeting of the Coalition Theory Network organised by the GREQAM, Aix-en-Provence, France, January 24-25, 2003
- (lxii) This paper was presented at the ENGIME Workshop on “Communication across Cultures in Multicultural Cities”, The Hague, November 7-8, 2002
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- (lxv) This paper was presented at the EuroConference on “Auctions and Market Design: Theory, Evidence and Applications” organised by Fondazione Eni Enrico Mattei and sponsored by the EU, Milan, September 25-27, 2003
- (lxvi) This paper has been presented at the 4th BioEcon Workshop on “Economic Analysis of Policies for Biodiversity Conservation” organised on behalf of the BIOECON Network by Fondazione Eni Enrico Mattei, Venice International University (VIU) and University College London (UCL), Venice, August 28-29, 2003
- (lxvii) This paper has been presented at the international conference on “Tourism and Sustainable Economic Development – Macro and Micro Economic Issues” jointly organised by CRENoS (Università di Cagliari e Sassari, Italy) and Fondazione Eni Enrico Mattei, and supported by the World Bank, Sardinia, September 19-20, 2003

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