1
INTRODUCTION

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1. Conceptualising and Measuring Economic Resilience

Small developing states tend to be inherently prone to exogenous shocks over which they can exercise very little control, if any. In the main such proneness emanates from these states' structural trade openness and their very high dependence on a narrow range of exports. There are a number of small developing states that, in spite of their economic vulnerability, manage to generate a relatively high GDP per capita when compared with other developing countries. This can be ascribed to economic resilience building, which Briguglio et al. (2006) associate with policy-induced measures that enable a country to recover from or adjust to the negative impacts of adverse exogenous shocks and to benefit from positive shocks. Briguglio et al. argue that economic resilience depends upon appropriate policy interventions in four principal areas, namely macroeconomic stability, microeconomic market efficiency, good governance and social development.

Macroeconomic stability is essential in order to avoid an adverse economic shock hitting the economy when it is in a weak position, so that through fiscal and monetary policies resources could be mobilised to enable the country to absorb shocks or to rebound from the effects of such shocks. Microeconomic market efficiency is required to enable the country to rapidly reallocate resources to alternative uses when necessary. Good governance is an essential underpinning to appropriate policy formulation and hence an indispensable element of economic resilience. Social development reflects the extent to which social relations in a society are properly developed, enabling an effective functioning of the economic apparatus without the hindrance of civil unrest. This is likely to be associated with social cohesion and social dialogue, which would in turn enable collaborative approaches towards the undertaking of corrective measures.

Methodological Divergences

There appear to be two main strands of literature explaining the economic success which is sometimes attained by small states. One approach favours the notion that it is an advantage to be a small state, while the other asserts that a small state faces inherent disadvantages which can be mitigated or overcome through appropriate policy interventions.

The first stream of literature is often based on simple correlations between country size and indicators of performance such as for example between population size and GNP per capita, or population size and economic growth rates. Some studies even imply that economic vulnerability may explain the good economic performance of small states. A basic methodological weakness of this approach is that it focuses on correlation without analysing causality, thereby not distinguishing between inherent and policy-induced contributors to economic development.

The second stream of literature adopts the conventional economic approach that in order to associate one variable with another, one needs to keep other factors constant. In this regard, Briguglio et al. (2006) proposed a methodological approach based on the notion that small states are inherently economically vulnerable because they are exposed to external shocks, and that resilience-building policies have enabled many small states to perform relatively well. In order words, small states succeed in spite of, and not because, they are small.

An analogical example of a blind boy coming first in an examination illustrates the difference between the two approaches. On the basis of the first approach one would conclude that it is an advantage to be blind and this can be seen by the result of the examination. The second approach would lead to the opposite conclusion that it is indeed a disadvantage to be blind, but appropriate adjustments and effort by the blind boy enabled him to overcome his inherent disadvantages.

Collaboration

The methodological approach proposed by Briguglio et al. (2006) was the outcome of a collaborative project between the Commonwealth Secretariat and the Islands and Small States Institute of the University of Malta. The project was aimed at developing the conceptual underpinnings of economic resilience and at deriving a sound basis for its measurement. This work has resulted in the development of an Economic Resilience Index for a wide cross-section of countries on the basis of internationally-comparable data, which has generated considerable interest in academic and policy oriented spheres.

It is planned that this project will be further developed through the undertaking of country-specific case studies which may serve as examples of best practice towards economic resilience building.

This volume is one of the products of this collaboration. It is the fourth book published in the series[1] where the core message is that economic resilience building is of major importance for small states, due to their inherent exposure to shocks, and that small vulnerable states should not be complacent in the face of their economic vulnerability but should and could adopt policy measures to enable them to improve their ability to cope with or bounce back from adverse shocks.

2. Macroeconomic Stability

In their study on economic resilience, Briguglio et al. (2006) assign major importance to macroeconomic stability as a contributor to resilience building. Macroeconomic stability relates to the balance between an economy's aggregate demand and aggregate supply. If aggregate expenditure in an economy moves in equilibrium with aggregate supply, the economy would be characterised by internal balance, as manifested in a sustainable fiscal position, low price inflation and an unemployment rate close to the natural rate, as well as by external balance, as reflected in the international current account position or by the level of external debt. These can be all considered to be variables which are highly influenced by macroeconomic policy.

The Role of Public Policy

Macroeconomic policy is central to Schembri's argument (Chapter 2)[2] that a major economic goal of a nation state is to achieve stable and sustained growth through appropriate policy with the aim of improving the quality of life and reducing poverty. In the case of small states, stability is continually threatened due to their high dependence on international trade and on a narrow range of exports. Schembri argues that achieving macroeconomic stability through the adoption of appropriate fiscal, monetary, exchange rate and financial policies is a critical element in a broader set of public-policy objectives aimed at resilience building.

Schembri decomposes macroeconomic stability into its internal and external aspects. Internally, macroeconomic policy should be aimed at low, stable and therefore predictable price inflation, aggregate output at the full employment level and steady economic growth. Externally, policy should aim at exchange rate stability. The author argues that generally speaking, countries that attain internal and external balance should be better able to achieve and maintain steadily-improving living

[1] The other three books are *Competitive Strategies for Small States* (2004), *Vulnerability and Resilience of Small States* (2004) and *Building the Economic Resilience of Small States* (2006).
[2] All reference to chapters relate to this volume, unless otherwise stated.

standards. The attainment of such balances requires a coherent macroeconomic policy framework aimed at absorbing external shocks and at bringing about a rapid recovery in their aftermath.

Schembri refers to the indicators chosen by Briguglio et al. (2006) to measure macroeconomic stability, namely (i) the fiscal deficit to GDP ratio (ii) the sum of the unemployment and inflation rates; and (iii) the external debt to GDP ratio. Schembri contends that strictly speaking, only variable (ii) is directly related to macroeconomic stability. Variables (i) and (iii), though potentially related to the macroeconomic stability in cases when the fiscal and current account deficits may not be sustainable, can be more usefully thought of as measures of the effective stewardship of public and externally provided resources, including the extent of manoeuvrability available to economic policy in meeting the effects of exogenous shocks.

Schembri therefore contends that macroeconomic policies aimed at resilience building should include, other than those that foster economic stability per se, those that promote effective stewardship of public and externally provided resources. Well-managed fiscal, monetary and exchange policies can create a stable macroeconomic environment in which expectations are well anchored on the future paths of output, prices, taxes, fiscal deficits and other variables that are crucial for economic decisions, in particular, investment plans.

Government Expenditure and Small States

One of the major problems faced by small states relates to expenditure indivisibilities associated with their limited ability to reap the benefits of economies of scale. For this reason, government expenditure, which is to a large extent an overhead cost for society, is likely to be higher in per-capita terms or as a percentage of GDP in small states compared to larger ones.

This relationship is investigated by Medina Cas and Ota (Chapter 3) who, using a new IMF dataset, confirm that on average, small states have relatively larger government expenditures and higher public debt. An interesting finding advanced by the authors associated with this observation is that small states with smaller governments and lower public debt tend to grow faster and are more economically resilient to external shocks. The authors argue that expenditure restraint can underpin growth, especially when embedded in an economic reform programme.

This conclusion is in line with the argument put forward by Briguglio et al. (2006) and Schembri (Chapter 2), that a healthy fiscal position, including low debt, will give policymakers the flexibility to react effectively to shocks. Fiscal restraint can thus be growth-supportive in small states, especially if implemented through reductions in current expenditure rather than revenue increases.

Medina Cas and Ota further argue that fixed exchange rate regimes, which are prevalent in small states, limit the effectiveness of monetary policy. This leaves fiscal policy as one of the few, and possibly the most effective, policy option that small states have at their disposal in order to respond countercyclically to economic downturns and shocks.

Fiscal Policy in the Pacific Region

Jayaraman (Chapter 4), also discusses macroeconomic policies that are conducive to resilience building, but focuses on the small island states in the Pacific region. The author presents a review of fiscal performance in these small states during recent years. He argues that fiscal vulnerability indicators show that present debt levels, both domestic and external, are currently not large enough to cause any immediate concerns. However, growing annual fiscal deficits experienced by some of these countries, due to expansionary fiscal policies, are placing them in high-risk situations.

Jayaraman also points out that most Pacific small states are very dependent on trade taxes and with trade liberalisation, such regimes will not be sustainable.

Jayaraman argues that exposure to external shocks need not condemn a country to failure. He shows that there are notable examples of successful small states which have overcome these handicaps by nurturing economic resilience through sound macroeconomic management. The author attributes such success principally to sound fiscal policy.

Jayaraman identifies a number of areas which need early attention in the Pacific small island states. These include:
1. the introduction of effective expenditure control and budget-monitoring systems;
2. efficient and effective mechanisms for generating revenue;
3. improved measures for responding to volatile non-tax and aid revenues;
3. redirection of aid money into capacity building projects by trimming the civil service and reducing recurrent expenditures;
4. careful debt management; and
5. improving foreign earnings by maintaining a competitive real exchange rate so that external debt servicing does not pose problems in the long run.

Trade Policy

The issue of trade liberalisation as a resilience-building option is treated by Preville (Chapter 5), who discusses trade policies in the Caribbean small states, members of CARICOM. In so doing, he argues that there is a need to review the stances taken by CARICOM in external trade negotiations. He proposes a more aggressive approach based on improving access to export markets, rather than a defensive one aimed at the retention of barriers to imports.

Preville's contention is that in the region there remains excessive fear that liberalisation will result in undermining the economic development of member countries, especially the smaller ones, and in weakening their fiscal systems. However, Preville argues that while there may be a basis for such fear, insufficient attention is being given to the opportunities that may be realised from liberalisation.

Preville discusses the connection between trade policy and economic resilience and argues that unless the specialisation agenda is taken seriously, the prospects for building economic resilience in the Caribbean small states will remain weak. In his view, resilience for small economies like those of CARICOM can only be built if trade policy is conducive to market flexibility and sound macroeconomic policies, permitting enterprises to specialise in those areas where they compete effectively.

Preville contends that members of CARICOM with significant orientation towards liberalisation have grown faster and more consistently than those that have take more defensive stances. It seems therefore that the region would better serve itself by pursuing a more liberal trade policy.

Macroeconomics and Resilience Building

Part 1 of this publication, dealing with macroeconomic aspects of resilience, therefore conveys the message that resilience building can be promoted through policies that foster stability, stewardship and competitiveness. This approach echoes the strategy proposed by the Commonwealth/World Bank Report entitled "Toward an Outward-Oriented Development Strategy for Small States: Issues, Opportunities, and Resilience Building" (Briguglio, Stern and Persaud, 2006). The Report emphasises the need for a policy package that fosters a regulatory environment that enhances stability and competitiveness, and at the same time, predictability. The Report argues that "The success of the small states in implementing such an outward-oriented approach will be critically dependent on ... resilience mechanisms specifically designed to offset their unique vulnerabilities."

3. Microeconomic Efficiency

Part 2 of this publication deals with market efficiency. Briguglio et al. (2006) hypothesised that the efficient operation of markets is essential to the allocation of resources in the economy and this applies also following an external shock. If, on the other hand, the market mechanism is not allowed to work through, for example, inappropriate government intervention, resources are not likely to be efficiently allocated, resulting in welfare costs, manifested, for instance, in unemployed resources and waste or shortages in the goods markets. The authors also contended that activities that inhibit effective competition and increase the costs of production discourage the efficient allocation of resources and curtail the economy's ability to absorb shocks. Where markets can work properly, be they in goods and services, in finance, or in labour services, the role of policy would be to ensure that such markets are not hampered by excessive bureaucracy or by restrictive practices and by other activities that impede competition.

However, as is well known in economic theory and in economic reality, the operation of markets sometimes produces sub-optimal results. The most obvious instances include the presence of externalities, where prices fail to adequately reflect social costs and benefits, and the presence of natural monopolies, where competition is not possible.

Market Failure

Cordina (Chapter 6), emphasises the need to enhance market efficiency in small states where instances of market failure, through thin and missing markets, natural monopolies and externalities are common. According to the author, these states, therefore, tend to have greater need for policy measures aimed at enhancing the operation of the market mechanism or at replacing them with appropriate instruments conducive towards building economic resilience. Policy intervention is especially called for to ease market access and to promote private sector development. In the case of natural monopolies, regulatory arrangements need to be put in place so as to limit abuse from dominant positions. An additional problem identified by Cordina is that policy intervention in small states may be fraught with failure, including mistakes in formulation of policies, problems in policy implementation and high costs of policy intervention. This is due to the social proximity of economic agents, insufficient human and administrative capacity and indivisibilities in the cost of the public sector.

In spite of these difficulties, Cordina recognises that many small states have achieved varying degrees of success in improving market efficiency through appropriate policy intervention and governance. Cordina argues that such policy should assign importance to small-economy realities including thin markets and indivisibilities of overhead expenditure, limited ability to achieve economies of scale especially in manufacturing and, in the case of islands, high transport costs.

This suggests that small states that need to build their economic resilience should not always take "off-the-shelf" remedies from larger countries but should emulate successful models pertaining to other small countries with similar characteristics and problems.

Private Sector Development

As already pointed out, small states are often characterised by high unit costs, partly due to problems related to indivisibilities of overhead costs and relatively high transport costs, thereby eroding their external competitiveness. The globalisation process has brought on a new set of economic challenges including a faster than anticipated preference erosion for exports, as well as greater exposure to economic shocks (Briguglio, Persaud and Stern, 2006).

Vella (Chapter 7) argues that private sector development is essential to enable small economies to respond effectively to such shocks. She contends that the private sector is better able to foster market efficiency and flexibility than the public sector as the former tends to be more exposed to market competition where survival requires a quick and cost-effective response to market dynamics. Private sector development is also essential in order to generate entrepreneurial skills and transform savings into productive investment. Furthermore, in small states, the private sector operates mostly through small or micro enterprises which require particular attention.

Vella makes extensive reference to the World Bank's "Index on the Ease of Doing Business". She contends that although this Index shows that, in general, small states do not fare badly in this regard, there are many inherent features which render small states disadvantaged, including the very small size of the average business concern and the relatively high cost they face due to the previously mentioned problem of indivisibility of overhead expenditures.

A major implication of these arguments is that governments should create conducive conditions which promote private sector development, including ease of entry into the market and the fostering of entrepreneurial attitudes. Vella also emphasises the need for credibility in government policies so as to ensure that the private sector takes them seriously and responds by increasing investment and production. Clear and consistent rules and regulations are critical in this regard.

Labour Mobility

Chand (Chapter 8) reiterates that the economic vulnerability of small states is due mainly to their inherent features, including their small size, isolation from major markets and the inability to use demand management for stabilisation. Resilience-building policies, the author argues, should be aimed at minimising the negative exposure to such inherent risks.

Chand considers the potential for access to foreign labour markets by workers from microstates as an instrument for resilience building. He argues, in addition, that access to foreign labour markets could be welfare enhancing for microstates, and he produces empirical evidence to back this assertion.

Labour mobility reduces vulnerability to consumption shocks in the face of volatile local production and employment. Labour mobility and remittance flows can feed off each other, creating a positive feedback loop. While an adverse local macroeconomic shock may, for example, induce greater inflows of remittances from workers already abroad, the shock in itself may equally induce further outward migration and reinforce the consumption-smoothing role of remittances.

Chand's study makes two important contributions to the literature on small states, with important policy implications. It formulated a model that considers the welfare impact of consumption volatility; and, in addition, it produced empirical evidence, through the estimation of the model, that labour mobility is resilience enhancing. One lesson for policymakers from microstates that can be derived from this paper is that, while they cannot rely only on labour mobility for stabilisation of income, having such access can be an instrument for consumption smoothing.

Chand makes the point that the potential gains to residents of microstates from labour mobility for resilience building are likely to be larger than that for their larger counterparts because microstates, given their small physical size and isolation from major markets, are vulnerable to macroeconomic shocks including sharp movements in the terms of trade, large swings in capital flows, and to natural disasters. Compounding the above is the fact that their capacity to use active stabilisation policy is limited by fiscal and monetary constraints imposed through size and location. These problems are magnified in low-income microstates with a limited capacity to draw on the global capital market for consumption smoothing. As an example, the author refers to the experience of the Cook Islands, where large reductions in public sector employment were possible through access to employment opportunities for laid-off workers in New Zealand and Australia.

The author also discusses the issue of remittances. He argues that there is considerable evidence from cross-country studies to suggest that remittance flows are far more stable than foreign direct investments and official development assistance.

Fair Competition

It is now widely recognised that the proper functioning of the price mechanism requires competition unhampered by restrictive practices, collusion and abuses from dominant positions. In small states, a fairly small firm by international standards can easily gain a dominant position in the relevant market. In addition, social proximity and ease of contact with politicians may facilitate collusion. These realities are compounded by the fact that a small market may not permit more than one player due to minimum critical size required for efficient operation, infrastructural constraints, transport costs (especially for small islands) and other factors which constitute natural barriers to entry.

Lee (Chapter 9) explores the theme of market dominance in small states and highlights some of the peculiarities of such states, focusing on Jamaica. Competition law in Jamaica, like in most other states, large or small, attempts to allow competitive forces to determine quantity and price outcomes, and in doing so, prohibits abuse of dominance in the market.

The underlying assumption in this regard is that prohibiting abuse of dominance will ensure the efficient allocation of resources. Lee's study posits that rigorous enforcement of competition law will protect the competitive process, thereby enabling the market to work more efficiently and neutralising shocks to the economy. The author contends that, by curbing abuse of dominant positions, competition law offers a means through which markets can adjust to volatility, thereby enhancing economic resilience.

Lee discusses the argument that small states need to be more tolerant than larger states of higher levels of concentration in the market, so that industries compete in the regional and global markets. She states that this argument is more suited for a discussion on trade remedies rather than for competition policy. She explains that such "tolerance" often leads to artificial barriers to entry, state aid, concessions, preferential awards of contracts or tax breaks, which can amount to the picking of winners/promotion of national champions, and therefore distort competition. Her view is that even in the context of trade remedies, sheltering from competition may not be the best option. To strengthen her argument, Lee refers to the Caribbean Cement Company, a large entity operating in Jamaica, where protection from competition resulted in barriers to entry, leading to losses in economic welfare.

The author emphasises the point that, rather than relying on mechanisms which seek to protect the few at the expense of the rest of society, small states should employ competition law and policy to promote rivalry among firms. She strongly argues that enforcement of competition law must be strict, consistent, and transparent, and refers to the telecommunications sector in Jamaica to demonstrate that unimpeded competition and keen enforcement of competition law will contribute to entrepreneurship and economic growth and could discipline dominant firms, thereby enhancing consumer welfare.

Suitable Microeconomic Policies for Small States

Part 2 of this volume, dealing with market efficiency, therefore stresses four main points, namely (i) the need for letting the market mechanism work when possible (ii) the need to promote private sector development (iii) the need to put in place competition regulatory frameworks particularly to remove barriers to entry and prevent abuse of dominant positions and (iv) the need to promote labour mobility to permit faster adjustment in the labour market.

These prescriptions are not equally important for all small states, but the major policy implication, namely that the market mechanism is essential for resilience building is of major significance for such states. Policy intervention in this regard should recognise the special constraints faced by small states in this regard, particularly market failures, ease of dominating the market and indivisibilities of overhead costs. These constraints should not be interpreted as forming a case against the market mechanism but, as Cordina (Chapter 6) argues, they point to the need that small states should give due consideration to their small economic size and its implications, and should not just take ready-made prescriptions from larger countries.

4. Good Governance

The issue of "good governance", as Sutton (Chapter 10) points out, is a contested term with a high normative content. What is good governance in one country may not be considered to be so in another, and some so-called "western" models may not appeal universally. In addition, some definitions of governance emphasise its human aspects, including security and crime control, while others focus on its economic aspects, such as facilitating market efficiency, and taking remedial action where markets fail. In some cases, governance is associated with the economic idea of the "big push", to ensure that investment is large enough to break the vicious circle of low income, low savings and low investment. The latter argument is often based on the assumption that in developing countries there are structural realities which limit the benefits of the market mechanism.

Nevertheless, Sutton argues, there is a broad measure of agreement as to what might be termed "essential" elements of good governance such as open, transparent and accountable government, efficient, effective and responsive administration, as well as respect for human rights and the rule of law.

Sutton contends that the governance debate should not focus exclusively on economic factors, as if good governance is only a means to promote economic development, but should also be considered as a desirable objective in its own right.

The author also discusses the question as to whether or not there are special governance considerations applicable to small states. He argues that issues dealt with in most studies on small states are not unique to such states, but are drawn largely from the literature on capacity building in developing countries. In many instances, Sutton argues, this is all that may be needed since most small states are developing states and development policy can be adapted to suit their specific needs. However, basing on his experience of 40 years of work and study in small states, the author states that there are unique characteristics in small states which are likely to require customised measures. One of these characteristics, Sutton argues, is the dense network of interrelations at the social and economic levels within small countries. This factor should be at the heart of efforts to improve governance and to promote economic resilience in small states.

Sutton's arguments, therefore, reiterate Cordina's opinion (Chapter 6) that measures and policies applicable to small states should not simply be "off-the-shelf" prescriptions. This argument should of course not be construed as implying that basic requirements of good governance, such as transparency, accountability and efficiency should not be applicable to small states, but that there should be additional ones, taking into account the special constraints and opportunities associated with small size. In addition, different regional traditions and practices should also be considered in the governance debate.

Governance Performance of Small States

Samy et al. (Chapter 11) refer to the many definitions and aspects of governance. They state that the World Bank focuses on economic aspects, whereas others, such as the Canadian International Development Agency (CIDA), draw more heavily upon the human security agenda for their definition. The Country Indicators for Foreign Policy (CIFP) governance index, proposed by the authors, incorporates both aspects.

Basing on empirical analysis, the authors find that the level of development, trade openness and the British legal system are important determinants of governance in small developing states, with the level of development being the most important factor.

An interesting finding presented in this chapter is that the governance index proposed by Samy et al. is strongly correlated with the Resilience Index proposed by Briguglio et al. (2006). This is not surprising as governance is one of the components of the Resilience Index.

An important statement made by Samy et al. is that in comparison to larger countries, challenges facing SIDS tend to be localised to specific policy areas. Weak SIDS are prone to low-level political instability and crime-related violence, but in most cases, such instability rarely leads to large-scale conflict. One implication of this statement is that small developing states could benefit from policy initiatives targeted at specific and well-defined problems. Thus, while the determinants of governance may be similar to those of larger countries, the specific threats to governance could be different. Again this echoes Cordina's (Chapter 6) and Sutton's (Chapter 10) conclusions that pre-fabricated prescriptions developed for large countries may not always be fully appropriate for small ones.

Governance in the Pacific Region

That a particular region may have governance realities different from those in other regions is demonstrated by Reddy (Chapter 12), who discusses the special issues facing Pacific small countries. Reddy's main contention is that the structure and performance of an economy are determined to a large extent by the overall governance practices. In this regard, the author examines the region's governance practices relating to the chiefly system and communal culture, the impartiality of the courts of justice and security, amongst other issues.

Regarding the chiefly system and communal culture, Reddy explains that most political systems in the Pacific Island Countries (PICs) have developed in such a way as to suit the political as well as the traditional authorities.

He describes the traditional governance system in most Pacific small states as outdated, with a top-down decision making system, flowing from the most authoritative person in a community, such the chief. The author contends that the communal system, with its strong clan loyalties, presents major difficulties for the establishment of a market economy because markets depend heavily upon competitive transactions.

Reddy argues further that the education system in the region is not always conducive to change and refers to certain social scientists in the region who view open markets and movement away from the communal system as undesirable.

Regarding the impartiality of the courts of justice, Reddy argues that provision of fair, competent, thorough and impartial judicial decision-making is paramount for good governance. He explains that during periods of political instability and crisis in the region, the courts are always targeted for control. He refers, by way of example, to a recent political crisis in Fiji where immediately after the overthrow of the government, the Chief Justice and the Chief Magistrate were suspended.

Regarding security, the author shows that over the past two decades there was a rise in security problems in a number of small states in the region and these constituted major threats to good governance and orderly economic growth. Instability and law and order problems in the region have basically been from within, in some cases, via the disciplined forces, often compounded by various issues associated with social transformation that are faced by Pacific communities.

Reddy's study therefore deals with an important and controversial issue of governance, namely that in a society, cultural traditions, which may be cherished by members of that society, may not always be conducive to good governance, as they may inhibit transparency and respect for the rule of law.

In addition, some traditional methods of governance, which may have served well in pre-industrial periods or in the early stages of development, may not be suited for modern economies, where the market mechanism is being increasingly relied upon for the allocation of resources, and where the government's role is being increasingly confined to a regulatory role.

5. Social and Environmental Concerns

Briguglio et al. (2006) associate resilience building with social and environmental concerns. They argue that social development can lead to effective social dialogue which would in turn enable collaborative approaches towards the undertaking of corrective measures in the face of adverse shocks. With regard to environmental factors, Briguglio et al. (2006) state that: "It could be useful to consider the effects of environmental management on economic resilience. The environment can be an important source of vulnerability by giving rise to shocks of an adverse nature, be they rapid events, such as earthquakes, or in the form of a gradual degradation over time. In turn, these would have important repercussions on the economy and society."

This volume dedicates four chapters to social and environmental concerns. The main themes covered are social cohesion, income distribution, migration and sustainable development.

Social Cohesion

Prasad (Chapter 14) focuses on the issue of social cohesion, contending that while small states are more economically vulnerable than larger countries, they tend to be more socially cohesive.

In many small states, he argues, one often finds closely-knit and integrated communities with highly personalised relationships characterised by a high degree of communal involvement and consensus in decision making. He also refers to the social homogeneity in many of these states. Prasad comes to the conclusion that this relatively high degree of social cohesion enables small states to attain relatively high levels of social capital.

The author hypothesises that social cohesion is a major contributing factor to resilience building, as it could in part compensate for the high exposure to external shocks. He showed empirically that this hypothesis is generally valid arguing that social cohesion may be the channel through which small states tend to have better governance institutions which leads to better outcomes in social and economic development.

The author however advises caution in interpreting these results. He points out that not all small states are economically and socially successful or are well governed. In addition, there are small states located in all regions that are experiencing political and/or ethnic conflicts and tensions. In these countries, the level of social cohesion may be adversely affected, leading to lower levels of social capital.

An important policy implication that emerges from Prasad's study is that social policy that seeks to enhance social cohesion is also likely to enhance the chances of economic success. Another implication is that attempts to strengthen the economic resilience of small states in order to enable them to better withstand or bounce back from external shocks should also assign due regard to social considerations.

Income Distribution

Another social aspect associated with resilience building investigated in this volume is income distribution. Fabri and Pizzuto (Chapter 15) argue that the pattern of income distribution can be expected to impinge upon the extent of social development and cohesion, as wide divergences in income tend to dent the ability of different groups to work together in response to adverse shocks.

The authors note that the methodology of measuring social development within the economic resilience framework proposed by Briguglio et al. (2006) makes no explicit use of an income distribution variable, and they investigated whether this variable should be included in the Economic Resilience Index. Their empirical results show that income distribution, as measured by the Gini Coefficient, is indeed associated with social development, and consequently with economic resilience building within a country.

However, while the Gini coefficient possesses a number of desirable characteristics as an indicator of economic resilience, the authors found that its inclusion did not change the ranking of country scores within the Economic Resilience Index. In addition, Fabri and Pizzuto refer to a practical problem in this regard, in that if the Gini coefficient index were to be included in the Index, some small countries would have to be excluded as this coefficient is not available for the whole country set covered by the Index.

Migration

Connell (Chapter 13) focuses on the issue of migration, arguing that this has its downside, principally associated with brain and skill drains, but also generates remittances, which are beneficial economically and socially.

The author first treats urban migration, stating that this has led to national populations becoming increasingly concentrated in the more central urbanised islands. This process has given rise to growing inequalities coupled with rising expectations. Connell explains that within the larger

Melanesian states, remittances from urban to rural areas play an important role, especially where migration is from small islands, and are probably the single largest source of income in several villages.

Referring to international migration with reference to the Pacific SIDS, Connell argues that such migration has been partly a response to the collapse of commodity markets and the inability of governments to effectively diversify domestic economies. Migration therefore could effectively be instrumental in spreading economic risk beyond the small nations themselves.

In addition, the remittances from migrants provide new development opportunities for small island states, at village and national levels. There is evidence from cross-country studies to suggest that remittance flows are more stable than foreign direct investment and official development assistance, and that such flows can have the effect of a hedge against economic shocks.

An important policy implication in this regard, according to Connell, is the need to develop effective policies for channelling remittances into development opportunities, permitting small nations to engage more fruitfully with the globalising world.

Sustainable Development

Small states, especially island ones, face major environmental problems, a reality acknowledged in the Mauritius Strategy for the further implementation of the Programme of Action for the sustainable development of small island developing states (United Nations, 2005). This document proposes a series of measures that can be adopted by governments and the international donor community for the promotion of sustainable development. Economic resilience building features prominently in these measures. In particular, Article 81 proposed that consideration should be given to the establishment of a task force to elaborate a resilience index, supported by the international community.

Economic resilience building is essentially intended for material advancement, by reducing damages arising from external shocks, and this would, in turn, enable social improvements and better environmental protection. Briguglio (Chapter 16) contends that for these reasons, social and environmental concerns cannot be considered in isolation from economic realities when discussing sustainable development.

Briguglio argues that economic resilience building is a necessary but not sufficient condition for sustainable development, in that sustainable development has a much wider meaning than economic resilience building. In particular, sustainable development is based on ethical considerations and takes a long-term view of development, whereas economic resilience building is basically oriented towards a particular requisite of sustainability, namely economic stability. The two are therefore not in conflict with each other as both economic resilience and sustainable development aim to improve human welfare. Moreover, they both require efficiency in the use of resources.

The chapter argues very strongly that sustainable development cannot be compatible with economic stagnation and retardation – the word "development" itself suggests improvement, including that from the material point of view.

Briguglio also looked into the question as to whether the Maltese economy is sustainable, by first discussing the overall characteristics of the economy, followed by a review of the different sectors of the economy. A number of economic practices and issues which impinge upon sustainable development were also discussed. What emerges from the discussion is that the Maltese economy faces inherent constraints, associated mostly with small economic size, insularity and high population densities, and that certain unsustainable economic practices exacerbate the situation.

The chapter identifies construction, agriculture and manufacturing as the economic sectors with the highest negative impacts on the environment and which therefore pose serious sustainability problems.

An important conclusion that emerges from Briguglio's study is that economic resilience building should be considered as a major requisite for sustainable development, given that it aims to stabilise the economy.

6. The Role of International Organisations

Many international organisations deal with small states issues. Although the combined populations of small states is less than 1 percent of the global population, these states often have their voice heard at the global level through these organisations. Small states constitute about 20 percent of all sovereign states, and they often act as a group to promote their development agenda, as is the case of the Alliance of Small Island State within the United Nations. The lobbying of AOSIS has led to the organisation of two major international conferences on the sustainable development of SIDS, one in Barbados in 1994 and the second in Mauritius in 2005, both held under the auspices of the United Nations.

Part 5 of this volume deals with two international organisations, namely the Commonwealth Secretariat and the World Trade Organisation (WTO), both of which deal with small states issues.

The Commonwealth Secretariat

Small states play a major role in the Commonwealth Secretariat. Thirty-two of the Commonwealth's fifty three member countries are small states — mostly with populations of less than 1.5 million. The Secretariat attaches high priority to supporting their integration in the global economy, helping them to build their resilience and competitiveness, and to take advantage of the opportunities and challenges arising from globalisation.

Vigilance (Chapter 17) explains how the Commonwealth Secretariat provides advocacy, policy advice and technical assistance to its small state members. As a result, the Secretariat has developed a comparative advantage in these matters and has become a trusted partner of small states in their development endeavours. The Secretariat has worked with a number of development partners, including universities, to ensure that the issues affecting small states receive the international attention they deserve. One result of this collaboration is the publication of this book, which is part of a project spanning over a number of years and culminating in the development of an Economic Resilience Index as well as the publication of studies on issues dealing with vulnerability and resilience.

The World Trade Organisation

Small states have been very active trying to persuade the international community that they have special characteristics which warrant special treatment. Within the WTO the term "small, vulnerable economies" (SVEs) has been used with regard to small states, although the organisation does not recognise small states as a separate category of WTO Members.[3] In spite of this, Werner (Chapter 18) argues that the Doha Round of multilateral trade negotiations offers a great opportunity for these member states to ensure that future trade rules are more in line with their development needs. Werner also points out that the WTO has a mandate from its Ministerial meeting in Hong Kong (2005) to "monitor progress of the small economies' proposals in the negotiating and other bodies" and to provide "responses to their trade-related concerns".

[3] At the 2001 WTO Doha meeting Ministers agreed "to frame responses to the trade-related issues, identified for the fuller integration of small, vulnerable economies into the multilateral trading system, and not to create a sub-category of WTO members" (Ministerial Declaration, Para. 35).

A major issue for SVEs within the WTO and the current Doha Round negotiations relates to which countries can be eligible for special treatment and flexibilities with regard to WTO rules. One proposal is to consider a member state's share of international trade as a condition for eligibility,[4] together with other vulnerability criteria. However on this issue there is still divergence of opinion within the WTO, as countries that are not usually considered to be "small" also want to obtain any additional flexibilities granted to SVEs.

7. Composite Indices

This volume dedicates a section to composite indices. The reason for this is that many of the concepts presented in this chapter are accompanied by relevant indices, generally constructed by averaging a number of sub-indices.[5]

Composite indices are multi-dimensional in that they attempt to combine a number of factors associated with the concept being considered. These indices are often used because they have a strong intuitive appeal due to the fact that they simplify complex realities into a single number. As Farrugia (Chapter 19) however points out, composite indices are often criticised on account of their subjectivity, in particular with regard to the choice of variables and the weighting procedure used.

Desirable Criteria

Farrugia describes some quality frameworks for developing statistics and composite indices and, on the basis of such frameworks, she proposes some desirable criteria for the construction of composite indices, including sound methodological underpinnings, simplicity, ease of comprehension, coverage of relevant issues and transparency. She argues that transparency is particularly important as this implies that the methodology and the variables upon which a composite index is constructed are made available for other researchers. This criterion is related to the other desirable criterion of replicability, implying that it should be possible for other researches to rework the index to verify the results and evaluate its methodology and implications.

[4] Proposal were made that to qualify as an SVE, a country's share should be no more than 0.16 percent of world merchandise trade, no more than 0.10 percent of Non-agricultural (NAMA) trade, and no more than 0.40 percent of world agricultural trade.
[5] The indices referred to in the volume include the Economic Resilience Index, the Economic Vulnerability Index, the Human Development Index, the Governance Index, the Country Indicators for Foreign Policy, the Environment Sustainability Index, and the Economic Freedom of the World Index.

Farrugia also discusses problems often encountered when constructing composite indices including: selection of the components; dealing with missing data; weighting and aggregation of the components; and testing and reviewing the results obtained.

The major implication of this chapter is that it is very important that an index be built on sound methodological approaches and the other desirable criteria as this will enhance credibility in the index and render it a valuable instrument.

The Human Development Index

McGillivray et al. (Chapter 20), like Farrugia, consider a number of methodological issues relating to the construction of composite indices, focusing on the UNDP Human Development Index (HDI), which is one of the most widely used and best known composite indices. After providing an overview of the Index and its scores for various countries, the chapter provides a critical evaluation of the HDI. Like other composite indices, the first and perhaps foremost problem encountered relates to the choice of components and the weighting of same.

The authors discuss the redundancy problem with regard to the HDI. This is perhaps the most important weakness of the Index, as its components are very highly correlated, and many studies argued that it may not yield much more information than the GNP per capita alone. In practice, when one includes two highly correlated components, one would be implicitly adding weight to the phenomena captured by both components.

Another implication is that when the components are highly correlated, assigning different weights to these components will not make much difference in the Index. McGillivray et al. in fact provide computations of the 2002 HDI with highly different weights and show that the correlation coefficient between the original HDI and the ones with pronounced different weights is very high.

The authors also consider whether the HDI is valid for small island states. They refer to studies that conclude that small states have particular characteristics which impact on their well-being, such as economic vulnerability. They argue that there are many factors that the HDI fails to consider with regard to small states, but, in their view, customising the Index for particular groups of countries might lead to the possibility of not attaining a major objective of an index based on country comparisons, namely the use of a common yardstick for comparing the well-being of countries across the globe.

8. Concluding Remarks

The past five decades have seen a marked development in the literature and discussion concerning the economics of small states. The early days of this debate were characterised by questions concerning the viability of these states in terms of their political security and their inherent economic disadvantages associated with resource limitations and high per unit costs. With time, it became apparent that small states survived and some of them actually thrived, and, as a result, a strand of literature developed dealing with the observation that small states may overcome their disadvantages through appropriate policy interventions.

The contribution made by the economic vulnerability and resilience framework constitutes a synthesis of these two schools of thought. The framework is based on the argument that the special inherent characteristics of small states do expose them to shocks outside their control that may impinge negatively on economic growth. Policy-induced economic resilience contributes to mitigate the effects of negative shocks and allows small countries to better benefit from positive ones, thereby enhancing economic performance. The inherent exposure to shocks and differences in the degree of economic resilience in part explain the pronounced divergences in economic attainment observed among small states.

Conceptual Framework and Policy Prescriptions

This conceptual development opened an interesting debate on the optimal policy stances to be pursued by small countries in their quest for economic resilience, with implications at the national and supranational levels. It also highlighted the need to focus on the broad spectrum of policy elements needed to build economic resilience, ranging from macroeconomic stability to market efficiency, good governance, and social development. These elements are necessary for economic resilience, and deficiencies in any one of them would be likely to compromise the country's ability to withstand exogenous shocks.

The discussion has also focused on the ways in which the necessary conditions for economic resilience may be achieved by small states, through policy prescriptions which may be different from those applicable to larger countries. In the area of macroeconomic stability, for instance, small countries often have little latitude in setting discretionary fiscal and monetary policies, and would thus have to focus essentially on factor and product market flexibility, underpinned of course by fiscal and monetary stability. In the area of market efficiency, small countries tend to have a higher proneness to market failure as well as policy failure, calling for country-specific solutions in this regard. With regard to good governance, special attention would have to be given to the dense network of social relations in small states, and to certain traditions and customary practices. In the realm of social development and environmental issues, particular attention need to be paid to the longer-term effects of migration and to sustainable development.

From the General to the Particular

In this publication, several authors suggested that in the case of small states, using off-the-shelf policies and prescriptions applicable to developing states in general may not always yield the desired results in view of the special circumstances of these states, in particular their high degree of economic openness and their high degree of exposure to exogenous shocks.

In addition, small states differ among themselves, with some being more developed than others, and some more exposed to shocks than others. Many of the studies included in this volume are based on cross-sectional studies aimed at deriving indexes from readily-available data with the aim of deriving comparisons between countries. For individual countries, this serves as an interesting benchmarking exercise. However, for the individual small state, this approach does not delve with sufficient depth into the causes of its economic vulnerability and the courses of action available to it in order to build its economic resilience.

This strand of literature will therefore have more value added if the concepts discussed and lessons learned so far are used to analyse specific country vulnerabilities and to suggest tailor-made solutions based in part on international best practices while giving due weight to indigenous issues. Such a specific case-study approach would not only enrich the literature on the economics of small states, but would go a long way in assisting national policymakers and the international donor community in their endeavour to engender economic development in this group of countries.

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